Happy New Year 2017

DEMONETISATION

DAWN OF A NEW ERA IN INDIAN ECONOMY
Accounting & Actuarial Fundamentals of Standard on Employee Benefits

As per Notification of MCA dated 16th February 2015, MCA has given roadmap for applicability of Ind AS to various companies. These standards are prepared in line with IFRS with some carve outs as per Indian economic scenarios to increase the transparency and comparability in financial statements of various companies. This Article provides applicability of Standard on Employee Benefits under existing Indian GAAP (AS 15) as well as Ind AS 19. It also provides comparative disclosure to Notes to Accounts for existing AS 15 and Ind AS 19. It covers accounting as well as actuarial aspects of the Standard. Read on to know more.....

Introduction of Employee Benefits and their needs

Employer plays a key role in educating, encouraging or compelling their employees to plan benefit provision. However, the most significant role played by the employers is financing employee benefits for their employees. Such financing may be a result of:

• Compulsion (Statutory like Gratuity, Negotiated benefits like compensated absence)
or encouragement (NPS contribution) from the government,
- A paternalistic desire to look after employees and their dependants financially beyond the level provided by the government,
- Income Supplement in Retirement or Desire to attract and retain the services of key employees.

The benefits which are provided or funded by the employer will affect its disclosed accounts. The accounting standard dealing with the employee benefits is 'Accounting Standard 15' (namely Indian GAAP or AS 15) and new IFRS converged 'Indian Accounting Standard 19' (namely Ind AS or Ind AS 19).

**Applicability of Accounting Standard 15 (AS 15)**

Accounting Standards as issued by the ICAI are applicable to Non-corporate entities. There are three levels of entities defined under AS 15. Level I as Non-SMEs (big entities); Level II entities and Level III entities are considered to be the Small and Medium Entities (SMEs).

On the other hand, as per the Companies (Accounting Standards) Rules, 2006 there are only two levels, namely, Small and Medium-sized Companies (SMCs) as defined in the Rules (listed company, turnover, borrowing limits) and companies other than SMCs i.e. Non-SMCs. As far as the compliance of accounting standards is concerned, Non-SMCs are required to comply with all the Accounting Standards in their entirety, while certain exemptions/relaxations have been given to SMCs. In case of AS 15, following exemptions are given:-
- Short-term accumulating compensated absences which are non-vesting (paragraphs 11 to 16). [For example, Sick leave which is allowed to be carry forward but encashment not allowed in future]
- Post–Employment benefit - Para 50 to 123 for recognition and measurement principles & disclosure requirements. However, accrued liability to be determined actuarially by using the Projected Unit Credit Method and the discount rate as per Para 78. [Hence, Actuarial valuation is compulsory, however disclosure to Notes to accounts is not required]

Further relaxations are also available to non-corporate SMEs (following AS issued by the ICAI) and employing less than 50 employees, can calculate accrued liability by reference to some other rational methods, while other entities have to get the liability valued by an Actuary.


**Actuarial Valuation of Employee Benefits**

- As per Financial reporting framework entity has to recognise liability if the entity has a present obligation arising from past events, the settlement of which is expected to result in an outflow of resources embodying economic benefits from the entity.
- As per Accounting Standard 15, company has to make provision in books for liability as at balance sheet date by using Projected Unit Credit Method and considering valuation assumptions viz, Discount rate, salary escalation rate, employee turnover rate etc. as prescribed in Accounting Standard.
- Company has to disclose certain items for employee benefit in their notes to accounts, which are calculated & provided by Actuary using methodology prescribed in AS 15.
- In some instances, Insurer provides Closing liability (funding valuation) to company, but company has to ensure that they give certain disclosures in notes to account based on applicability of accounting standard. For instance, Post-Employment Benefit’s...
Disclosure in Notes to accounts is mandatory for Non- SMC Company.

- Valuation assumptions can be different for funding valuation based on company’s view. For example, cautious assumptions for funding, but Accounting Standard requires Best Estimate Assumptions for provisioning in books of accounts.

