Accounting Standard 15 (Revised 2005)

Employee Benefits

Scenario:

The complication in employee compensation structures have increased quite considerably in recent times .The manner in which today's employee gets remunerated has been significantly innovated, and very often accounting is complex and challenging.

Revised AS-15 - 'Employee Benefits', generally deals with all forms of employee benefits, many of which were not dealt with by pre-revised AS 15.

The standard has a significant impact on the financial statements of an enterprise, arising due to:
a) actuarial assumptions and actuarial method to be applied
b) Definition of employee under revised AS 15 includes part time, casual and temporary employees. Due to absence of this definition in the pre-revised AS 15, provisions may not have been made by some enterprises
c) Coverage of all forms of employee compensation, for example, post retirement medical expenses, jubilee award, loyalty programs, etc
d) Treatment of provident fund as defined contribution rather than defined benefit
e) Treatment of gratuity scheme funded with LIC as defined benefit rather than defined contribution
f) Deferral of past service cost, which was not permitted by pre-revised AS 15
g) Emphasis on constructive obligation for recognition purposes
h) Application of the transitional provisions
i) Tax effect of the above items

Case Study on Daimler Benz:

There is a very interesting folklore that highlights the importance of this standard. Many believe that accounting under German GAAP tends to be very conservative. Despite that, in 1993, under German GAAP Daimler-Benz reported a profit of 168 million Deutsche Marks but under US GAAP for the same period, the company reported a loss of almost a billion Deutsche Marks, largely caused by pension blues. Other than being a solid case for global deviation of accounting standards, it also highlighted problems related to pension accounting and funding.

Though in India, pension payments are quite insignificant in comparison to global enterprises, as Indian companies become global, this will become a critical issue.

Recent Updates:

ICAI Okays deferment of AS-15 (February, 7th 2007)

Companies may soon get some relief on the applicability of revised accounting standard on employee benefits (AS-15) - a key accounting code that also covered accounting treatment of retirement benefits.

Acting on representations from organizations such as State Bank of India, the Institute of Chartered Accountants of India on Tuesday said that it has approved the deferment of the applicability of this accounting code.

A number of blue-chip companies had also expressed reservations over the revised AS-15, stating that this code would affect their balance sheet strength. The transitional provisions were particularly a thorny issue for some organizations such as the SBI, as it required the additional liability to be adjusted against the reserves.

Date of applicability

"The revised AS-15 would now be applicable from accounting periods beginning on or after December 7, 2006. Industry had expressed its practical difficulties. Keeping in view the genuine hardships, we have agreed for the deferment. It was earlier applicable for the current fiscal itself (beginning April 1, 2006)," Mr. Sunil Talati, the newly elected ICAI President.

Mr. Talati said that the transitional provisions of revised AS-15 might be modified to provide an option to corporates to charge additional liability arising from the first application of the standard as an expense over a period up to five years. The ICAI Vice-President, Mr. Ved Jain, said that the unrecognized amount would however be required to be disclosed in the balance sheet.

Mr. Talati, however, said that the entire matter (deferment and transitional provision relief) would now be taken up with the National Advisory Committee on Accounting Standards (NACAS) as the Union Government has already notified the revised AS-15 under the Companies Act.

"Since the Government has already approved the revised AS-15, any change or deferment would require its approval. So companies will have to wait but ICAI Council has agreed it will help," sources said.

Many enterprises had voiced concerns over the transitional problems to the new standard, stating that this would result in higher provisions for retirement and other employee benefits. The revised AS-15 has stringent requirements concerning measurement of employee benefits costs.

Objective:

To prescribe the **accounting and disclosure** for employee benefits.

An enterprise is required to recognize:

- a **liability** when an employee has provided service in exchange for employee benefits to be paid in the future; and
- an **expense** when the enterprise consumes the economic benefit arising from service provided by an employee in exchange for employee benefits

Applicability:

This standard applies from April 1, 2006 in it's entirely for all Level 1 Enterprises. Certain exemptions are given to other than Level 1 Enterprises, depending on upon whether they employ 50 or more employees.

Scope:

1. Applicable to **all** employee benefits *except employee share-based payments which are dealt with by a separate Guidance Note.*

2. **Does not** deal with accounting and reporting by employee benefit plans (E.g. Provident fund Trusts, Gratuity Fund Trusts).

3. The **Employee benefits** include those provided:

- under formal plans/agreements between an enterprise and individual employees, groups of employees or their representatives;
- under legislative requirements/industry arrangements, whereby enterprises are required to contribute to state, industry or other multi-employer plans; or
- by those informal practices that give rise to an obligation. (Informal practices give rise to an obligation where the enterprise has no realistic alternative but to pay employee benefits. An example of such an obligation is where a change in the enterprise's informal practices would cause unacceptable damage to its relationship with employees.)

4. **Employee benefits** include benefits provided to employees or their spouses, children or other dependants and may be settled by payments (or the provision of goods or services) made either:

- directly to the employees/their spouses/children/other dependants/legal heirs/nominees; or
- to trusts/insurance companies.

5. An **employee** may provide services to an enterprise on a full-time, part-time, permanent, casual or temporary basis.
For the purpose of AS 15, employees include whole-time directors and other management personnel.

Case Studies:

1. Informal Arrangements - Unused Leaves

Query
A company has an informal understanding with its employees that unused leave may be taken as paid vacation in the following year. Would a provision be required for unused leave?

Response
Yes, if an informal understanding casts a constructive obligation on the company such that it cannot go back on its agreement without causing a significant damage to its relationship with the employees.

2. Informal Arrangements – Constructive Obligation

Query
Can public statements about benefits improvements create a constructive obligation for a company?

Response
Yes, public statements can create constructive obligation. However, a public statement in itself may not be sufficient to create a constructive obligation and an entity should consider all the facts and circumstances relevant to each case. For example, it is important to note who in the company has made those public statements and the authority attached to such public statements or what is the acceptability of these statements by the trade unions, etc.

A. Short Term Employee Benefits:

It includes:

- wages, salaries and social security contributions;
- Non-monetary benefits (such as medical care, housing, cars and free or subsidized goods or services) for current employees.
- short-term compensated absences (such as paid annual leave) where the absences are expected to occur within twelve months
- profit-sharing and bonuses payable within twelve months; and

Wages, Salaries & Social Security Contributions
Non-Monetary Benefits

Recognition & Measurement

The enterprise should recognize the benefits:

- **As an expense**, unless another standard requires/ permits the inclusion of the benefits in the cost of an asset *(e.g. AS 10 Accounting for Fixed Assets).*

- **As a liability** after deducting amounts already paid. If amount paid exceeds the amount of benefits, the excess should be recorded **as an asset**

Short Term Compensated Absences

There are two kinds' accumulated compensated absences and non-accumulated compensated absences.

Meaning

o Accumulated Compensated absences:

They are those that are **carried forward** and can be used in future periods if the current period's entitlement is not used in full.
It may be either **vesting** (i.e. employees are entitled to cash payment for unused entitlement on leaving the enterprise); or
non-vesting (when employees are not entitled to a cash payment for unused entitlement on leaving).

o Non-accumulating compensated absences

They are those that are **not carried forward**. They lapse if the current period's entitlement is not fully used and do not entitle employees to a cash payment for unused entitlement on leaving the enterprise.
e.g. Maternity or paternity leave

Recognition & Measurement

- Accumulated Compensated absences:

Recognise when the employees render service that increases their entitlement to future compensated absences.

