OM SHRI GANESHAY NAMAH

AS – 15 “EMPLOYEE BENEFIT”

[Submitted by CA. Mohit Agarwal ACA]

October 2, 2008

EMPLOYEE BENEFITS – all forms of payments, in exchange for services rendered by employees. This standard applies to all employee benefits, except share based payments.

Long Term Employee Benefits

Short Term Employee Benefits

Termination Benefits

Other long term Benefits

Post Employment Benefits

Defined Contribution Plan

Defined Benefit Plan

SHORT TERM EMPLOYEE BENEFITS

- Benefits which fall due wholly within 12 months from the end of period, to which employee service relates,
- Will be treated as accrued expense (if not paid, or less paid) or as an prepaid assets (if paid more),
- In this case undiscounted figure is considered,
- Like wages, salaries, profit sharing and bonus payable, short term compensated balance etc.

Short term compensated Absences (e.g. pay leave, maternity leave etc.)

Non Accumulating

Accumulating

Vesting
(Cash Payment)

Non Vesting
(Probability of leaving should also be considered)

Recognise the expected cost

On rendering of services, that increases future entitlement. i.e. recognise additional liab. at Balance Sheet Date

when the absence occurs.

.

POST EMPLOYMENT BENEFIT PLAN

Those benefits which are payable after the completion of employment, except TERMINATION BENEFIT. such as gratuity, pension, other retirement benefits, post employment life insurance etc.

DEFINED CONTRIBUTION PLAN

- Employer's liab. is restricted to contribution amt.
- Straightforward amount – Contribution amount.
- No actuarial assumptions are required.
- Actuarial risk & investment risk is not lies to employer.
- Treatment-as an expense and over paid or under pymt as O/S liab and prepaid asset.
- In some cases, employers liab. is not restricted to contribution amt., then considered as defined benefit schemes.
- If contributions don't fall due wholly within 12 months , they should be discounted.

DEFINED BENEFIT PLAN

Employer is liable to provide defined (agreed) benefits
Complex calculations of PV of Defined benefit obligations, current service cost, past service cost, interest cost etc.
Actuarial assumptions are required.
Possibility of actuarial gain or loss.
Obligations are measured on a discounted basis using Projected Unit Credit Method (PUC) method.
Management responsibility to measure the obligation, but normally help of qualified actuary's help is taken.

<u>DEFINED BENEFIT PLAN</u>

- ➢ PRESENT VALUE OF A DEFINED BENEFIT OBLIGATION (PV of DBO)
  It is present value of expected future payments (without deducting plan assets).
- ➢ CURRENT SERVICE COST
  Increase in PV of DBO resulting from employee service in current period.
- ➢ INTEREST COST
  Increase in the PV of DBO arises because the benefits are one period closer to settlement. (simply interest amount on opening balance of DBO.)

ACCOUNTING STEPS -

- ✓ Make a reliable estimate of the employee benefit amount, using actuarial techniques. It requires, enterprise to determine how much benefit is attributed to current and prior period and to make estimates (actuarial assumptions) about demographic variables (e.g. employee turnover and mortality) and financial variables (e.g. discount rate, future increase in salaries).
- ✓ Discounting that benefit, using Projected Unit Credit Method for determining PV of DBO and the current service cost.
- ✓ Determine the fair value of any plan assets.
- ✓ Determine the total amount (net) of actuarial gain or loss.
- ✓ Past service cost in case of introduction and change in plan.
- ✓ Curtailment and settlement gain or loss.

RECOGNITION

(A) Amt. to be recognised in Balance sheet –

DEFINED BENEFIT LIABILITY

= PV of DBO at Balance Sheet date
Less: Past service cost not yet recognised
Less: Fair value of plan asset at Balance Sheet date

IT MAY BE A NEGATIVE FIGURE (An asset) → may arise because defined benefit plan has been :

(a) over funded
(b) higher actuarial gains are realized.

It should be measured at lower of -

(1) This figure, or
(2) PV of any economic benefits available in the form of

Refunds from the plan | Reduction in future contribution to the plan

(B) Recognise Net total of the following amounts in P& L -

I. Current service cost
II. Interest cost
III. Expected return on any plan asset and on any reimbursement right.
IV. Net actuarial gain or losses
V. Past service cost
VI. Effect of any curtailment or settlement, and
VII. Written down value of assets, to bring down the value of assets to the extent of FV of economic benefits available.

MEASUREMENT

ACTUARIAL VALUATION :-

Detailed actuarial valuation of PV of DBO may be made at intervals not exceeding 3 years. and necessary adjustment should also be considered to reflects material transactions and other material changes in circumstances b/w the valuation date and balance sheet date. But Fair value of any plan assets is determined at each balance sheet date.

