CRUCIBLE KNOWLEDGE GROUP

PRESENTS

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A PEEP INTO IND AS 19: EMPLOYEE BENEFITS

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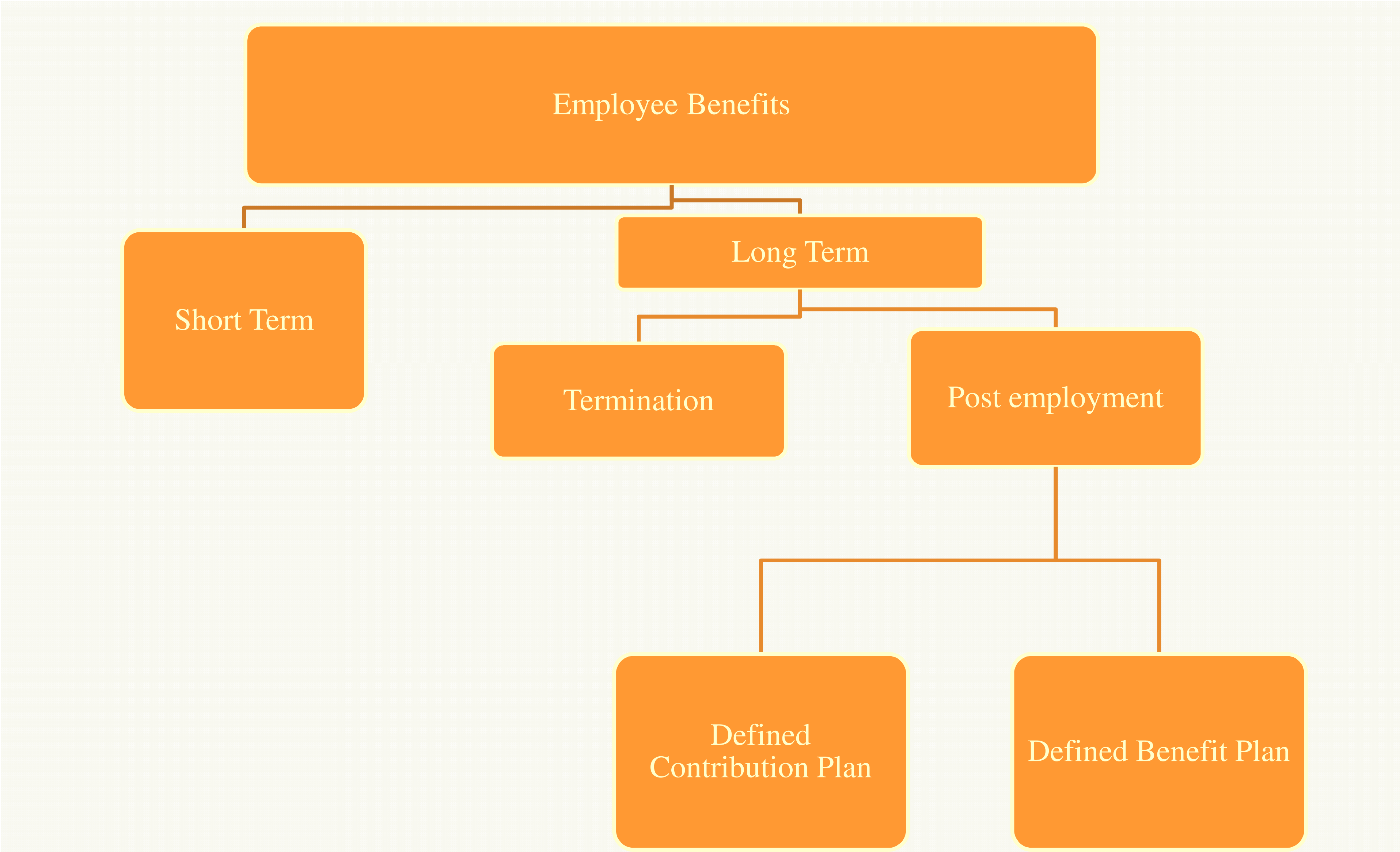
Agenda

- Ind AS 19 Employee Benefits – Scope
- Basic Terminologies
- Model Actuarial Report
- Actuarial Assumptions
- Ind AS 19 - Impact for the Companies

SCOPE & MEANING

Ind AS-19-Employee Benefits



Ind AS-19-Employee Benefits

MEANING

- All forms of payments , in exchange for services rendered by employees–full time, part time,permanent,casual or temporary basis.