- Non-accumulating compensated absences

Recognise when the absences occur.

An enterprise should measure the expected cost of accumulating compensated absences as the additional amount that the enterprise expects to pay as a result of the unused entitlement that has accumulated at the balance sheet date.

Example

An enterprise has 100 employees, each entitled to 5 days leave for each year. Unused leave may be c/f for 1 calendar year.
The leave is taken first out of the current year's entitlement and then out of any balance b/f from previous year on a LIFO basis. At 31 December 20X4, the average unused entitlement is two days per employee. The enterprise expects, based on past experience which is expected to continue, that 92 employees will take no more than five days of leave in 20X5 and that the remaining eight employees will take an average of six and a half days each.
The enterprise expects that it will pay an additional 12 days of pay as a result of the unused entitlement that has accumulated at 31 December 20X4 (one and a half days each, for eight employees).
Therefore, the enterprise recognizes a liability, as at 31 December 20X4, equal to 12 days of pay.

Profit Sharing & Bonus Plans

- Profit Sharing

Under some profit-sharing plans, employees receive a share of the profit only if they remain with the enterprise for a specified period.
Such plans create an obligation as employees render service that increases the amount to be paid if they remain in service until the end of the specified period.
The measurement of such obligations reflects the possibility that some employees may leave without receiving profit-sharing payments.

- Bonus Payments

An enterprise may have no legal obligation to pay a bonus. Nevertheless, in some cases, an enterprise has a practice of paying bonuses. In such cases also, the enterprise has an obligation because the enterprise has no realistic alternative but to pay the bonus.
The measurement of such obligation reflects that some employees may leave without receiving a bonus.

Recognition & Measurement

An enterprise should recognize the expected cost of profit-sharing and bonus payments when and only when:

- the enterprise has a *present obligation* * to make such payments as a result of past events; and
- a *reliable estimate* ** of the obligation can be made.

** Present Obligation:*
A present obligation exists when, and only when, the enterprise has no realistic alternative but to make the payments.

** *Reliable Estimate:*
An enterprise can make a reliable estimate of its obligation under a profit-sharing or bonus plan when and only when:

- the **formal terms of the plan contain a formula** for determining the amount of the benefit; or
- the enterprise determines the amounts to be paid **before the financial statements are approved**; or
- **past practice** gives clear evidence of the amount of the enterprise's obligation.

General Disclosure

This statement does not require specific disclosures about short-term employee benefits. However other standard like AS 18 Related Party Disclosures requires disclosure about employee benefits for key managerial personnel.

Case Studies:

1. Compensated Absences

Query
An entity has several employees, each of whom is entitled to 8 working days of paid sick leave for each year. Unused sick leave may not be carried forward to the next year. Employees are also not entitled to a cash payment for unused entitlement of sick leave on leaving the entity. Management is preparing the interim financial report for the 1st quarter of the year. Whether one quarter of the unused annual sick leave entitlement should be provided, because the sick leave may be used in the remaining 3 quarters?
Response
Management should not recognize a provision for unused sick leave since the use of sick leave is determined by an unpredictable future event that is the illness of the employee and not through the employee's own wish. A low level of sickness in the 1st quarter odes not cause a higher level of sickness in future quarters. Management should not recognize an expense in respect of non-accumulating sick leave until the time of absence, because employee service does not increase the amount of the benefit.

2. Profit Sharing Plans

Query
When employee participates in profit sharing plans, whether the profit share should be treated as an appropriation or charge to the profit and loss account?
Response
An obligation under profit sharing and bonus plans results from employee service not from a transaction with the enterprise's owners. Therefore, an enterprise recognizes the cost of profit sharing and bonus plans not as a distribution of net profit but as an expense.

3. Bonus Payments Plans – Basics

Query
There are 11 employees each of whom will receive a bonus of Rs 15,000/-for their service in calendar year 2005, provided they continue to be on the payroll of the entity up to June 06. Assuming 1 employee will leave by June 06, how is the liability measured? The company feels that the charge for 2005 is Rs. 100,000/- determined for 10 employees, assuming the cost of Rs. 15,000/- is for 1.5 year.
Response
Under some profit sharing plans, employees receive a share of the profit only if they remain with the enterprise for a specified period. The measurement of such obligations reflects the possibility that some employees may leave without receiving profit sharing systems. The liability is Rs. 150,000/-(Rs. 15,000/- * 10) for the year 2005. The company's assumption that the cost should be spread over one and half year is not correct, since the bonus is for one year of service and hence the cost should be fully absorbed in that year.

4. Bonus Payments Plans - Performance based

Query

A goods dealer has a practice of paying a performance bonus to its sales staff based on targets. Past evidence indicates that staff who meet their sales targets received a bonus of 5% of their current salary package at the year end. Sales staff who were not in service throughout the whole year received a bonus in proportion to their service period. The bonuses are paid to the sales staff, who are still employed by the entity, in the first quarter of the following year. At year-end, 10 of the sales staff met their sales targets. Three of the 10 began their employment halfway through the year, and one of them left the entity at year-end.

Response

The dealer created a valid expectation among the sales staff that they would receive bonuses if they met their sales targets and were still in the entity's service when the bonuses were paid, that is there is a constructive obligation; and the amount of the payment can be estimated reliably. There are 6 sales staff who will receive bonus of 5% of their current salary packages, and 3 who will receive 2.5% because their employment commenced halfway through the year. No provision should be recognized for the employee who resigned at year end, because he left the entity before the bonuses were paid and will therefore not receive a payment.

5. Bonus Payments Plans – Provision of Bonus

Query

A Ltd grants annual bonus to its employees on discretionary basis. A ltd has a March 06 year-end and finalizes accounts by April 06, but bonus is announced and paid in late May 06. Is a provision required to be made for bonus if not made in March 06 accounts?

Response

Since in the given case, there is no formula, nor is the amount finalized before the financial statements are approved, nor is there a reliable past practice, provision for bonus is not made in March 06 accounts.

B. Post Employment Benefits

Meaning

- Post-employment benefits are employee benefits (*other than termination benefits*) which are payable **after the completion** of employment.
  E.g. Gratuity, pension, other retirement benefits, post employment life insurance and post employment medical care.

- Post-employment benefit plans are **formal or informal arrangements** under which an enterprise provides post-employment benefits for one or more employees.

- Post employment benefits are either **defined contribution plans** or **defined benefit plans**.

o Defined contribution plans
  They are post-employment benefit plans under which an enterprise pays fixed contributions into a separate entity (a fund) and will have no obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.

o Defined benefit plans
  They are post-employment benefit plans other than defined contribution plans.

- Defined Contribution plans **v/s** Defined Benefit plans

  The distinction between defined contribution and defined benefit is important, since accounting is significantly different for the two plans. In defined contribution plans the contribution is charged to **income statement**, whereas in defined benefit plans, a **detailed actuarial calculation** is performed to determine the charge.

