Recent Trends in Accounting Standards with Special Emphasis on AS 15 (Revised)

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Notification of Companies (Accounting Standards) Rules, 2006

- Rules were notified by MCA under advice of NACAS
- Notified AS to come into effect in respect of accounting periods commencing on or after 07/12/2006
- Notified AS to substitute AS issued by ICAI to the extent of their applicability to Cos is concerned
- Distinction between Level I, II and III redundant. Rules make distinction only between ‘SMCs’ and ‘other than SMCs’
- AS issued by ICAI will continue to apply to other enterprises in terms of announcement of ICAI
- Status of AS issued by ICAI subsequent to notification?
- Convergence with IFRS wef 01/04 /2011 as announced by ICAI

Salient Features of the Rules

- Central Govt has prescribed AS 1 to 7 and 9 to 29 recommended by ICAI with some modifications
  - Applicability to SMCs (discussed in the next slide)
  - Differences observed in AS 9 and AS 11
- AS to be applied in preparation of General Purpose Financial Statements
- Every Company and *<u>its auditor</u>* to comply with these AS
- SMCs opting for relaxations to give by way of note:

  "The Company is a Small and Medium-sized Company (SMC) as defined in General Instructions in respect of Accounting Standards notified under the Companies Act, 1956. Accordingly, the Company has complied with the Accounting Standards as applicable to a Small and Medium-sized Company."

Relaxations / Exemptions to SMCs

- Exemptions
  - AS 3: Cash Flow Statements
  - AS 17: Segment Reporting

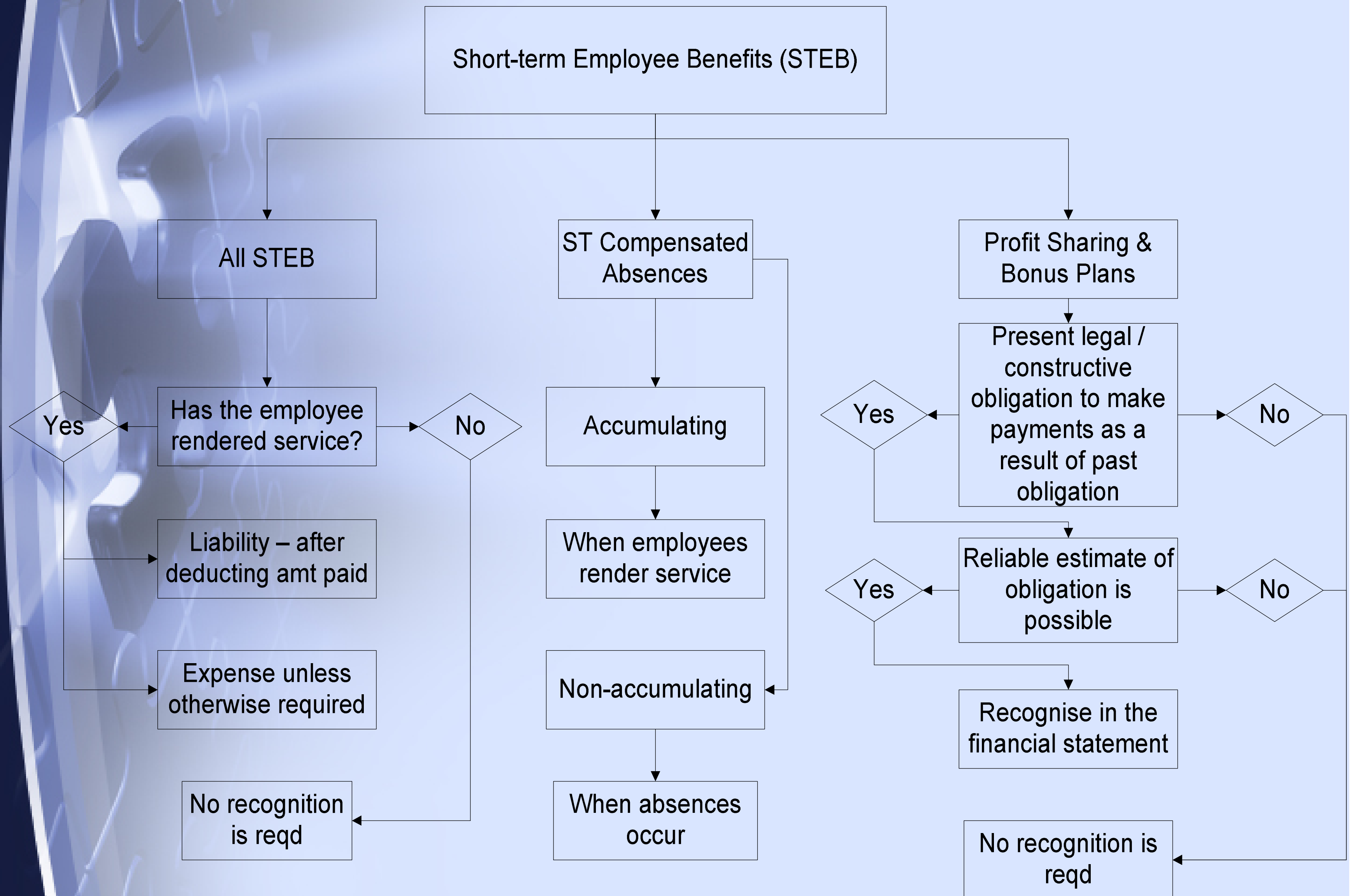
- Relaxations
  - AS 15: Employee Benefits
    - Exemption from recognition and measurement of Short-term accumulating compensated absences which are non-vesting.
    - Exemption from discounting of contributions to defined contribution plan (falling due beyond 12 months)
    - Recognition and Measurement principles for long-term benefits not required to be followed. However, liability to be actuarially valued.
    - Disclosure requirements are not as onerous.
  - AS 19: Leases…. Some disclosures not required to be made.
  - AS 20: Earnings per Share ….. Not required to disclose Diluted EPS
  - AS 28: Impairment …. Definition of value in use
  - AS 29: Provisions and Contingent Liabilities / Assets …. Disclosure in respect of provisions.

