

HAWK' EYE – AS 15 – EMPLOYEE BENEFITS

This happens to be one of the most ignored topic by the examiners and hence also by the students of CA profession. But it has to be embarrassing for a qualified chartered accountant in being ignorant, unable to understand the terms used in the employment benefits disclosure in notes to financial statements of a company to which this standard applies. This write-up is to ensure that the reader doesn't face difficulty in understanding the said disclosures particularly in the movement of gratuity obligation.

AS 15 can be subdivided into 4 parts:

(1) Termination benefits:-

Compensation agreed at retrenchment and voluntary retirement compensation fall under this. The liability / expense are recognized in the books when the probability of obligation is established with a reliable estimate i.e usually when the employer and employee arrive at a consensus.

(2) Short term employee benefits:-

Other than termination benefits which fall due within 12 months from the period end. Eg. Salary, Short term compensated leave falling due within 12 months. For salary, the accounting is straight forward i.e Debit salary A/c (expenses) and credit salary payable A/c (liability). If the same is paid in advance then, create an asset (prepaid salary) and expense it off at the appropriate period.

Compensated absences ("Earned leave") are leave days available to an employee if he / she served in employment for a particular term. Arrangements may be structured in such a way for instance for every 1 month employed, 1 day is earned. The earned days earned may be compensated by cash or paid leave. The same may be carried forward for future periods (accumulating) or get exhausted in the current period (non-accumulating). For "accumulating", the expense is booked as and when the entitlement arises and for "non-accumulating", when the absence occurs.

Eg:- 1 day earned for 1 month served. It can be accumulated for next period- Accounting – Recognize expense of 1 day per employee at every month end. If it gets exhausted in the current period – Accounting – Recognize expense when the employee avails the paid leave.

(3) Post-Employment benefits:-

These are benefits (other than termination benefits) which are payable after the completion of employment. These are broadly classified into two categories:-

- (a) Defined contribution plan:-The employer pays fixed contributions and will have no obligation to pay further contributions in the current and prior periods. Eg:- Contribution to provident fund. Fixed rate of 12% + admin charges is paid on the Basic salary +DA of the employees and no further contribution is required. Since the contribution is certain, and no other payment is probable, the accounting is straight forward as in short term employee benefits i.e. Debit expenditure (Contribution to provident fund) A/c and credit liability (PF payable) A/c. Further in case the obligation arises 12 months or more than the period end, discounting to arrive at the present value should be done.

- (b) Defined benefit plan:-

This is defined as post-employment benefits other than defined contribution plans. Generally, contributions to plans where the end – benefit is known fall under this category. Considering the case of gratuity, a certain amount is payable to the employee at the end of his service, which is based on whether the employee served at least 5 years, his last drawn salary, number of years served, death of the employee etc. To make an approximation of the end obligation, various assumptions are used with regard to increment in salary, death

rate, attrition rate (employees leaving) etc. This brings complexity in calculation and in most cases the obligation is computed by actuarial valuation.

Provision for gratuity by a company may be funded or unfunded. When the company meets the gratuity obligation by itself as and when it arises, it is unfunded. When the employer contributes to a dedicated fund which in turn invests for returns and also meets the gratuity obligation, it is a funded scheme.

Employer→Contribution→Fund→Plan assets

The assets in which the fund invests are called “Plan assets”. The fair value of the plan assets should be deducted from the present value of gratuity liability, to arrive at the net obligation in the employer’s books.

The difference between the obligation at the beginning and the end of the period is recognized in the profit and loss A/c under the heads specified in AS 15.