Defined Contribution Plans

Features

- Obligation limited to a defined contribution
- Risks not with the employer
  - Actuarial risk (benefits will be less than expected)
  - Investment risk (assets invested will be insufficient to meet expected benefits)

Accounting

When an employee has rendered service to an enterprise during a period, the enterprise should recognize the contribution payable to a defined contribution plan in exchange for that service:

- **as a liability** (accrued expense), after deducting any contribution already paid. If the contribution already paid exceeds the contribution due for service before the balance sheet date, an enterprise should recognize that **excess as an asset (prepaid expense)** to the extent that the prepayment will lead to, for example, a reduction in future payments or a cash refund

- **as an expense**, unless another Accounting Standard requires or permits the inclusion of the contribution in the cost of an asset
  e.g. AS 10, Accounting for Fixed Assets

Where contributions to a defined contribution plan do not fall due wholly within 12 months after the end of the period in which the employees render the related service, they should be discounted using the discount rate.

Defined Benefits Plans

Meaning

- **Defined benefit plans** are retirement benefits plans like gratuity plan, pension plan that defines an amount of benefits to be provided usually as a **function** of one or more **factors** such as age, year of service or compensation/salary.
- Example: A gratuity payment obligation at the time the employee leaves the enterprise or retires is calculated based on past service period and salary at the time of retirement. *In this case, benefit is defined but not the amount of liability.*
- Defined benefit plans may be **unfunded** or **funded** (partly or fully) by contributions by an **enterprise**, and sometimes by its **employees**, into an entity or fund which is legally separate from the enterprise.
- The **payment of benefits** depends on the financial position, investment performance of the fund and the enterprise's ability to make good any shortfall in the fund's assets. Therefore, risks like actuarial and investment risks are with the employer.

Accounting

Accounting for defined benefit plan is **complex** because:

- Actuarial assumptions are required to measure the obligation.
- Obligations are measured on discounted basis because they are settled many years after the employee render the service.
- Actuarial gain or loss is possible.

Steps for accounting of Defined Benefit plans

1. Use actuarial techniques for reliable estimate of the benefit amount that the employee have earned in return for their service in the current and prior periods. i.e. use the **projected unit credit (PUC)** method to measure its obligations and costs.

2. 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 certain changes in state benefits). Financial assumptions should be based on market expectations, at the balance sheet date, for the period over which the obligations are to be settled.

3. Determine the **discount rate** by preferences to market yields at the balance sheet date on government bonds.

4. Determine the **fair value of any plan assets**.

5. **Deduct the fair value of plan assets from the carrying amount of the obligation.** Certain reimbursement rights that do not qualify as plan assets are treated in the same way as plan assets, except that they are presented as a separate asset, rather than a deduction from the obligation.

6. Determine the total amount of **actuarial gains and losses** and recognize in profit and loss account as income and expense respectively.

7. If a plan has been introduced or changed, recognize **past service cost** on a straight-line basis over the average period until the amended benefits become vested.

8. **Recognize gains or losses on the curtailment or settlement** of a defined benefit plan when the curtailment or settlement occurs. The gain or loss should comprise any resulting change in the present value of the defined benefit obligation and the fair value of the plan assets and the unrecognized part of any related actuarial gains and losses and past service cost.

➢ *Presentation in Balance sheet:*

The amount recognized as a **defined benefit liability** should be the net total of the following amounts:

Present value of defined benefit obligation at balance sheet date	XXX
Less: Past service cost not yet recognized	(XXX)
Less: Fair value of plan assets at balance sheet date	(XXX)
The amount determined may be negative (an asset).	(XXX)

An asset may arise where a defined benefit plan is **over funded** or in certain cases where **actuarial gains** are recognized.

➢ *Measurement of defined benefit asset*

An enterprise should measure the resulting asset at the **lower of**:

(a) the amount determined above; and

(b) the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.

The present value of these economic benefits should be determined using the discount rate.

➢ *Presentation in Profit & Loss Account:*

An enterprise should recognize the net total of the following amounts in the statement of profit and loss, *except to the extent that another Accounting Standard requires or permits their inclusion in the cost of an asset*:

(a) current service cost

(b) interest cost

(c) actuarial gains and losses

(d) past service cost

(e) the expected return on any plan assets and on any reimbursement rights

(f) the effect of any curtailments or settlements and

(g) Effect of recognition of over funding (assets) of defined benefit plan at lower of over funding amount and present value of any economic benefits available in the plan or reduction in future contribution to the plan.

Example:

1. Basic Example – DBP Liability:

The Following information is given about a funded DBP.
All the transactions are assumed to occur at year end.
The PV of the obligation & the Fair value of plan Assets were both Rs.1000 on 01.04.2006

Sr.No	Particulars	Amount (INR)		
		2006-07	2007-08	2008-09
1	Discount rate at start of year *(Interest rate)*	10%	9%	8%
2	Expected rate of Return on Plans Assets at start of year	12%	11.10%	10.30%
3	Current Service Cost	130	140	150
4	Benefits paid	150	180	190
5	Contributions paid	90	100	110
6	PV of Obligations as on 31.03	1141	1197	1295
7	Fair value of Plan Assets as on 31.03	1092	1109	1093
8	Average remaining life of employees (years)	10	10	10

In 2007-08, the plan was amended to provide additional benefits effective from year 2006-07
The PV at the end of year 1 of additional benefits for employee service before 2006-07 was Rs.50 for vested
benefits & Rs.30 for non- vested benefits.
As on 01.04.2007, the enterprise estimated that the average period until the non-vested benefits would become vested was 3 years, the past service cost arising from additional non - vested benefits is therefore on SLM over 3 years.
Calculate amounts reconginsed in Balance - sheet & P/L.

Step 1 : Calculation of changes in PV of Obligation & in Fair value of Plan Assets for Actuarial Gain or Loss(net) :

A: PV of Obligation

Particulars	2006-07	2007-08	2008-09
Opening PV of Obligation as on 01.04	1,000.00	1,141.00	1,197.00
Interest Cost (at 10%,9% & 8% respectively)	100.00	103.00	96.00
Current Service Cost	130.00	140.00	150.00
Past Service Cost - Vested	0.00	50.00	0.00
Past Service Cost - Non - Vested	0.00	30.00	0.00
Less :			
Benefits paid	(150.00)	(180.00)	(190.00)
	1,080.00	1,284.00	1,253.00
Actuarial Loss or (Gain) --- b/f	*61.00*	*(87.00)*	*42.00*
Closing PV of Obligation as on 31.03	1,141.00	1,197.00	1,295.00

B.Fair Value Of Plan Assets

Particulars	2006-07	2007-08	2008-09
Fair Value as on 01.04	1,000.00	1,092.00	1,109.00
Expected Return (at 12%, 11.10% & 10.30%)	120.00	121.00	114.00
Contribution paid	90.00	100.00	110.00
Less :			
Benefits paid	(150.00)	(180.00)	(190.00)
	1,060.00	1,133.00	1,143.00
Actuarial (Loss) or Gain --- b/f	32.00	(24.00)	(50.00)
Fair Value as on 31.03	1,092.00	1,109.00	1,093.00

C. Net Actuarial Gain or Loss

Particulars	2006-07	2007-08	2008-09
Actuarial Loss or (Gain) --- as per Step 1 (a)	61.00	(87.00)	42.00
Actuarial (Loss) or Gain --- as per Step 1 (b)	(32.00)	24.00	50.00
Net Actuarial Loss or (Gain)	29.00	(63.00)	92.00

Step 2 : Liability to be recognised in Balance-Sheet :

