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August 29, 2012

Accounting Standard 15 (Revised 2005)

Employee Benefits

Content

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Introduction

The Institute of Chartered Accountants of India (ICAI) had issued Accounting Standard 15 initially in 1995 after that the same has revised by the ICAI in 2005. This revised Standard is an improvement version of old AS 15 (1995).

The revised AS 15 has significant impact on the financial reporting of the enterprises:

1. This is covered all types of Employee Benefits, except share base payments.
2. Definition of employee under the revised AS-15 includes part time, causal and temporary employees.
3. Treatment of provident fund as defined contribution rather than defined benefit.
4. Treatment of gratuity scheme funded with LIC as defined benefit rather than defined contribution.
5. Deferral of past service cost, which was not permitted by pre revised As-15.
6. Prescribed actuarial assumptions and method for valuation of employee benefits.
7. Application of the transitional provisions.
8. Tax effects of the above items.

Applicability

A notification by Ministry of Company Affairs came on 7th December, 2006 makes rules called Companies (Accounting Standard) Rules, 2006 and Central Government, in consultation with National Advisory Committee on Accounting Standards (NACAS) prescribes Accounting Standards as recommended by the ICAI which are specified in these rules.

For the purpose of applicability the definition of "Small and Medium Sized Company (SMC) had been changed and accordingly some relaxations/exceptions are given to SMC under the said the rules.

Entities	Details of Company	Applicability	Exception
Corporate Entity **NON SMC**	1. Enterprises' Equity/Debentures Listed in India/Outside India 2. Enterprises in process of listing their securities 3. Bank/Financial Institutions/Insurance Company 4. Enterprises either Turnover > 50 crore or Borrowings > 10 crore 5. Holding and subsidiary enterprises of any one of the above	Fully	Nil
SMC	1. Enterprises either Turnover > 40 lakhs but < 50crore or 2. Borrowings > 1 crore but < 10 crore. 3. Holding and subsidiary enterprises of any one of the above	With Exception	1. Recognition and measurement of short-term accumulating compensated absences in respect of which employees are not entitled for cash. 2. Discounting of amounts that fall due more than 12 months after the balance sheet date as regards Defined contribution plans and Termination benefits. 3. Recognition, measurement and disclosure principles in respect of defined benefit plans and other long-term employee

			benefit plan. (However provide & disclose accrued liability in respect of these as per actuarial valuation).
Non-Corporate Entity	Average numbers of employee is 50 or more.	With Exception	1. Recognition and measurement of short-term accumulating compensated absences in respect of which employees are not entitled for cash. 2. Discounting of amounts that fall due more than 12 months after the balance sheet date as regards Defined contribution plans and Termination benefits. **3.** Recognition, measurement and disclosure principles in respect of defined benefit plans and other long-term employee benefit plan. (However provide & disclose accrued liability in respect of these as per actuarial valuation).
	Average numbers of employee is Less than 50	With Exception	Exception 1 & 2 is same as mention above. 3. Recognition, measurement and disclosure principles in respect of defined benefit plans and other long-term employee benefit plan. (provide liability and expense in respect of these assuming that such benefits are payable to all employees at the end of the accounting year)