The following is a model actuarial report which explains the movement in obligation between period beginning and end:

Rates assumed - uniformly over 3 years for simplicity				
Discount / Interest rate				10%
Expected Return on plan assets				12%

Year	1	2	3	Reference
Present value of obligation - Opening	1,000	1,182	1,211	
Interest Cost	100	118	121	Note a
Current Service Cost	124	136	150	Note b
Past Service Cost - (non vested benefits)	30	-	-	Note c
Past Service Cost - (vested benefits)	50	-	-	Note c
Benefits paid	(150)	(180)	(190)	Note d
Actuarial (Gain) loss on obligation (Bal fig)	28	(46)	52	Note g
Present Value of obligation - Closing	1182	1211	1344	
Fair Value of Plan Assets - Opening	1,000	1,092	1,109	
Expected Return on Plan Assets	120	131	133	Note e
Contributions	90	100	110	Note f
Benefits paid	(150)	(180)	(190)	Note d
Actuaril Gain (Loss) on Plan Assets (bal fig)	32	(34)	(69)	Note g
Fair Value of Plan Assets - Closing	1,092	1,109	1,093	
Total Actuarial Gain (loss)	(4)	(12)	121	

Notes:-

(a) Interest cost:

Defined as “increase in the present value, arising because the benefits are one period closer to settlement”.

Simply stating, it is obtained by applying the interest rate (10%) on the opening obligation.

(b) Current service cost:

Defined as “increase in the present value, resulting from employee service in the current period”. In simple terms, it is the present value of the benefit attributed to current year.

Eg:- Assuming that the gratuity amount payable as at end of year 3 is Rs. 450 which is equally attributable to 3 years.

Year	1	2	3
Attributable (1)	150	150	150
Discounted at 10% (2)	0.826	0.909	1.000
PV / Current service cost (3) = (1) x (2)	124	136	150

(c) Past service cost:

Though the nomenclature appears to be related to current service cost, the concept here is different. It relates to the change in current period in present value of defined benefit obligation, arising from new / changes in existing benefits.

Eg. An employer agrees to pay Rs.160 at the end of 8 years. Rs. 20 is attributable to each year and at the end of year 5 the amount of obligation will be Rs.100 (discounting ignored for clarity). Now if there is a revision in the pay from Rs. 160 to Rs. 240 i.e Rs. 80 increase. Of which Rs. 50 is vested (5 years completed) which is to be recognized immediately in Profit and loss account and the balance of Rs.30 is unvested and to be written off over the remaining 5 years by SLM basis.

(d) Benefits paid:-

This refers to the amount paid by the fund, to employees during the year for whom gratuity is due. There is a reduction in both obligation (liability) and plan asset as Cash paid reduces the value of plan assets. The obligation reduces since the liability is paid.

(e) Expected return on plan assets:-

The employer should estimate the return expected on plan assets after considering the interest and dividend income on the investments, realized and unrealized gains on the assets and administration costs.

(f) Contributions:-

This refers to the periodic contributions by the employer towards the fund.

(g) Actuarial Gain / loss:-

This represents the balancing figure in the difference between opening and closing obligation / FV of plan assets after considering all of the above items.

Double Entry reconciliation

The following table explains where the difference between opening and closing net obligation is accounted:

(Year 1 figures in the above table is considered)

	Amount	Remarks
Net obligation - Opening (1000-1000)	0	
Net obligation - Closing (1182-1092)	90	
Movement	90	

Interest cost	100	Profit/loss A/c
Current service cost	124	Profit/loss A/c
Past service cost-Vested	50	Profit/loss A/c
Past service cost-Unvested-current year	10	Profit/loss A/c
Past service cost-Unvested-subsequent years	20	Reduction in liability
Expected return on plan assets	-120	Profit/loss A/c
Contributions	-90	Reduction in asset(bank A/c)
Actuarial Gain / Loss	-4	Profit/loss A/c
Total	90	

(4) Other Long – Term Employee Benefits

These are benefits other than Post-Employment Benefits and Termination benefits which do not fall due wholly within 12 months after the end of the period. Deferred compensation, salary and bonus payable after 1 year fall under this category.

The accounting is less complicated than for post-employment benefits insofar as that all Past Service cost is recognized immediately.

This write-up should not be construed as an exhaustive note on Accounting standard – 15 as only the areas which are considered to be basic were analyzed. The objective stated at the beginning should be achieved and hence many concepts such Multi-Employer plans, State Plans, Insured Benefits etc. are not discussed.

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