Particulars	2006-07	2007-08	2008-09
PV of Obligation as on 31.03	1,141.00	1,197.00	1,295.00
Less :			
Unrecognised Past Service Cost(Non - Vested)	0.00	(20.00)	(10.00)
FV of Plan Assets	(1,092.00)	(1,109.00)	(1,093.00)
Total Liability to be recongnised in Balance-Sheet	49.00	68.00	192.00

Step 3 : Expenditure to be recognised in P&L

Particulars	2006-07	2007-08	2008-09
Current service Cost	130.00	140.00	150.00
Past Service Cost - Vested	0.00	50.00	0.00
Past Service Cost - Non - Vested	0.00	10.00	10.00
Interest Cost	100.00	103.00	96.00
Less : Expected Return	(120.00)	(121.00)	(114.00)
Add/Less : Acturial (Gain) or Loss	29.00	(63.00)	92.00
Total Expenditure to be recongnised in P & L	139.00	119.00	234.00

2. Basic Example – DBP Asset:

A defined benefit plan has the following characteristics	
Particulars	**Amount(Rs.)**
Present Value of obligation	1,100
Fair value of plan assets	(1,190)
Difference(A)	(90)
Unrecognized past service cost (B)	(70)
Negative amount (A - B)= I	(160)
Present value of available future refunds and reductions in future contributions - II	90
Limit under AS 15 (Lower of I & II)	90
Rs. 90 is less than Rs. 160. Therefore, the enterprise recognizes an asset of Rs. 90 and discloses that the limit reduced the carrying amount of the asset by Rs. 70.	

3. Case Study on Pension – Exceptional Item:

During the current year, a deficit in the employee's pension fund amounting to Rs. 661 lakhs has been determined on the basis of actuarial valuation carried out by the company. The above deficit arising out of certain changes in the actuarial valuation assumption has been provided for in the accounts as an exceptional item in the profit and loss account. [ICI India Limited 2001-02]

❖ *Technical Terms:*

o *Current Service Cost:*

It is the increase in the present value of the defined benefit obligation resulting from employee service in the current period.

o *Actuarial Valuation:*

Meaning:

The ultimate cost of a defined benefit plan may be influenced by many factors, such as final salaries, employee turnover and mortality, medical cost trends and, for a funded plan, the investment earnings on the plan assets. The ultimate cost of the plan is uncertain and this uncertainty is likely to persist over a long period of time.

In order to measure the present value of the post-employment benefit obligations and the related current service cost, it is necessary to:

(a) apply an **actuarial valuation method**;

(b) attribute **benefit to periods of service**; and

(c) make **actuarial assumptions**

Explanations:

(a) Actuarial Valuation Method:

The projected unit credit method (also known as the accrued benefit method prorated on service or as benefit/years of service method) considers each period of service as giving rise to an additional unit of benefit entitlement and measures each unit separately to build up the final obligation.

(b) Attributing Benefit to period of Service:

- For determining the present value of its defined benefit obligations and related current service cost and past service cost (if applicable), an enterprise should attribute benefit to periods of service under the plan's benefit formula.
- However, if an employee's service in later years will lead to a materially higher level of benefit than in earlier years, an enterprise should attribute on a straight line basis from:

"Date when service by employee first leads to benefits under the plan until date when further service by employee will lead to no material amount of further benefits under the plan, other than from further salary increases"

- An enterprise attributes benefit to periods in which the obligation arises to provide post-employment benefits. That obligation arises as employees render services in return for post employment benefits which an enterprise expects to pay in future reporting periods. Actuarial techniques allow an enterprise to measure that obligation with sufficient reliability to justify recognition of a liability.

(c) Actuarial Assumptions:

- Actuarial assumptions are an enterprise's **best estimate** of the factors that will determine the ultimate cost of providing post-employment benefits.
- Actuarial assumptions which comprises of **demographic** and **financial assumptions** should be unbiased and mutually compatible.
- Actuarial assumptions are **unbiased** if they are neither imprudent nor excessively conservative.
- **Demographic assumptions** about the future characteristics of current and former employees (and their dependants) who are eligible for benefits are as follows:

1. Mortality, (both during and after employment) – the ratio of no of deaths relative to the number of living person in a particular group. This is a consideration used by actuaries in determining long term benefits expense and related funding. Actuaries refer mortality tables, which indicate death rates by age.
2. Rates of employee turnover, disability and early retirement.
3. The proportion of plan members with dependants who will be eligible for benefits and
4. Claim rates under medical plans.

- **Financial assumptions** are as follows:

1. The discount rate.
2. Future salary and benefit levels.
3. In the case of medical benefits, future medical costs, including where material, the cost of administering claims and benefit payments and
4. The expected rate of return on plan assets.

- **Actuarial assumptions with regards to discount rate:**

  - Discount rate is a **material** actuarial assumption. The discount rate reflects the time value of money but not the actuarial or investment risk.

  - The discount rate should be determined by reference to market yield on **Government bonds** at the balance sheet date. In some cases, there may be no government bonds with a sufficiently long maturity to match the estimated maturity of all the benefits payments. In such cases, an enterprise uses **current market rates** of the appropriate term to discount shorter term payments and estimates the discount rate for longer maturities by extrapolating current market rates along the yield curve.

  - The currency and term of the government bonds should be consistent with the currency and estimated term of the post employment benefits. Therefore the discount rate for determining actuarial liability in the case of company **in India** cannot be based on example on US Treasury bill rates. The discount rate should be long term government bond rates applicable in India.

- **Actuarial assumptions with regards to salaries, benefits and medical costs:**

  a. Estimated future salary increases – estimates of future salary increase taking into account inflation, seniority, promotion and other relevant factors, such as supply and demand in the employment market.

  b. Assumptions about medical costs should take account of estimated future changes in the cost of medical services, resulting both from inflation and specific changes in medical costs. It also requires assumptions about the level and frequency of future claims and the cost of meeting those claims. An enterprise estimates future medical costs on basis of historical data from other enterprises, insurance companies, medical providers or other sources. It also considers the effect of technological advances; changes in health care utilization or delivery patterns and changes in the health status of plan participants.

- ***Actuarial Gains / Losses:***

  - Actuarial gains and losses comprise: experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred); and the effects of changes in actuarial assumptions.

  - Actuarial gains and losses should be recognized immediately in the statement of profit and loss as income or expenses.

  - Actuarial gains and losses may result from either

    1. Increases or decreases in the present value of the defined benefit obligation or
    2. Increases or decreases in the fair value of any related plan assets.

  - Examples for causes of actuarial gains and losses may include:

    1. Unexpectedly high or low rates of employees turnover, early retirement or mortality or of increases in salary, medical costs;
    2. Effect of changes in estimates of future employee turnover, early retirement or mortality or of increases in salaries, or medical costs;
    3. Effect of changes in the discount rates;
    4. Differences between the actual return on plan assets and the expected return on plan assets.

Case Studies:

1. Actuarial assumptions - Gratuity

Query

For the purposes of determining gratuity provision a software company considers salary growth rate of 8% when five years past experience suggest that it has been @ 20%. Would this be a reasonable assumption?

Response

Actuarial assumptions have to be supportable and for this purpose detail facts and circumstances should be considered. The salary growth rates that are factored in actuarial computation are very long term, and in a long period it would be hard to imagine a consistent salary growth rate based on limited past experience. Empirical evidence suggests that in the very long term consistent high salary growth rate is not possible. A lot of software companies pay compensation using stock options and sweat equity, which are not to be included for the purposes of determining salary growth rates as gratuity is computed based on last drawn basic wages.