- Includes benefits provided to employees, their spouses , children or other dependant.

- Excludes : (i.e. covered under separate guidance notes)
  - Profit Sharing Plans [PL(IAS 26) &
  - Employee benefit Plans

    e.g., ESOP (Ind AS 102 - IFRS 2)

Ind AS-19-Employee Benefits

(Case Study)

A Ltd has a scheme whereby on the death of an employee during the service period , the dependents would be granted Rs.100,000. Does it come under Employee Benefits ?

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Short Term Employee Benefits

Ind AS-19-Employee Benefits

Short term employee Benefits:

- ✓ Benefits payable within 12 months after providing Services ;

- ✓ Obligation measured undiscounted basis

  (no actuarial valuation required.) ;

- ✓ Amount to be treated as expenses

  (i.e. Debit Salary A/C and Credit Salary payable A/C)

- ✓ Examples could be Salaries , CL / ML / PL, PPI/EPI and Non Monetary Benefits) i.e. Medical Care, Self Lease accommodation and annual Gift etc.

Ind AS-19-Employee Benefits

Short term employee Benefits:

CONCEPT OF COMPENSATED ABSENCES

- **Compensated Absences** **(Paid Leave)**
  - **Accumulating** (Can be carried forward and can be used for future periods e.g. AL/SL)
    - **Vesting** (Employees Entitled to a Cash Payment for unused entitlement -when they leave the entity e.g. AL and SL at the retirement)
    - **Non-Vesting** (Employees do not receive such Cash Payment -when they leave the entity e.g. SL at the time of resignation)
  - **Non-Accumulating** (Gets Exhausted in the current period e.g. CL)

Ind AS-19-Employee Benefits

Short term employee Benefits: (Case Study)

- Would you make an actuarial provision for Casual Leave , maternity leave or paternity leave ?

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Ind AS-19-Employee Benefits

Short term employee Benefits: (Case Study)

- Sick leave can be accumulated upto 320 days during service period (Out of which 300 days is encashable at the time of retirement or death).
- Other 20 days can be used in the following year , failing which it lapses.
- Whether provision required for 300 or 320 days ?

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Ind AS-19-Employee Benefits

Short term employee Benefits: (Case Study)

- Employee has not completed 5 Years – Would Gratuity Provision need to be determined ?

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Termination Benefits

Ind AS-19-Employee Benefits

- Termination Benefits : (Benefits payable due to employer's decision to terminate / employee's decision to accept VRS).

✓ Compensations agreed at retrenchment and VRS .

✓ 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.

Post- Employment Benefits

Ind AS-19-Employee Benefits

Post Employment Benefits

- Defined Contribution Plan / Obligation

- Defined Benefit Plan / Obligation

Ind AS-19-Employee Benefits

Defined Contribution Plans :

- Wherein a certain amount or percentage of money is set aside each year by a company for the benefit of the employee. E.g. In DC scheme, say ,employer and employee each contributes 12 % of eligible salary towards PF.
- Since the Contribution is certain and no payment is probable, the accounting is straight forward :-

  - i.e. Debit Expenses A/C (Contribution to PF)

    Credit Liability A/C (PF Payable)

- Liability of Enterprise : Periodic Contribution e.g. Provident Fund.
- On Retirement Employee gets : Accumulated Contribution and Appreciation of Fund.

Ind AS-19-Employee Benefits

- **Defined Benefit Plans –**
- A retirement plan , considering the case of Gratuity , where employee benefits are sorted out based on a formula, using factors such as last drawn salary,duration of employment and various actuarial assumptions like Expected rate of return on Plan Assets,discount rate, salary escalation rate, Mortality, Health care cost, Claim rates under medical plans and attrition rate etc.
- Actuarial valuation will be required for DB plans based on actuarial assumptions.
- Benefit on Retirement or Post Retirement

  - Expense to be provided during service period of the employee.

Ind AS-19-Employee Benefits

- **Defined Benefit Plans –**

Liability for Expense :

Unfunded : (Leaves & BERECHS) : When the Company meets obligation by itself as and when it arises.

Funded : (Gratuity) : When the Company contributes to a dedicated fund (Trust Fund) which in turn invests for returns and also meets the gratuity obligations.