There are three issues :-

(i) Actuarial valuation method,
(ii) Attribute benefits to period of service,
(iii) Make actuarial assumptions.

ACTUARIAL VALUATION METHOD – Projected Unit Credit Method (PUC Method)

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 obligations. Also known as Accrued benefit method.

ATTRIBUTING BENEFITS TO PERIOD OF SERVICE -

(1) It means attributing benefits to current period as Current service cost and prior period as Past service cost. It says, start attributing benefits from the date of service, which leads to benefits (conditional or unconditional) till the date when he will not be entitled to material amount of further benefits.
(2) However, if an employee service will lead to material higher level of benefit than in earlier years, an enterprise attributes benefit on a SLM basis, until the date when no material benefit occurs.
(3) Even though the benefits are conditional on future conditions (i.e. they are not vested), it gives rise to an obligation to enterprise. And due to this reason, in all calculations, probability that the employee may not satisfy the necessary conditions should also be considered.

ACTUARIAL ASSUMPTIONS

Financial Assumptions

Demographics assumptions
(Future characteristics of current and former employees and their dependents)

-Should be unbiased - if they are neither imprudent nor excessively conservative.

ACTUARIAL GAIN OR LOSS –

Due to

Increase or decrease in the PV of DBO

Change in fair value of any related plan assets

Change in PV of DBO: -
-due to actuarial experience is different from assumed, e.g. Salary higher/lower than expected
- Change of DBO due to change in assumptions.

Change in Fair Value if Assets: -
-Change of asset value due to actual return from different from assumed.

Should be recognised net of figures of above two in the Profit & Loss immediately as income or expenses,

Example of PUC Method :-
The following table shows how the obligation builds up for an employee who is expected to leave at the end of year 5.

(Rs. In lacs)

Year		**1**	**2**	**3**	**4**	**5**
Benefits attributed to:						
- prior years	A	0	131	262	393	524
- current year (1% of final salary)	B	131	131	131	131	131
- current and prior years	C	**131**	**262**	**393**	**524**	**655**
Opening obligations (see note 1)	D	-	89	196	324	476
Interest at 10% (E = 10% of D)	E	-	9	20	33	48
Current Service Cost (see note 2)	F	89 (131 X .683)	98 (131 X .751)	108 (131 X .826)	119 (131 X .909)	131 (131 X 1)
Closing Obligation (G = D+E+F)	G	**89**	**196**	**324**	**476**	**655**

NOTES :
1.The Opening Obligation is the present value of benefit attributed to prior years.
2.The Current Service Cost is the present value of benefit attributed to the current years.
3.The Closing Obligation is the present value of benefit attributed to current and prior years.

PAST SERVICE COST

- Change in PV of DBO, related to prior period’s employee service, due to “introduction of” or “Changes” to post employment benefits or other long-term employment benefits.
- It can either be positive (where benefits are introduced or improved)
  Or can be negative (where existing benefits are reduced)

- Past Service Cost

Benefits has been vested

YES	NO
Recognise it immediately.	Recognise it over the remaining vesting period (SLM Basis)

PLAN ASSETS

Assets on which entity has no right and out of which the obligations are settled directly.

It comprises :-

- Asset held by long term employee benefit fund (separate entity)
- Qualifying insurance policies (i.e. policy issued by non related party)

It excludes :-

- Unpaid contribution to the fund
- Non transferable financial instrument issued by enterprise and held by the fund

- It will also be reduced by the liability that don't relate to employee benefit obligation.
- It will be valued at Fair Value at each balance sheet date.
- It is shown as deduction from Defined Benefit Obligation liability in Balance Sheet.

RETURN ON PLAN ASSETS: -

Interest, dividend, other revenue, realized & unrealized gain or loss (Changes in FV of plan assets).
Less: any cost of administering the plan or any tax payable

The difference b/w the expected return on plan assets and the actual return on plan assets is an actuarial gain or loss.

REIMBURSEMENT RIGHTS –

- Virtual certain that another party will reimburse some or all of the expenditure require to settle defined Benefit Obligation. e.g. Non qualifying insurer.
- In the statement of profit and loss, the defined benefit plan expense should be shown net of the amt. recognised reimbursement.
- It is recognised at fair value, it will be treated in the same way as plan assets., except it's presentation. It will be recognised as separate asset, instead of deduction from DBO liability.
- AS – 15 requires, to disclose a brief description of the link between the reimbursement rights and related obligation.