2. Actuarial assumptions – Gratuity

Query

T Ltd has calculated the net present value of the defined gratuity obligation on the assumption that Salary cost will increase in line with general price inflation at 7% a year (this is based on T Ltd past experience)

(a) The rate of return on plan assets is 8%
(b) The discount rate, calculated by reference to the yield on high-quality fixed-rate government bonds, is 7.5%
(c) Inflation index published by Government is 4.6%.

Response

Actuarial assumptions are mutually compatible if they reflect the economic relationships between factors such as inflation rates, interest rates and discount rates. The rate of return on plan assets is usually greater than the discount rate, reflecting the difference between the risk and time profile of plan assets and the risk on high-quality government bonds. T Ltd should demonstrate that the difference between the discount rate and the return on plan assets assumptions is justified based on the mix of plan assets. However, T Ltd assumptions about salary inflation and the inflation index appear to be incompatible.

3. Attributing benefits to period of service:

Query:

A plan provides a monthly pension of 0.2% of final salary for each year of service. The pension is payable from the age of 60.

Response:

Benefit equal to the PV, at the expected retirement date, of a monthly pension of 0.2% of the estimated final salary payable from the expected retirement date until the expected date of death is attributable to each year of service. The current service cost is the present value of the benefits. The PV of the defined benefit obligation is the PV of monthly pension payments of 0.2% of final salary, multiplied by the number of years of service up to the balance sheet date. The current service cost and the present value of the defined benefit obligation are discounted because pension payments begin at the age of 60.

4. Current Service Cost - Medical Plan:

Query:

A post employment medical plan reimburses 40% of an employee's post employee medical costs if the employee leaves after more than 10 and less than 20 years of service and 50% of those costs if the employee leaves after 20 years of service.

Response:

Under the benefit plans formula, the enterprise attributes 4% of the PV of the expected medical costs (40% /10 years) to each of 1st 10 years and 1% (10%/10 addn years) to each of subsequent 10 years. The current service cost in each year reflects the probability that the employee may not complete the necessary period of service to earn part or all of the benefit. For employees expected to leave within 10 years, no benefit is attributed.

- ***Past service cost:***

➩ **Meaning:**

Sometimes post employment benefit schemes may be modified. This would have a positive or negative impact not only in respect of future service to be rendered but also for service that has already been rendered. The impact to the extent the service has already been rendered is known as the past service cost.

➩ **Measurement:**

An enterprise should recognize past service cost as an expense on a straight-line basis over the average period until the benefits become vested. If the benefits are already vested the past service cost is recognized immediately in the profit and loss account. However, in the pre-revised AS 15, past service cost was required to be recognized immediately and deferral was not permitted.

➩ **Examples:**

1. An entity operates a gratuity plan for eligible employees under the payment of gratuity Act. Under the act the benefit vests after 5 years of service. The entity increases the benefit from 15 days for each completed year of service to 20 days.

Scene 1: employee has completed 5 service years. If an employee has completed 5 years of service the benefit vest immediately and hence the increased benefit (5 days) for each completed year of service needs to be recognized immediately.

Scene2: employee has completed 3 years of service. If an employee has completed 3 years of service, the benefit vest only after 2 years. Thus the benefit of 15 days (5*3) can be equally amortized over the following 2 years.

2. An enterprise operates a pension plan that provides a pension of 2% of final salary for each service year. The benefits become vested after 5 service years. On 1Jan 2005 the enterprise improves the pension to 2.5% of final salary for each service year starting from 1 Jan 2001. at the date of improvement, the present value of the additional benefits for service from 1 Jan 2001 to Jan 2005 is as follows:

PARTICULARS	**AMOUNT**
Employees with more than 5 year's service at 01.01.05	Rs. 150
Employees with less than 5 year's service at (average period until vesting is 3 years)	Rs. 120
Total	Rs. 270

The enterprise recognizes Rs. 150 immediately because those benefits are already vested. The enterprise recognizes Rs. 120 on a straight-line basis over three years from 1 Jan 2005.

- *Plan assets:*

➢ **Meaning:**

The above comprises assets held by a long-term employee benefit fund; and qualifying insurance policies. Assets held by a long term employee benefit fund are assets that:

1. are held by an entity (a fund) that is legally separate from the reporting enterprise and exists solely to pay or fund employee benefits (Eg. Gratuity Fund Trust) and;

2. are available to be used only to pay or fund employee benefits, and not available to the reporting enterprise's own creditors(even in bankruptcy), and cannot be returned to the reporting enterprise, unless either:

   a. the remaining assets of the fund are sufficient to meet all related employee benefit obligation of the plan of the reporting enterprise *or*
   b. the assets are returned to the reporting enterprise to reimburse it for employee benefits already paid.

➢ **Valuation of plan assets**

Return on plan assets is presented as below:

Particulars	**Amount**
Interest	XXX
Dividends	XXX
Other revenue derived from plan assets	XXX
Add/Less: Realized and unrealized gains and losses on plan assets	XXX
Less: Administrative costs of plan	(XXX)
Less: Tax payable by the plan	(XXX)
Return on Plan assets	**XXX**

The fair value is deducted in determining the amount recognized in the balance sheet. If market price is not available, the fair value of plan assets is estimated by discounting expected future cash flows that reflects both risk associated with the plan assets and the maturity of expected disposal date of those assets(or if they have no maturity, the expected period until settlement of the related obligation).

- **Exclusions:**

  The following are exclusions for plan assets:

  - Unpaid contributions due from reporting enterprise to the fund
  - Any non transferable financial instruments issued by the enterprise and held by the fund.
  - Liabilities of the fund that do not relate to employee benefit

- **Reimbursements:**

  - An enterprise should recognize its right to reimbursement as a separate asset when, and only when, it is virtually certain that another party will reimburse some or all of the expenditure required to settle a defined benefit obligation.
  - The enterprise should treat that asset in the same way as plan assets. In the statement of profit and loss, the expense relating to a defined benefit plan may be presented net of the amount recognized for a reimbursement.

- **How is the presentation different in case of plan assets and reimbursement rights?**

  - The enterprise recognizes its right to reimbursement under the insurance policy as a separate asset, rather than as a deduction in determining the defined benefit liability.
  - In all other cases including determination of fair value the enterprise treats that asset in the same way as plan assets.
  - If the right to reimbursement arises under an insurance policy that exactly matches the amount and timing of some or all of the benefits payable under a defined benefit plan, the fair value of the reimbursement right is deemed to the present value of the related obligation, (subject to any reduction required if the reimbursement is not recoverable in full).

- **Disclosure**

  AS 15 requires the enterprise to disclose a brief description of the link between the reimbursement right and the related obligation.

- ***Curtailments and settlements:***

  - Recognition:

    Recognize the gain or losses of curtailment or settlement when the curtailments and settlement occurs. The gain or losses on curtailment or settlement comprises:

    a. any change in the PV of the defined benefit obligation
    b. any change in the fair value of plan assets
    c. any related past service cost that had not been recognized previously.

  - When does the curtailment occur?

    It occurs if either:

    a. an enterprise has a present obligation to make a material reduction in the number of employees covered by the plan arising from requirement of a statute or otherwise.
    b. An enterprise amends the terms of a benefit plan in such a way that material element of future service by current employees will no longer qualify for benefits.