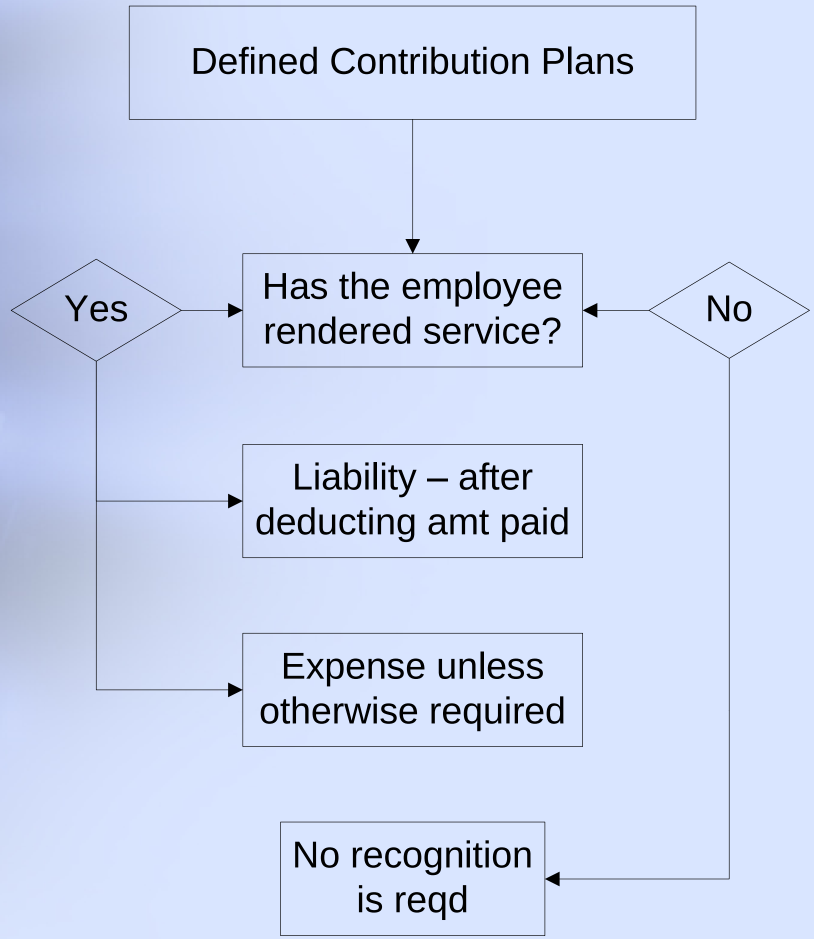
AS 15 (R) – Employee Benefits

Scope of AS 15 (Revised)

All Employee Benefits

- Short-term benefits (e.g. salaries, paid leave, housing) – Paras 8 to 23
- Post employment benefits (All Defined benefits, gratuity, superannuation) – Paras 24 to 126
- “Other Long-term benefits” (e.g. Long-term disability, Leave Benefit) – Paras 127 to 132
- Employer initiated termination benefits – Paras 133 to 142


Short-term Employee Benefits (STEB)
All STEB
ST Compensated Absences
Profit Sharing & Bonus Plans
Has the employee rendered service?
Yes
No
Liability – after deducting amt paid
Expense unless otherwise required
No recognition is reqd
Accumulating
When employees render service
Non-accumulating
When absences occur
Present legal / constructive obligation to make payments as a result of past obligation
Yes
No
Reliable estimate of obligation is possible
Yes
No
Recognise in the financial statement
No recognition is reqd