- As per Income tax rules, Directors can be part of trust fund if shareholding is less than 5% & whole time employee of company, but for AS 15 provisioning liability for whole-time directors should be included in balance sheet.

Benefits of Funding Employee Benefits

- Provide Security to employees that benefit will be paid as they are insured and managed by professionals and regulated by competent authority.

- Provide Flexibility to employer to contribute towards accumulation of fund.

- Company may not face liquidity problem when they have to pay huge amount to outgoing employees for benefits to be paid.

- As per Income-tax Act, superannuation benefits, gratuity, and other benefits are deductible from income when benefits are paid or Contribution made in trust fund to the limits prescribed in Income tax rules 87-88 & 101-104.

- Provides Tax benefits on investment income of trust fund, so company should consider tax effective return for considering funding decision.

- Company may fund with Insurance Company/ Fund manager and can gain by their expertise in this field and economies of scale of investment by achieving higher return on assets.

- Beneficial in case of employee transfers: When employee transfers from one organisation to another may be as part of mergers & acquisition or transfer within group Company, accrued benefit liability as on date of transfer should also be transferred to another company. In case scheme is funded, equitable transfer of assets also needs to be made to another fund. In case an employee transferred from one group company to another company then the company should transfer their Gratuity, PF (in case of recognised provident fund) from one trust fund to another, since continuation of service is pre-requisite for getting tax free benefit and for that transfer of fund is required.

Recording Liability Transfer In/Out.

For Example:- Mr. Ram who served 10 years in Company X Ltd. and transferred to Group Company, Company Y Ltd. in current year with continuation of service. He left the organisation after 8 months service. Now Mr. Ram will ask for Gratuity at the time of Final settlement, since his total duration is 10 years 8 months, round to 11 years, he will be eligible for 11 years Gratuity i.e. 11*15/26* last basic salary and this will be paid by Y limited at time of FNF. But effectively out of this 11 years only 1 year belong to Y Ltd., so ideally they should recover 10 years equivalent Gratuity from X Ltd. Now whether to recover or not, is company’s call and it depends on materiality of transaction amount. In other companies, generally, company provides us amount they are recording of Liability Transfer In/ Out for Company X to Y Ltd.

Journal Entry:

In books of Transferee (Y Limited):
At time of transfer:

\[ X \text{ limited A/c Dr } Transfer \text{ value (10 years } \times \frac{15}{26} \times \text{ salary at time of transfer or actuarially calculated) } \]

To Provision for Gratuity A/c
(Being amount of Gratuity of accrued service of Mr. Ram in X limited is recorded)

At time of amount received from X limited:

\[ \text{Bank A/c Dr } \]

To X Limited A/c
(Being amount received on account of Gratuity of accrued service of Mr. Ram in X limited)

[If Transfer is made in to Fund, Debit will be to Gratuity Trust Fund A/c in spite of Bank Account]

In books of Transferor (X Limited):
At time of transfer:

\[ \text{Provision for Gratuity A/c Dr } \]

To Y limited A/c
(Being amount payable to Y limited on account of transfer of Mr. Ram to Y limited)

At time of amount paid to Y limited:

\[ Y \text{ limited A/c Dr } \]

To Bank A/c
(Being amount paid)

[If Transfer is made out of fund, Credit will be to
Gratuity Trust Fund A/c in spite of Bank Account]

**Suggestion:** Entry should be recorded to ensure true and fair view of Accounts, otherwise results of BOTH companies deviate to the extent amount is Material.