CURTAILMENT & SETTLEMENT

Recognise gains or losses on the curtailment or settlement of a defined benefit plan, when they occur.

It's Gain or loss comprise:

1. Any resulting change in PV of DBO
2. Any resulting change in FV of plan asset
3. Any related past service cost, had not previously been recognised.

Before determining it's effect , an enterprise should remeasure the obligation (and the related plan assets, if any), using current actuarial assumptions.

CURTAILMENT

When an enterprise, either

(a) make material reduction in number of employees

(b) amends the terms of plan resulting – no benefits
-- or, reduced benefits.

Resulting from an isolated event of –

- closing of a plant, discontinuation of an operations
- termination or suspension of a plan.

SETTLEMENT

Enterprise enters into a transaction that eliminates all further obligation for part or all of the benefits.
e.g. When a lump sum cash payment is made (for all post employment benefits).

MULTI EMPLOYER PLANS -

(Other than State Plans and Group administration plan)

It can be both Defined Contribution Plan or Defined Benefit Plan that

- ➢ Pool the assets contributed by various entities that are not under common control
- ➢ Use those assets to provide payments to employees of more than one entity, irrespective of the fact that employees relate to which entity.

IF DEFINED BENEFIT PLAN - employer should consider it's proportionate share
However AS – 15 provides a practical exemption, if insufficient information is available to use Defined Benefit Accounting. In such circumstances (a) treat it as Defined Contribution Plan,
(b) make this disclosure and reason for this.

STATE PLAN –

- Established by legislation to cover all entities.
- State Plans are normally Defined Contribution Plan.
- In rare cases State Plan is a Defined Benefit Plan. (In this case accounted for in the same way as for Multi Employer Plan).

INSURED BENEFITS –

Qualifying Insurance Policy

→ Not available to reporting entity's own creditors (in case of bankruptcy)

Will be treated as Defined Contribution Plan
(Liability is restricted to contribution amount)

But if enterprise obligation is not restricted to only insurance premium

- If entity is obliged to pay employee benefit directly when fall due.
- Pay further amount, if insurer does not pay.

Then Defined Benefit Plan

And in this case accounts for a qualifying insurance policy as a Plan asset. And in case of other than qualifying insurance policy – treat as reimbursement rights.

OTHER LONG TERM EMPLOYEE BENEFIT –

Other than post employment benefit and termination benefits, which do not fall due wholly within 12 months.
It includes :-

- ➢ Long term compensated balance

- Jubilee or Other long service benefits
- Long term disability benefits
- Profit sharing bonuses payable after 12 months
- Deferred compensation etc.

↓

Same treatment as post employment benefit, except there is rarely Past Service Cost.

TERMINATION BENEFIT

Benefit payable due to:

1. Enterprise decision to terminate, or
2. Employee's decision to accept VRS.

Should recognise as a liability and as an expense when, and only when –

- present obligation from past event.
- outflow of resources to settle the liability.
- reliable estimate can be made.

RECOGNITION :-

AS –15 requires immediate recognition of expenses as and when occurred.

However, Where expenditure incurs on or before 31 Mar 2009, the entity can defer as per it's previous Policy, but in no case , it can be c/f to accounting periods commencing on or after 1st April 2010.

Entity should also disclose contingent liab. in respect of termination benefit, if required.

TRANSITIONAL PROVISIONS

Transitional Liability for Defined Benefit Plan :-

✓ PV of DBO at the date of adoption,
Less : fair value of the plan assets
Less : any past service cost (which is to be recognised in later periods).

Difference (as adjusted any tax expenses) between transitional liability and liabilities as per previous policy immediately, against opening balance of Revenue Reserve.

SOME OTHER IMPORTANT POINTS :-

- ✓ It covers all type of employees, full time, part time, permanent , casual or temporary basis.
- ✓ This statement does not deal with accounting and reporting by employee benefit plan.
- ✓ Employee benefit expense should be charged to P & L, unless other accounting standard requires It to be debited to cost of assets (e.g. AS-10).
- ✓ It is not applies to only benefits provided under formal plans and arrangement, it also applies to those informal practices that give rise to an obligation (i.e where enterprise has no alternative but to pay employee benefit).
- ✓ The rate of discount should be determined with reference to market yields on government bonds, the currency and terms of which should be consistent with the estimated terms of the obligation.
- ✓ Where an enterprise has its own Provident Fund, there is an obligation to pay the minimum interest prescribed by the authorities irrespective of the interest actually earned by the Fund. In such an event this would need to be treated as a defined "benefit" plan instead of as defined "contribution" plan and additional provisioning for any expected shortfall in interest may need to be made.