  - What is material?

    An event is material if the recognition of curtailment gain or loss is would have a material effect on the financial statements.

  - When does a settlement occur?

    It occurs when an enterprise enters into a transaction that eliminates all further obligations for part or all of the benefits provided under a defined benefit plan.

    Eg. When a lump-sum cash payment is made to or on behalf of plan participants in exchange for their rights to receive specified post employment benefits.

    A settlement and curtailment occurs together if a plan is terminated such that obligation is settled and the plan ceases to exist.
    However, the termination of a plan is not a curtailment or settlement if the plan is replaced by a new plan that offers identical benefits.

- **Example**

An enterprise discontinues a business segment and employees of the discontinued segment will earn no further benefits. This is a curtailment without a settlement. Using current actuarial assumptions (including current market interest rates and other current market prices) immediately before the curtailment, the enterprise has a defined benefit obligation with a net present value of Rs. 1,000 and plan assets with a fair value of Rs. 820 and unrecognized past service cost of Rs. 50. The curtailment reduces the net present value of the obligation by Rs. 100 to Rs. 900.

Of the previously unrecognized past service cost, 10% (Rs. 100/Rs. 1000) relates to the part of the obligation that was eliminated through the curtailment. Therefore, the effect of the curtailment is as follows:

Amount in Rs.			
	Before Curtailment	**Curtailment gain**	**After Curtailment**
Net PV of obligation	1,000	(100)	900
Fair value of assets	(820)	-	(820)
	180	(100)	80
Unrecognized past service cost	(50)	5	(45)
Net liability recognized in balance sheet	130	(95)	35

❖ Employment Benefit Plans:

There are **three** types of employment benefit plans (Defined Contribution plan / Defined Benefit plan):

1. <u>Multi-employer plans:</u>

- These are defined contribution or defined benefit plans that:

  a. pool assets contributed by various entities that are not under common control; and

  b. use those assets to provide benefits to employees of more than one entity, on the basis that contribution and benefit levels are determined without regard to the identity of an enterprise that employs the employees concerned.

- A multi-employer plan usually includes participation of two or more un-related employee by creating independent entity (e.g. Trust.) The plan is usually administered by a board of trustees; all the participating employers contribute in trust/plan for the post employment benefit of their employees. The contribution is invested in asset/investment and is called plan asset. Thus the assets are aggregated for all employers and are available and unrestricted to pay benefits to all the employees regardless of whom they are employed by. In other words there is no segregation of assets in a particular employer's account.

- Multi employer plans may be defined contribution plan depending upon terms of plan. Generally multi employer plan are defined contribution plan and therefore accounting is done accordingly. If multi-employer plan is classified as defined benefit plan the accounting shall be according to that plan. Accounting for multi-employer plan treating it as defined contribution plan, is simple. Periodical contribution paid by the employer in multi-employer plan is debited in expense account and credited in bank account. If the contribution is not paid and partly paid the amount is credited to payable account.

- If sufficient information is not available to use defined benefit accounting for a multi-employer plan that is define benefit plan an enterprise should account for the plan as defined contribution plans with a disclosure of this fact and the reason why sufficient information is not available.

2. <u>State Plans:</u>

- State plan are established by legislation to cover all enterprises or all enterprises of a specific industry and are operated by national or local government,
- <u>Example</u>: Provident fund administered by the Govt. of India.
- State plan may be categorized as defined contribution plan or defined benefit plan based on enterprise obligation under the plan. However, in most cases state plans are defined contribution plans as enterprises/employers has only obligation to pay contribution and has no obligation to pay the future benefits.
- Contribution paid by the employer is debited as expense and if payable it is credited to liability account.

3. <u>Insured Benefits:</u>

- If an employer takes insurance policy from an insurance company for meeting its obligation under post employment benefits and the employer has no obligation to pay benefits to the employee and the insurer has the sole responsibility to pay benefits. Also, the employer pays fixed premium to the insurance company then the employer should record as defined Contribution Plan else treat as Defined benefit plan.

C. Termination Benefits

Meaning

Termination benefits are employee benefits as a result of **either** an enterprise's decision to terminate an employee's employment before the normal retirement date; **or** an employee's decision to accept voluntary redundancy in exchange for those benefits(voluntary retirement). AS-15 deals with termination benefits separately from other employee benefits because the event which gives rise to an obligation is the termination rather than employee service.

Recognition & Measurement

- An enterprise should recognize termination benefits as a liability and an expense when and only when:
  - the enterprise has a **present obligation** as a result of past events;
  - it is probable that an **outflow of resources** embodying economic benefits will be required to settle the obligation; and
  - a **reliable estimate** can be made of the amount of the obligation

- AS 15 requires immediate **expensing** of expenditure on termination benefits (including expenditure incurred on voluntary retirement scheme (VRS)). However, where the enterprise incurs expenditure on termination benefits on or before 31st March, 2009 the enterprise may choose to follow accounting policy of deferring such expenditure over its pay back period. However, the expenditure cannot be carried forward to accounting periods commencing on or after 1st April, 2010.

- Termination benefits are typically lump-sum payments, but sometimes also **includes**:
  - enhancement of retirement benefits or of other post-employment benefits, either indirectly through an employee benefit plan or directly; and
  - salary until the end of a specified notice period if the employee renders no further service that provides economic benefits to the enterprise.

- Where termination benefits fall due more than 12 months after balance sheet date, they should be **discounted** using the discount rate determined as per AS 15.

Case Studies:

1. Termination Benefits - Gratuity

Query
Is gratuity paid at the time of departure of an employee a termination benefit?

Response
A gratuity scheme does not meet the definition of a termination benefit for the following reasons:

a. the entity did not decide to terminate the employees employment before normal retirement date; and
b. the employees are not leaving the entity as a result of accepting an offer of voluntary redundancy.

However, the scheme meets the definition of a post employment benefit. The payments of the benefits are certain, based on a formula taking into account the number of years of service, although the timing of the payments is uncertain. Gratuity should therefore be recognized as a post employment benefit based on an actuarial valuation.

2. Termination Benefits – Various Cases

Query
B Ltd. has a practice of providing a termination benefit based on a specific number of months of salary varying with years of service when employment is terminated. The payment is made in case of a) normal retirement, b) voluntary termination of the employment by the employment by the employee and c) involuntary termination of employment by the entity. How should B Ltd. account for the termination benefit?

Response
The termination gratuities provided are post employment benefits. Only additional payments made as a result of either a) an entity's decision to terminate an employee's employment before the normal retirement date; or b) an employee's decision to accept voluntary redundancy in exchange for those benefits can be considered termination benefits. A liability should be recognized at the present value of the defined benefit obligation determined using PUC Method. The event which gives rise to the obligation is the outgoing service rendered by the employees rather than the termination of employment.

D. Other Long Term Employee Benefits:

Meaning

- Other long-term employee benefits include, **for example**:

  1. long-term compensated absences such as long-service or sabbatical leave
  2. jubilee or other long-service benefits
  3. long-term disability benefits
  4. profit-sharing and bonuses payable twelve months or more after the end of the period in which the employees render the related service; and
  5. deferred compensation paid twelve months or more after the end of the period in which it is earned.