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UNDERSTANDING THE TERMS USED IN DISCLOSURE AT NOTES TO FINANCIAL STATEMENTS TO WHICH IND AS 19 APPLIES

Ind AS-19-Employee Benefits

TERMINOLOGIES

Present Value Of Obligations (PVO)

Projected Unit Credit Method (PUC)

Current Service Costs

Past Service Costs

- **Vested**
- **Non Vested**

Expected Return on Plan Assets

Actual Return on Plan Assets

Fair Value of Plan Assets

Projected Unit Credit Method (PUC)

Ind AS-19-Employee Benefits

Present Value Of Obligations (PVO)

This refers to actuarial liability as we understand it now. PVO is the present value of the benefits payable on exit viz. normal retirement or death or resignation or earlier retirement.

- While computing this we take into account future projected salary, but service up to valuation date only. This is known as Projected Unit Credit Method (PUC) . It considers each period of service as giving rise to an additional unit of benefit entitlement and measures each unit separately to build up final obligation.

Ind AS-19-Employee Benefits

Example on PUC Method :

A lump sum benefit , equal to 1% of final salary for each year of service is payable on termination of service. The Salary in Year 1 is Rs.10000/= and is assumed to increase 7% (compound) each year resulting Rs.13100/= at the end of year 5. The discount rate used is 10% per annum.

Determine (a) PVO

(b) Current Service Cost

Ind AS-19-Employee Benefits

EMPLOYEE TABLE SHOWING THE OBLIGATION FOR AN EMPLOYEE EXPECTED TO LEAVE AT THE END OF YEAR 5

YEAR	1	2	3	4	5
Benefit attributed to :					
(A) PRIOR YEAR	0	131	262	393	524
(B) CURRENT YEAR (1% of Final Salary)	131	131	131	131	131
(C) CURRENT AND PRIOR YEARS	**131**	**262**	**393**	**524**	**655**
(D) OPENING OBLIGATION (PVO)	-	89	196	324	476
(E) INTEREST AT 10% OF (D)	-	9	20	33	48
(F) CURRENT SERVICE COST	89	98	108	119	131
(G) CLOSING OBLIGATION : (D+E+F)	**89**	**196**	**324**	**476**	**655**
Do U Know :- Closing obligation for any year = n x Current Service Cost					
Note : (I) Current Service Cost discounted @ 10%	90='131/(1.10)^4	98=131/(1.10)^3	108=131/(1.10)^2	119=131/(1.1)^1	131
(II) PVO : Present Value of Obligations	Present Value of Benefits payable on exit i.e. Service upto valuation date only.				

Discount Rate@10% P.A :Interest cost is the increase during a period in the PVO because the benefits are one period closer to settlement

Current Service Cost is the present value of benefit attributed to current years

MODEL ACTUARIAL REPORT

Ind AS-19-Employee Benefits

MODEL ACTUAL REPORT- EXPLAINING MOVEMENT OF OBLIGATIONS BETWEEN PERIODS

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	1000	1182	1211	
Interest Cost	100	118	121	@ 10% on Opening Obligation
Current Service Cost	124	136	150	
Past Service Cost - Non-Vested Benefits	30			
Past Service Cost - Vested Benefits	50			
Benefits Paid	(150.00)	(180.00)	(190.00)	Paid by the Fund to the Employees
Actuarial (Gain) loss on Obligation (Bal Fig)	28	-45	52	Balancing Fig. (Closing and Opening)
Present Value of Obligation - Closing	1182	1211	1344	Actuarial Liability - Payable
Fair Value Plan Assets - Opening	1000	1092	1109	
Expected Return on Plan Assets	120	131	133	
Contributions	90	100	110	By the employer towards Fund
Benefits Paid	(150.00)	(180.00)	(190.00)	Paid by the Fund to the Employees
Actuarial Gain (Loss) on Plan Assets (Bal Fig)	32	-34	-69	Balancing Fig. (Closing and Opening)
Fair Value Plan Assets - Closing	1092	1109	1093	Fund Position with Gratuity Trust
Total Actuarial Gain (Loss)	(4.00)	(11.00)	121.00	

CURRENT SERVICE COST

(Present Value of the Benefit attributed to current year)

E.G. ASSUMING THAT GRATUITY AMOUNT PAYABLE AS AT END YEAR 3 IS RS.450 WHICH IS EQUALLY ATTRIBUTABLE TO 3 YEARS

YEAR	1	2	3
Attributable (1)	150	150	150
Discount at 10% (2)	0.8264	0.9091	1.0000
PV / CURRENT COST (3) =(1)* (2)	124	136	150

Ind AS-19-Employee Benefits

Past Service Cost

(Change in Current Period in PVO arising from change in existing benefits)

- **Vesting**
  - Payment of Benefits does not depend upon employee putting in further years of service.
  - Recognition: Past Service Cost should be recognized as an expense immediately.
- **Non-Vesting**
  - Granting of Benefits depend upon an employee completing a certain minimum service which he has not completed as on valuation date.
  - Recognition :Past Service Cost should be recognized as an expense on a straight line basis over the average period until the benefits become vested.