Defined Contribution Plans
Yes
Has the employee rendered service?
No
Liability – after deducting amt paid
Expense unless otherwise required
No recognition is reqd

Defined Benefit Plans

- Amount to be recognised in the BS

  PV of defined benefit obligation

  Less: Past service Cost not yet recognised

  Less: Unrecognised part of transitional liability

  Less: Fair Value of Plan Assets

- Amount to be expensed in the PL A/c

  Current Service Cost

  Add: Interest cost

  Less: Expected return on plan assets

  Add/(Less): Recognised Actuarial losses / (gains)

  Add: Recognised past service cost

  Add: Effect of curtailments or settlements

PV of defined benefit obligation

- Reliable estimate of the value of benefits earned in return for current and prior periods
- Application of actuarial valuation method – “PUC” method
- Attribution of benefit to periods of service
- Making of actuarial assumptions
  - Financial assumptions such as discount rate, salary increase, expected return on assets, etc.
  - Demographic assumptions such as mortality, disability, employee turnover, early retirement, etc.
- The actuarial assumptions should be
  - Set by employer with advice of qualified actuary
  - Best estimate of the possibility
  - Unbiased and mutually compatible
  - Reflect the market expectations at the B/S date

Actuarial gains and losses

- Change in liability in over accounting period due to
  - Variation in actual experience vs previous assumptions
  - Change of assumptions
- Change in fair value of assets over accounting period due to
  - Actual Market Return different from assumed

Examples

1. Pension Plan of Company A provides a benefit of Rs. 500 for each year of service, payable in full at the date of retirement. The following table illustrates the calculation of Company A's pension liability for years 14, 15 and 16 for an employee expected to provide 20 years of service (i.e. earn a benefit of Rs. 10000). Disc rate assumed is 6%.

	14	15	16
PV of Rs. 10000 disc at 6% at start of year	6651	7050	7473
Benefits earned through service to date	65%	70%	75%
Liability, start of year	4323	4935	5605
PV of benefits earned for the year (500 disc. at 6% or 1/20th of PV at the end of year of total expected payment of 10000)	353	374	396
Interest on Liability at 6%	259	296	336
Expense for the year	612	670	732
Liability, end of year	4935	5605	6337

Examples

2. There are 2 companies, A Ltd and B Ltd. A Ltd manages its PF through a trust specifically created for the purpose. In B Ltd, PF is contributed to the govt. Are the two schemes defined benefit or defined contribution?

AS 15 sets out examples of cases where enterprise's obligation is not limited to the amount it agrees to contribute. This includes a guarantee of a specified return on contributions. Such schemes would be defined benefit schemes. Thus PF scheme in the case of A Ltd. will be a defined benefit plan.

In the case of B Ltd., the company has no obligation beyond its contribution to govt. and thus, such schemes will qualify as defined contribution.

Examples

3. S Ltd makes the following actuarial assumptions while determining the gratuity liability: (a) Increase in salary cost is in line with price inflation of 7%; (b) Rate of return on plan assets is 8%; (c) Discount rate 7.5%; (d) inflation 4.6%. Please comment.

Actuarial assumptions should be unbiased and mutually compatible. The rate of return is usually greater than the Disc. Rate to reflect the risk profile of assets invested. The difference between the two should be justified on the basis of mix of plan assets.

However, S Ltd.'s assumptions about salary increase and inflation index appear to be incompatible.

Examples

4. W Ltd grants annual bonus to its employees on a discretionary basis. W Ltd. financial year ends on 31 March 2008 and accounts are finalised in April 2008, but bonus is announced and paid in late May 2008. Is a provision required to be made in March 2008 accounts?

   Since in the given case there is no formula nor is the amount finalised before financial statements are approved, nor is there a reliable past practice, provision need not be made in March 2008 accounts.

Transitional Provisions

- Incremental adjustment arising out of first time implementation of AS 15 (Revised) to be considered as transitional provision.
- Transitional provision to be adjusted with revenue reserves net of tax effect.
- Option given to the Company vide notification dtd 27th March 2008 to amortise the same over a period of 5 years.

Disclosure Requirements

- Payments made to Defined Contribution plan
- Description of the Defined Benefit plan
- Components of Net Employee Benefit expense
- Components of the amounts recognised in the BS
- Changes in the PV of defined benefit obligation during the year
- Changes in the fair value of plan assets during the year
- Major categories of plan assets
- Actuarial assumptions
- Amounts for the current and previous four periods – Defined Benefit Obligation, Plan Assets, Surplus/(Deficit), Experience adjustments on plan liabilities and on plan assets.

To Summarise …

- AS 15 (Revised) is not about retirement benefits only
- All employee benefits need to be valued
- Discount rate is not a function of return on plan assets
- Obligation may not be equal to value of assets in the fund
- P/L charge is a component of 4 items

Thank you