- In case of other long-term employee benefits, the introduction of, or changes to, other long-term employee benefits rarely causes a material amount of past service cost. For this reason, this Statement requires a simplified method of accounting for other long-term employee benefits. This method differs from the accounting required for post-employment benefits in so far as that all past service cost is recognised immediately.

Recognition & Measurement

Presentation in Balance sheet:

The amount recognised as a liability for other long-term employee benefits should be the net total of the following amounts:

Present value of defined benefit obligation at balance sheet date	XXX
Less: Fair value of plan assets at balance sheet date	(XXX)
Liability for Other long Term Employee Benefits.	(XXX)

Presentation in Profit & Loss Account:

An enterprise should recognize the net total of the following amounts in the statement of profit and loss, except to the extent that another Accounting Standard requires or permits their inclusion in the cost of an asset:

(a) current service cost
(b) interest cost
(c) actuarial gains and losses
(d) past service cost

(e) the expected return on any plan assets and on any reimbursement rights
(f) the effect of any curtailments or settlements

Long-term disability benefit:

If the level of benefit depends on the length of service, an obligation arises when the service is rendered. Measurement of that obligation reflects the probability that payment will be required and the length of time for which payment is expected to be made. If the level of benefit is the same for any disabled employee regardless of years of service, the expected cost of those benefits is recognised when an event occurs that causes a long-term disability.

General Disclosure

This Statement does not require specific disclosures about other long-term employee benefits; other Accounting Standards may require disclosures.

Example:
Where the expense resulting from such benefits is of such size, nature or incidence that its disclosure is relevant to explain the performance of the enterprise for the period (see AS 5 Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies). Where required by AS 18 Related Party Disclosures an enterprise discloses information about other long-term employee benefits for key management personnel.

E.Transitional Provisions:

Where an enterprise first adopts this Statement for employee benefits, the difference between the liability in respect of employee benefits other than defined benefit plans and termination benefits, as per this Statement, existing on the date of adopting this Statement and the liability that would have been recognised at the same date**, as per the pre-revised AS 15,** should be adjusted against opening balance of revenue reserves and surplus.

F.Comparison with IAS 19, Employee Benefits (as amended in December 2004)

Revised AS 15 (2005) differs from International Accounting Standard (IAS) 19, Employees Benefits, in the following major respects:

1. Recognition of Actuarial Gains and Losses:

- IAS 19 provides **options** to recognise actuarial gains and losses as follows:

  1. by following a 'Corridor Approach', which results in deferred recognition of the actuarial gains and losses, or
  2. immediately in the statement of profit and loss, or
  3. immediately outside the profit or loss in a statement of changes in equity titled 'statement of recognised income and expense'.

- The revised AS 15 (2005) **does not** admit options and requires that actuarial gains and losses should be recognised immediately in the statement of profit and loss. The following are the **reasons** of requiring immediate recognition in the statement of profit and loss:

  1. Deferred recognition and 'corridor' approaches are complex, artificial and difficult to understand. They add to cost by requiring enterprises to keep complex records. They also require complex provisions to deal with curtailments, settlements and transitional matters. Also, as such approaches are not used for other uncertain assets and liabilities, it is not appropriate to use the same for post-employment benefits.
  2. Immediate recognition of actuarial gains and losses represents faithfully the enterprise's financial position. An enterprise will report an asset only when a plan is in surplus and a liability only when a plan has a deficit. Paragraph 94 of the Framework for the Preparation and Presentation of Financial Statements notes that the application of the matching concept does not allow the recognition of items in the balance sheet which do not meet the definition of assets or liabilities. Deferred actuarial losses do not represent future benefits and hence do not meet the Framework's definition of an asset, even if offset against a related liability. Similarly,

deferred actuarial gains do not meet the Framework's definition of a liability.

3. Immediate recognition of actuarial gains and losses generates income and expense items that are not arbitrary and that have information content.
4. The primary argument for the 'corridor approach' is that in the long term, actuarial gains and losses may offset one another. However, it is not reasonable to assume that all actuarial gains or losses will be offset in future years; on the contrary, if the original actuarial assumptions are still valid, future fluctuations will, on average, offset each other and thus will not offset past fluctuations.
5. Deferred recognition by using the 'corridor approach' attempts to avoid volatility. However, a financial measure should be volatile if it purports to represent faithfully transactions and other events that are themselves volatile.
6. Immediate recognition is consistent with AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies. Under AS 5, the effect of changes in accounting estimates should be included in net profit or loss for the period if the change affects the current period only but not future periods. Actuarial gains and losses are not an estimate of future events, but result from events before the balance sheet date that resolve a past estimate (experience adjustments) or from changes in the estimated cost of employee service before the balance sheet date (changes in actuarial assumptions).
7. Any amortisation period (or the width of a 'corridor') is arbitrary.
8. Actuarial gains and losses are items of income and expense. Recognition of such items outside the statement of profit and loss, as per the option (iii) above is not appropriate.
9. Immediate recognition requires less disclosure because all actuarial gains and losses are recognised.
10. Immediate recognition is also permitted under IAS 19. Providing only one treatment is in line with the ICAI's endeavor to eliminate alternatives, to the extent possible.
11. The existing AS 15 (1995) also requires immediate recognition of actuarial gains and losses.

2. Recognition of Defined Benefit Asset

- Both IAS 19 and revised AS 15 (2005) specify an 'asset ceiling' in case of a situation of defined benefit asset. AS 15 (2005) provides that the asset should be recognised only to the extent of the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan. IAS 19, on the other hand, provides that the asset should be recognised to the extent of the total of (i) any cumulative unrecognized net actuarial losses and past service cost; and (ii) the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan. IAS 19, however, also provides that the application of this should not result in a gain being recognised solely as a result of an actuarial loss or past service cost in the current period or in a loss being recognised solely as a result of an actuarial gain in the current period.

- The aspect with regard to unrecognized net actuarial losses is not relevant in the context of revised AS 15 (2005) since it does not permit the adoption of 'corridor approach'. In respect of past service cost, it is felt that in a situation of defined benefit asset, the asset, to the extent of unrecognized past service cost, should not be required to be recognised in view of the prudence consideration for preparation of financial statements.

3. Termination Benefits – Recognition of Liability

- IAS 19 provides that an enterprise should recognise termination benefits as a liability and an expense when, and only when, the enterprise is demonstrably committed to either (a) terminate the employment of an employee or group of employees before the normal retirement date; or (b) provide termination benefits as a result of an offer made in order to encourage voluntary redundancy. It further provides that an enterprise is demonstrably committed to a termination when, and only when, the enterprise has a detailed formal plan for the termination and is without realistic possibility of withdrawal. It is felt that merely on the basis of a detailed formal plan, it would not be appropriate to recognise a provision since a liability cannot be considered to be crystalise at this stage. Accordingly, the revised AS 15 (2005) provides criteria for recognition of liability in respect of termination benefits on the lines of AS 29, Provisions, Contingent Liabilities and Contingent Assets.

4. Transitional Provisions

- In respect of transitional liability for defined benefit plans, IAS 19 provides that if the transitional liability is more than the liability that would have been recognised at the same date under the enterprise's previous accounting policy, the enterprise should make an irrevocable choice to recognise that increase as part of its defined benefit liability (a) immediately, under IAS 8 Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies; or (b) as an expense on a straight-line basis over up to five years from the date of adoption subject to certain conditions. IAS 19 also requires that if the transitional liability is less than the liability that would have been recognised at the same date under the enterprise's previous accounting policy, the enterprise should recognise that decrease immediately under IAS 8.