### New Accounting Standard for Employee benefits and its effect

**Roadmap for applicability of Ind AS's**

- **Voluntary Adoption**
  - Period on or after 1st April, 2015

- **Phase I**
  - All companies with net worth > = INR 500 Crs.
  - Period on or after 1st April, 2016

- **Phase II**
  - All Listed Companies
    - Period on or after 1st April, 2016
  - Unlisted Companies with net worth between INR 250-500 Crs.
  - Period on or after 1st April, 2017

- **Scheduled commercial banks (excluding RRBs) and Insurer/Insurance Companies**
  - Period on or after 1st April, 2018

- **NBFC – Phase I (All NBFCs Net worth INR 500 Crores or more)**
  - Period on or after 1st April, 2018

- **NBFC – Phase II (Listed NBFCs Net worth Less than 500 Crores; Unlisted NBFC: 250-500 Crores)**
  - Period on or after 1st April, 2019

### Applicability:
- It will apply to holding, subsidiary, joint venture or associate companies also. Once Ind AS is applicable, company has to prepare standalone as well as consolidated standard as per Ind AS only.

### Effect of Ind AS on Actuarial Valuation Requirement:

Assuming company falls into phase 1, i.e. company shall follow Ind AS from accounting period starting on or after 1st April, 2016. In this case, company prepares interim financial statement i.e. as at 30.06.2016 or 30.09.2016, company has to follow Ind AS 34 on Interim Financial Reporting, as per this standard para 1, it does not mandate which entities should be required to prepare interim financial reports, but if an entity is required (by market regulator or government) or elects to publish an interim financial report in accordance with Indian Accounting Standards, then this standard will apply.

As per Ind AS 34, an entity can publish complete set of financial statements or condensed financial statements and selected explanatory notes. Para 15 of standard gives an indicative list of significant events and transactions that should be part of notes to accounts, so it is not mandatory to publish full disclosure/notes to accounts in condensed interim financial report.

As per Clause 41 of Listing Agreement with stock exchanges it requires Unaudited Financial Results to be prepared, as per this requirement. Listed company generally takes actuarial valuation on quarterly basis, although not mandatory.

Considering Ind AS 34 & Clause 41 requirement, Disclosure is not mandatory but entity will need to prepare Profit & Loss (Results) for interim period. Now, as per application of Ind AS 19, for post-employment benefit, since actuarial gain/loss charged to OCI, actuary will be required to provide separate charge to Profit & Loss, amount recognised in OCI and closing liability, for period as required by respective legislation, which is generally current interim period, current year to date, similar previous year comparative figures. Previous years comparatives figures' requirement is exempted in case of 1st time adoption.

When entity prepares its first Ind AS financial statements (as at 31.03.2017), it has to comply with Ind AS 101, and need to provide comparative figures for 31.03.2016 which will need to be prepared by preparing opening Ind AS Balance Sheet at 01.04.2015 and applying effect of Ind ASs and arrive at figures at 31.03.2016 to be used as comparatives for financial statements of 31.03.2017.

So, Actuarial Valuation report as at 31.03.2016 will need to be provided by both basis, existing AS-15 & Ind AS 19.

As per roadmap, Companies to which Ind AS is not applicable should have to follow Accounting Standards specified in Annexure to the Companies (Accounting Standards) Rules, 2006. So, actuaries will have to provide reports to both set of companies, to whom different rules apply.

### Significant changes in Ind AS 19 compared to AS 15:
- Discount Rate should be used with reference
Accounting

to market yields at the end of reporting period on Government Bonds. However, Subsidiaries, Associates, Joint Ventures and branches domiciled outside India market yields on high quality corporate bonds, but if no deep market then use Government Bonds.

- Expected return on assets will be same as Discount rate used for valuation of obligation and Net interest cost to be calculated on Net Liabilities/Assets.

- For Post-retirement benefit plans (example Gratuity, Pension & PRMB) Actuarial Gain/ Loss will be taken to Other Comprehensive Income and not to be reclassified into Profit & Loss in subsequent period whereas AS 15 required it to be recognised in Profit & Loss.

- For Other long term benefits (example compensated absences & long service award) Actuarial gain/loss continues to be recognised in Profit & Loss. Hence, recognition criteria remain same in Ind AS 19 as was in AS 15.

- Past service cost to be recognised in Profit & Loss in year of occurrence. Ind AS 19 does not differentiate between vested & non-vested past service cost recognition.