Ind AS-19-Employee Benefits

Past Service Cost :

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 (discount ignored for clarity) .

Now , if there is a revision in the pay from Rs.160 to Rs.240 i.e. Rs. 80 increase. Out 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 remaining 3 years by SLM basis.

Q : RETURNS ON PLAN ASSETS

The fair value of plan assets of M/s X & Co.Ltd. was Rs. 200000/= in respect of Gratuity plan as on 1st April, 2010. On 30th September, 2010 the plan paid out benefits of Rs. 25,000 and received inward contributions of Rs. 55,000. On 31st March, 2011, the fair value of plan assets was Rs. 3,00,000. On 1st April, 2010 the company made the following estimates, based on its market studies and prevailing prices.

	%
Interest and Dividend Income (after tax) payable by Fund	10.25
Realized Gains on Plan Assets	3.00
Fund Administrative Costs	(3.00)
Expected Rate of Return	10.25

Calculate the expected and actual returns on plan assets as on 31st March, 2011, as per AS 15.

Computation of Expected Returns on Plan Assets as on 31st March, 2011, as per AS 15

	Rs.
Return on opening value of plan assets of Rs. 2,00,000 (held for the year) @ 10.25%	20,500
Add: Return on net gain of Rs. 30,000 (i.e.Rs. 55,000 – Rs. 25,000) during the year i.e. held for six months @ 5% (equivalent to 10.25% annually, compounded every six months)	1,500

Expected return on plan assets as on 31st March, 2011	22,000

Computation of Actual Returns on Plan Assets as on 31st March, 2011, as per AS 15

	Rs	Rs
Fair value of Plan Assets as on 31st March, 2011		3 00 000
Less: Fair value of Plan Assets as on 1st April, 2010	200000	
Add: Contribution received as on 30th September, 2010	55000	(255000)
		45000
Add: Benefits paid as on 30th September, 2010		25000
Actual returns on Plan Assets as on 31st March, 2011		70000

Double Entry Reconcilation

Table explaining where the difference between Opening and Closing Net Obligation is considered.

(Year 1 Figures in the above table is considered.)

Particulars	Amt (Rs.)	Remarks
Net Obligation - Opening (1000 - 1000)	0	
Net Obligation - Closing (1182 - 1092)	90	
Movement	**90**	**Credit Liability a/c.**
Interest Cost	100	P/L a/c.
Current Service Cost	124	P/L a/c.
Past Service Cost - Vested	50	P/L a/c.
Past Service Cost - Unvested-Current Year	10	P/L a/c.
Past Service Cost - Unvested-Subsequent Years	20	Reduction in Liability
Expected Return on Plan Assets	-120	P/L a/c.
Contributions	-90	Reduction in Assets (Bank a/c)
Actuarial Gain / Loss	-4	P/L a/c.
Total	**90**	

Actuarial Assumptions

Actuarial Assumptions

- Assumptions
  - Unbiased and mutually compatible
  - Based on market expectations over the projection period
  - Employer to decide on the assumptions
- Demographic
  - Mortality
  - Employee turnover, disability and early retirement
  - Claim rates under medical plans
- Financial
  - Discount Rate
  - Salary escalation rate
  - Medical expenses
  - Expected return on plan assets

Effects of Changes in Major Actuarial Assumptions

Assumption	Increase	Decrease
Discount rate	DBO would decrease and leads to actuarial gain	DBO would increase and leads to actuarial loss
Salary Increase Rate	DBO would increase and leads to actuarial loss	DBO would decrease and will lead to actuarial gain
Attrition Rate	DBO would decrease and leads to actuarial gain	DBO would increase and leads to actuarial loss

Actuarial Assumptions: (Case Study)

- For the purpose of determining Gratuity provision , a Software Company considers salary growth rate of 8% when 5 past years experience suggests that it has been 20%.Would this be a tenable assumption ?

?

Q & A

Ind AS 19

- Impact for the Companies

Ind AS 19 - Impact for the Companies

- Will help the companies improve their disclosure and better align with IAS 19 reporting if any.