- The revised AS 15 (2005), on the other hand, provides no choice in this regard, and requires that the difference between the transitional liability as per this Statement and the liability that would have been recognised **as per the pre-revised AS 15**, should be adjusted against the opening balance of revenue reserves and surplus. This treatment is in line with the transitional provisions provided in other Indian Accounting Standards.

- In respect of termination benefits, the revised AS 15 (2005), considering that the industry in India at present is passing through a restructuring phase, specifically contains a transitional provision providing that where an enterprise incurs expenditure on termination benefits **on or before 31st March, 2009,** the enterprise may choose to follow the accounting policy of deferring such expenditure over its pay-back period**. However, the expenditure so deferred cannot be carried forward to accounting periods commencing on or after 1st April, 2010 .IAS 19 does not provide such a transitional provision.**

G.Duty of an Auditor

- In using an actuarial method, an actuary bases his computations on various factors, accordingly, uses an appropriate rate of interest for the purpose of discounting. The auditor's duty with regard to actuarial valuation is to the extent of obtaining an understanding of the assumptions and method used by an actuary, to determine that they are reasonable based on the auditors knowledge of the business and on the results of his audit procedures and whether they are in accordance with the revised AS 15.
- Where the auditor is not satisfied in this regard and concludes as stated in AAS- 9, he is required to report in the appropriate manner. If the auditor is of the view that the rate of interest used is inappropriate and he dose not agree with the amount of provision on actuarial basis, he should qualify his report on true and fair view that although provision has been made as per the actuarial method, the amount of provision not adequate.

At a Glance:

1. The Standard deals with all forms of employee compensation other than employee stock option. It also covers casual and temporary employees. Therefore all contract employee obligations would also get covered.

2. Liability is recognized not only for legal obligation or formal plans but also for constructive obligation, such as those arising out of informal practices, where the cost is unavoidable.

3. Short term employee benefits fall due within one year, and include, wages, leave, bonus, etc. They are accounted for on an undiscounted basis. Non-accumulating leave do not carry forward and hence are recorded as they occur. Accumulating leave is utilized or encashed in future years and hence provision for the same is required.

4. Post employment plans, could be defined contribution plans or defined benefit plans. Accounting for defined contribution is fairly straightforward, and contributions are recognized to income statement as and when they become due.

5. Accounting for defined benefit plan requires actuarial computation. The Standard does not allow flexibility in terms of the actuarial method to be used and requires the Projected Unit Credit method to be applied invariably. Similarly, the requirements relating to actuarial assumptions are more specific.
The assets held under the defined benefit plan are also required to be fair valued. Actuarial gains and losses are required to be recognized immediately. Past service costs are required to be deferred over the vesting period. To the extent the benefits are vested, past service cost should be charged immediately to the income statement.

6. Long term employee benefits include long term loyalty and jubilee awards, bonus, etc which fall due beyond one year and are accounted for in a similar fashion as defined benefit plans, except that past service cost are not deferred and are recognized immediately.

7. Termination benefits like voluntary retirement cost are recognized based on when the liability crystallizes rather than when the enterprise becomes demonstrably committed to a voluntary retirement scheme. To this extent there is a dilution of the general principle of recognizing liability based on constructive obligation.

8. There is a provision to the option of deferring termination benefit. No amount can be carried forward beyond accounting periods commencing on or after 1 April, 2010.

9. Transitional provisions require incremental provisions due to revised AS 15 to be adjusted to revenue reserves net of the tax effect.

Glossary:

The following terms are used in AS 15 with the meanings specified

- Employee benefits are all forms of consideration given by an enterprise in exchange for service rendered by employees.

- Short-term employee benefits are employee benefits (other than termination benefits) which fall due wholly within twelve months after the end of the period in which the employees render the related service.

- Post-employment benefits are employee benefits (other than termination benefits) which are payable after the completion of employment.

- Post-employment benefit plans are formal or informal arrangements under which an enterprise provides post-employment benefits for one or more employees.

- Defined contribution plans are post-employment benefit plans under which an enterprise pays fixed contributions into a separate entity (a fund) and will have no obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.

- Defined benefit plans are post-employment benefit plans other than defined contribution plans.

- Multi-employer plans are defined contribution plans (other than state plans) or defined benefit plans (other than state plans) that:
  (a) pool the assets contributed by various enterprises that are not under common control; and
  (b) use those assets to provide benefits to employees of more than one enterprise, on the basis that contribution and benefit levels are determined without regard to the identity of the enterprise that employs the employees concerned.

- Other long-term employee benefits are employee benefits (other than post-employment benefits and termination benefits) which do not fall due wholly within twelve months after the end of the period in which the employees render the related service.

- Termination benefits are employee benefits payable as a result of either:
  (a) an enterprise's decision to terminate an employee's employment before the normal retirement date; or
  (b) an employee's decision to accept voluntary redundancy in exchange for those benefits (voluntary retirement).

- Vested employee benefits are employee benefits that are not conditional on future employment.

- The present value of a defined benefit obligation is the present value, without deducting any plan assets, of expected future payments required to settle the obligation resulting from employee service in the current and prior periods.

- Current service cost is the increase in the present value of the defined benefit obligation resulting from employee service in the current period.

- Interest cost is the increase during a period in the present value of a defined benefit obligation which arises because the benefits are one period closer to settlement.

- Plan assets comprise:
  (a) assets held by a long-term employee benefit fund; and
  (b) qualifying insurance policies.

- Assets held by a long-term employee benefit fund are assets (other than nontransferable financial instruments issued by the reporting enterprise) that:
  (a) are held by an entity (a fund) that is legally separate from the reporting enterprise and exists solely to pay or fund employee benefits; and
  (b) are available to be used only to pay or fund employee benefits, are not available to the reporting enterprise's own creditors (even in bankruptcy), and cannot be returned to the reporting enterprise, unless either:
  (i) the remaining assets of the fund are sufficient to meet all the related employee benefit obligations of the plan or the reporting enterprise; or
  (ii) the assets are returned to the reporting enterprise to reimburse it for employee benefits already paid.

- A qualifying insurance policy is an insurance policy issued by an insurer that is not a related party (as defined in AS 18 Related Party Disclosures) of the reporting enterprise, if the proceeds of the policy:
  (a) can be used only to pay or fund employee benefits under a defined benefit plan; and
  (b) are not available to the reporting enterprise's own creditors (even in bankruptcy) and cannot be paid to the reporting enterprise, unless either:
  (i) the proceeds represent surplus assets that are not needed for the policy to meet all the related employee benefit obligations; or
  (ii) the proceeds are returned to the reporting enterprise to reimburse it for employee benefits already paid.

- Fair value is the amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm's length transaction.

- The return on plan assets is interest, dividends and other revenue derived from the plan assets, together with realized and unrealized gains or losses on the plan assets, less any costs of administering the plan and less any tax payable by the plan itself.

- Actuarial gains and losses comprise:
  (a) experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred); and
  (b) the effects of changes in actuarial assumptions.

- Past service cost is the change in the present value of the defined benefit obligation for employee service in prior periods, resulting in the current period from the introduction of, or changes to, post-employment benefits or other long-term employee benefits. Past service cost may be either positive (where benefits are introduced or improved) or negative (where existing benefits are reduced).

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