- Actuarial Gain or Loss due to change in assumption needs to be shown separately due to change in Demographic assumption & due to change in financial assumption. Calculation can be done by change of basis as the difference between the actual position on the old basis and the actual position on the new basis.

- As per AS 15, employee includes whole-time directors and other management personnel; whereas as per Ind AS 19, employees include directors and other management personnel.

- Guidance on Asset Ceiling is provided in form of Appendix B to Ind AS 19–Definition, Availability of a refund or reduction in expected future contributions.

Discount Rate should be used with reference to market yields at the end of reporting period on Government Bonds. However, Subsidiaries, Associates, Joint Ventures and branches domiciled outside India market yields on high quality corporate bonds, but if no deep market then use Government Bonds.

---

**Comparative Disclosures/ Notes to the Accounts for AS 15 & Ind AS 19**

### Assumption Table

<table>
<thead>
<tr>
<th></th>
<th>AS 15</th>
<th>Ind AS 19</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Valuation Assumptions</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Previous Period)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Discount Rate</td>
<td>7.90%</td>
<td>7.90%</td>
</tr>
<tr>
<td>Expected Return on Assets</td>
<td>8.50%</td>
<td>7.90%</td>
</tr>
<tr>
<td>Salary Escalation</td>
<td>6.00%</td>
<td>6.00%</td>
</tr>
<tr>
<td>Attrition Rate</td>
<td>7.50%</td>
<td>7.50%</td>
</tr>
<tr>
<td><strong>Valuation Assumptions</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Current Period)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Discount Rate</td>
<td>8.00%</td>
<td>8.00%</td>
</tr>
<tr>
<td>Expected Return on Assets</td>
<td>8.50%</td>
<td>8.00%</td>
</tr>
<tr>
<td>Salary Escalation</td>
<td>6.00%</td>
<td>6.00%</td>
</tr>
<tr>
<td>Attrition Rate</td>
<td>10.00%</td>
<td>10.00%</td>
</tr>
</tbody>
</table>

### Change in Present Value of Benefit Obligation

<table>
<thead>
<tr>
<th></th>
<th>AS 15</th>
<th>Ind AS 19</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening Present Value of Projected Benefit Obligation</td>
<td>407,859,866</td>
<td>407,859,866</td>
</tr>
<tr>
<td>Interest cost</td>
<td>32,220,929</td>
<td>32,220,929</td>
</tr>
<tr>
<td>Current service cost</td>
<td>83,883,077</td>
<td>83,883,077</td>
</tr>
<tr>
<td>Past Service Cost - Vested</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Past Service Cost – Non Vested</td>
<td>0</td>
<td>N.A.</td>
</tr>
<tr>
<td>(Benefit Paid Directly by the Employer)</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>(Benefit Paid from fund)</td>
<td>(24,147,000)</td>
<td>(24,147,000)</td>
</tr>
<tr>
<td>Actuarial (Gains)/Losses on Obligations - Change in Demographic Assumptions</td>
<td>(6,076,460)*</td>
<td>1,944,467</td>
</tr>
<tr>
<td>Actuarial (Gains)/Losses on Obligations - Change in Financial Assumptions</td>
<td>(8,020,927)</td>
<td></td>
</tr>
<tr>
<td>Actuarial (Gains)/Losses on Obligations - Experience Adjustment</td>
<td>(13,700,030)</td>
<td>(13,700,030)</td>
</tr>
<tr>
<td>Closing Present Value of Projected Benefit Obligation</td>
<td>480,040,382</td>
<td>480,040,382</td>
</tr>
</tbody>
</table>

* Actuarial Gain/ loss due to change in assumption.