(Employees include all Directors - As per AS 15 old standard the term employee includes only whole time directors whereas under Ind AS 19, the term includes directors. (Paragraph 6 of Ind AS 19)

- Inclusion of Directors: The companies would now need to include part time directors. Though they could be few in numbers, their pension cost could be significant . This would increase the expense and the net liability provisions.

Ind AS 19 - Impact for the Companies

- **Recognition of Actuarial Gains and Losses :**

  Ind AS 19 requires recognition of the actuarial gains and losses in other comprehensive income, which in turn to be immediately recognized in retained earnings. They should not be reclassified as profit or losses in a subsequent period. The old standard AS 15 requires the recognition of the actuarial gains and losses immediately in the statement of profit and loss as income or expense. (Paragraphs 92 and 93 of Ind AS 19)

- ***Actuarial Gains and Losses:*** **The actuarial gains and losses will now be immediately recognized in the other comprehensive income and not flow into the profit and loss. This will remove the volatility in the profit and loss which in turn improves the credibility and understanding Of the financial statements by the investors. This will also help achieve closer compatibility with the amended IAS 19 as the amended standard has similar provisions. The other comprehensive income would be adjusted against the retained earnings and the net liability provisions in the balance sheet would not change.**

Ind AS 19 - Impact for the Companies

Termination Benfit :

- **Ind AS 19 requires termination benefits to be recognised as an expense immediately. Where Termination benefits fall more than 12 months after reporting period, they shall be discounted using the discount rate. The old AS 15 treats VRS liability as per pre-revised AS- 15 shall be prior period expense /can be deferred under Indian GAAP over 3-5 years.**
- **Under Ind AS 19, the liability for termination benefits has to be recognized based on constructive obligation i.e. based on the demonstrable commitment by the entity, for e.g. Announcement of a formal plan. Termination benefits are dealt with under AS-15 (revised), which are required to be recognized based on legal obligation rather than constructive obligation i.e. only when employee accepts VRS scheme.**

➢ **Termination Benefits: The timing of recognition of termination benefits including voluntary redundancy could potentially impact the expenses if there is a termination or redundancy plan.**

Ind AS 19 - Impact for the Companies

Asset Ceiling :

- **As per Ind AS 19, one of the limits for ‘asset ceiling’ is the total of (i) any cumulative unrecognized past service cost and (ii) the present value of economic benefits plan or reductions in future contributions to the plan. As per the existing standard, the said limit is (ii) as above. (Paragraph 58(b) of Ind AS 19)**

Asset Ceiling: The cumulative unrecognized past service cost could now be included in the assets which could potentially lower the net liability for companies who have such a provision.

THANK YOU

Ind AS-19-Employee Benefits

(Case Study)

A Ltd has a scheme whereby on the death of an employee during the service period , the dependents would be granted Rs.100,000. Does it come under Employee Benefits ?

Yes , It is Employee Benefit as it includes benefits provided to employees, their spouses , children or other dependant.

Ind AS-19-Employee Benefits

Short term employee Benefits: (Case Study)

- Would you make an actuarial provision for Casual Leave , maternity leave or paternity leave ?

As Casual Leave is non-accumulating i.e.it can not be carried forward, they lapse during the current period if not used and do not entitle employees to encash payment for unused entitlement on leaving the company. Expense / Liability is not recognized since they lapse and are not carried forward. Such will be the case for maternity or paternity leave.

Short term employee Benefits: (Case Study)

- Sick leave can be accumulated upto 320 days during service period (Out of which 300 days is encashable at the time of retirement or death).
- Other 20 days can be used in the following year , failing which it lapses.
- Whether provision required for 300 or 320 days ?

- 300 Days constitute long term compensated absences. Hence, actuarial valuation is required.
- Remaining 20 days is short term compensated absence. Provision to be made to the extent it is expected that it will be utilised in the following year.

Ind AS-19-Employee Benefits

Short term employee Benefits: (Case Study)

- Employee has <u>not completed 5 Years</u> – Would Gratuity Provision need to be determined ?

- In the Instant case, <u>a non-vested</u> gratuity benefit arises. There is no provision for spreading this liability over the vesting period. <u>The valuation has to be conducted normally taking into account service up to valuation date.</u>

- Non Vesting Benefits also to be provided : e.g. Gratuity though payable after completion of five year of service but to be provided from Ist Year.

Actuarial Assumptions: (Case Study)

- For the purpose of determining Gratuity provision , a Software Company considers salary growth rate of 8% when 5 past years experience suggests that it has been 20%.Would this be a tenable assumption ?

- 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 based on limited past experience. Assumption of Salary growth rate of 8% is tenable.