### Change in the Fair Value of Plan Assets

<table>
<thead>
<tr>
<th></th>
<th>AS 15</th>
<th>Ind AS 19</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair Value of Plan Assets at the Beginning of the Period</td>
<td>209,667,844</td>
<td>209,667,844</td>
</tr>
<tr>
<td>Expected return on assets</td>
<td>17,821,767</td>
<td>16,563,760</td>
</tr>
<tr>
<td>Contributions by the Employer</td>
<td>72,238,733</td>
<td>72,238,733</td>
</tr>
<tr>
<td>(Benefit paid from Fund)</td>
<td>(24,147,000)</td>
<td>(24,147,000)</td>
</tr>
<tr>
<td>Actuarial Gains/(Losses) on Plan Assets - Experience Adjustment</td>
<td>(3,879,820)</td>
<td>N.A.</td>
</tr>
</tbody>
</table>
### Return on plan assets excluding amounts included in net interest cost

<table>
<thead>
<tr>
<th></th>
<th>AS 15</th>
<th>Ind AS 19</th>
</tr>
</thead>
<tbody>
<tr>
<td>N.A.</td>
<td>(2,621,813)</td>
<td></td>
</tr>
</tbody>
</table>

### Fair Value of Plan Assets at the End of the Period

<table>
<thead>
<tr>
<th></th>
<th>AS 15</th>
<th>Ind AS 19</th>
</tr>
</thead>
<tbody>
<tr>
<td>271,701,524</td>
<td>271,701,524</td>
<td></td>
</tr>
</tbody>
</table>

### Amount Recognised in the Financial Statement

<table>
<thead>
<tr>
<th>Expenses Recognised in the Statement of Profit or Loss</th>
<th>AS 15</th>
<th>Ind AS 19</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Service Cost</td>
<td>83,883,077</td>
<td>83,883,077</td>
</tr>
<tr>
<td>Interest cost</td>
<td>32,220,929</td>
<td>N.A.</td>
</tr>
<tr>
<td>(Expected return on assets)</td>
<td>(17,821,767)</td>
<td>N.A.</td>
</tr>
<tr>
<td>Net Interest Cost (Interest Cost – Expected Return)</td>
<td>N.A.</td>
<td>15,657,169</td>
</tr>
<tr>
<td>Past Service Cost - Vested</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Past Service Cost – Non Vested</td>
<td>0</td>
<td>N.A.</td>
</tr>
<tr>
<td>Actuarial (Gain)/ Loss on Obligation</td>
<td>(19,776,490)</td>
<td>N.A.</td>
</tr>
<tr>
<td>Actuarial (Gain)/ Loss on Assets</td>
<td>3,879,820</td>
<td>N.A.</td>
</tr>
<tr>
<td>Total Expense recognised in Statement of Profit or Loss</td>
<td>82,385,569</td>
<td>99,540,246</td>
</tr>
</tbody>
</table>

### Amount Recognised in Other Comprehensive Income

<table>
<thead>
<tr>
<th>Actuarial (Gains)/Losses on Obligations - Change in Demographic Assumptions</th>
<th>AS 15</th>
<th>Ind AS 19</th>
</tr>
</thead>
<tbody>
<tr>
<td>N.A.</td>
<td>1,944,467</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Actuarial (Gains)/Losses on Obligations - Change in Financial Assumptions</th>
<th>AS 15</th>
<th>Ind AS 19</th>
</tr>
</thead>
<tbody>
<tr>
<td>N.A.</td>
<td>(8,020,927)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Actuarial (Gains)/Losses on Obligations - Experience Adjustment</th>
<th>AS 15</th>
<th>Ind AS 19</th>
</tr>
</thead>
<tbody>
<tr>
<td>N.A.</td>
<td>(13,700,030)</td>
<td></td>
</tr>
</tbody>
</table>

### Additional disclosure requirements for Post-Employment Benefits compared with AS 15:

- **Objectives**: an explanation of the characteristics and risks associated with DB schemes and how the characteristics of the scheme may affect the amount, timing and uncertainty of the company's cash flows.

- **Characteristics**: a description of the scheme benefits and any risks the scheme poses to the company, in particular unusual risks or concentrations of risk. For example, if plan assets are invested primarily in one class of investments, e.g bonds, the plan may expose the entity to a concentration of bond market risk.

- **Analysis of the present value of the defined benefit obligation (Para 137)**:
  - vested benefits and accrued but not vested benefits
  - active members, deferred members, and pensioners

- **An entity may disaggregate disclosure about plans showing one or more of the following features (Para 138)**:
  - different geographical locations
  - different reporting segments
  - different funding arrangements (e.g wholly unfunded, wholly or partly funded).

- **Sensitivity of Assumptions (Para 145)**:
  - the significant assumptions used
  - the sensitivity of the value of the liabilities to changes in these assumptions
  - explanation on the methods used in the sensitivity analysis

- **An entity shall disclose a description of any asset-liability matching strategies used by the plan or the entity, including the use of annuities and other techniques, to manage risk (Para 146).**
• Effect on Future Cash flows (Para 147):
  • expected employer contributions over the coming year
  • description of the funding arrangements
  • weighted average duration of the obligation
  • maturity profile of the defined benefit obligation
• Five-year history of asset value, liabilities, surplus/deficit and experience gains and losses is not required to be disclosed.

Leave Valuation under Ind AS 19:
• For Other long term benefit para 153 to 158 of Ind AS 19 are relevant. Leave benefit is classified as other-long term benefit.
• As per Para 156, Actuarial Gain/loss is charged to P&L and no requirement of OCI unlike post-employment benefit obligation.
• As per Para 158 No specific Disclosure is required for Other-long term benefits. Whereas in case of Post-employment benefit para 135 requires detailed disclosure that’s why company have to make detailed disclosure in Notes to Accounts for benefit like Gratuity, Pension plans.

Current and Non-Current Liability Bifurcation as per Schedule III of The Companies Act, 2013:
• For a Un-Funded Scheme:- Current Liability is Expected Pay-out (Benefit Payment to employees) in next 12 months based on all decrements and Non-Current Liability is balancing figure.
• For a Funded Scheme:- Current Liability is Expected Contribution in Plan Assets (Trust Fund) in next 12 months based on Net Liability Status with appropriate cap as per Statutory tax limit and Non-Current Liability is balancing figure.

Frequently Asked Questions on Actuarial Valuations:
• Whether Company needs to take Actuarial valuation as at 31.03.2015 if they are in phase I?
  Since Liability as at 31.03.2015 remain same under existing AS 15 & Ind AS 19, there is no need for separate actuarial valuation as at 31.03.2015 for preparing opening balance sheet as at 01.04.2015 as required under Ind AS 101.
• How Ind AS19 differs in recognising benefit expenses?
  In case of post-employment benefits remeasurements (actuarial gain/loss) is charged to Other Comprehensive Income, whereas in case of other long term benefits, it is charged to Profit & Loss.
• What is Remeasurements of Defined Benefit Obligation?
  This will include Actuarial Gain/loss on obligation due to change in demographic (Attrition rate, mortality assumption) and financial assumption from opening valuation to closing valuation. Actuarial Gain/loss due to experience adjustment will show effect on liability due to experience being different than assumption. For example, unexpectedly high or low rates of employee turnover, early retirement or mortality or of increases in salaries, benefits or medical costs;
• How to determine discount rate for actuarial valuation?
  Discount Rate relates to the benchmark rate available on Government Bonds. For foreign counterparts, high quality corporate bonds to be used. The currency and term of the government bonds or corporate bonds shall be consistent with the currency and estimated term of the defined benefit obligations.
• What is average expected term of obligation (expected future service)?
  Expected Future service is calculated by applying Attrition rate & Death rate probabilities on potential future service (retirement age–current age). Benefits which are payable till lifetime of employee, this will also include longevity after retirement.

Conclusion:
IFRS is being used by most countries to account for Employee Benefits. This Standard has been issued with the idea that there will be similarities in accounting with other countries. In my opinion, there is a lot to be done by Accounting and Actuarial bodies, to create awareness so that the standard could be implemented smoothly.