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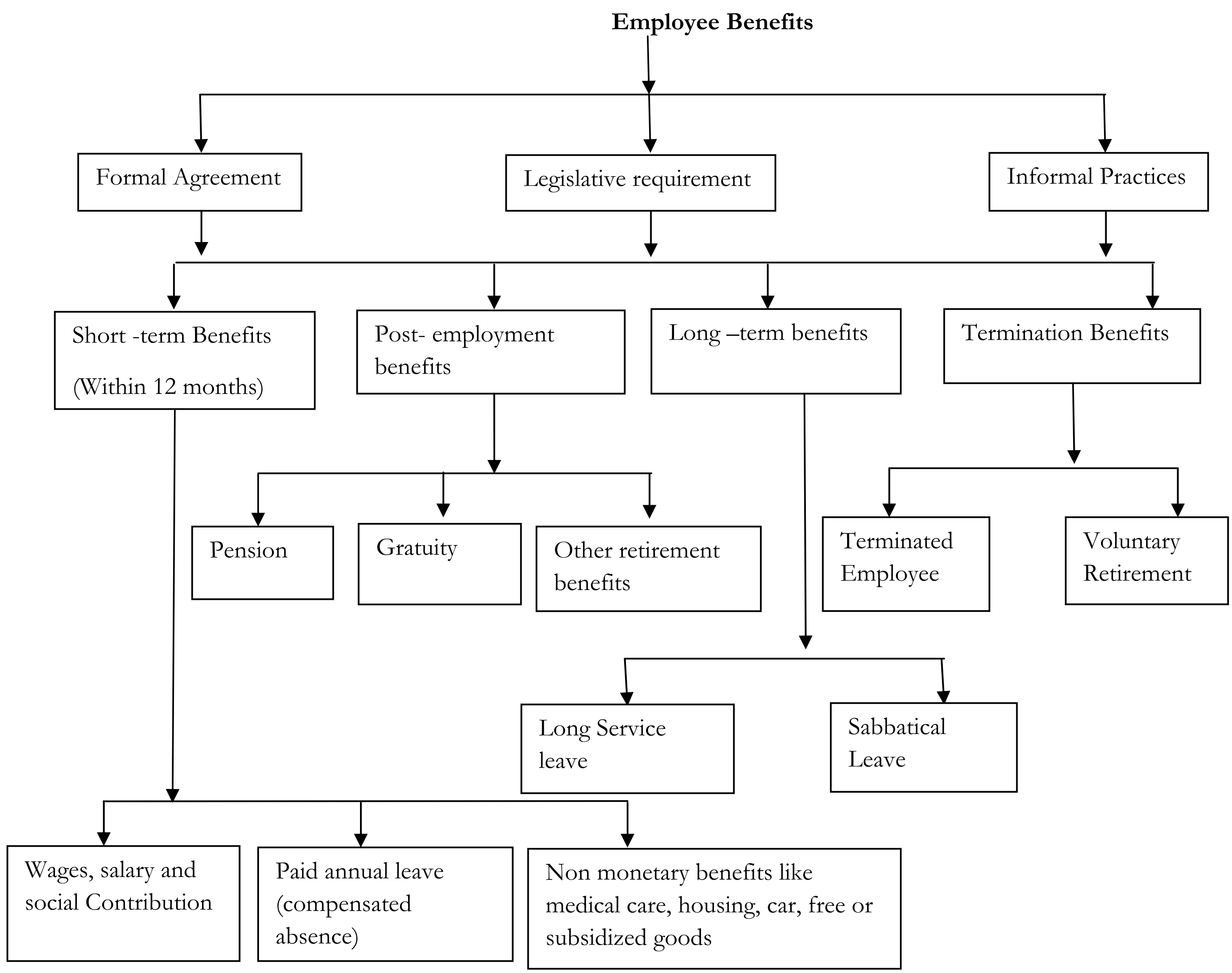
Key Features

AS-15 is covered all types of employee benefits which is provided by employer in consideration of service render by the employee except employee share based payment. Employee benefits under the said standards include which provided under formal plans or under legislative requirement or through informal practices.

Standard identifies four categories of employee benefits which are as follow:



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Recognition & Measurement

1. Short term Employee Benefit

The standard requires an enterprise to recognise the undiscounted amount of short term employee benefits. No actuarial assumptions are required to measure the obligation.

<table>
<tr><th>Short term Employee Benefits</th><th>Recognition & Measurement</th><th>Disclosure</th></tr>
<tr><td>Wages, Salary and Social Security Contribution</td><td rowspan="2">Record the expenses and liability & assets only when the Services are rendered.</td><td rowspan="4">Although this Statement does not require specific disclosures about short-term employee benefits, other Accounting Standards may require disclosures. (for example, where required by AS 18 Related Party Disclosures an enterprise discloses information about employee benefits for key management personnel)</td></tr>
<tr><td>Non Monetary Benefits (Car, Housing, Free or Subsidized goods)</td></tr>
<tr><td rowspan="2">Compensated Absence (Accumulating absence & Non Accumulating absence)</td><td>For Accumulating Absence (Vacation, Sickness)

If accumulating absence is vesting than record the expenses and liability & assets only when the Services are rendered.

If accumulating absence is non-vesting than record the expense and liability & assets only after taking into the account the probability e.g. leave may be availed. (Refer the below example)</td></tr>
<tr><td>For Non Accumulating Absence (Maternity, Paternity leave)

Record the expenses and liability & assets only when the absence occurs.</td></tr>
</table>

<u>**Note:**</u>

1. Vesting : entitled to cash payment for the unused entitlement on leaving.
2. Non vesting: not entitled to a cash payment for unused entitlement on leaving.

Non vesting accumulating leaves- Example

An enterprise has 100 employees, who are each entitled to five working days of leave for each year. Unused leave may be carried forward for one calendar year. The leave is taken first out of the current year's entitlement and then out of any balance brought forward from the previous year (a LIFO basis). At 31 December 2011, 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 2012 and that the remaining eight employees will take an average of six and a half days each.

Solution:

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 2011 (one and a half days each, for eight employees). Therefore, the enterprise recognises a liability, as at 31 December 2011, equal to 12 days of pay.

2. Post employment benefits plans

Post employment benefits plans are classified as either defined contribution plans or defined benefits plans. Under defined contribution plans, the enterprise's obligation is limited to the amount that it agrees to contribute to the fund and in consequence, actuarial risk (that benefits will be less than expected) and investment risk (that assets invested will be insufficient to meet expected benefits) fall on the employee.

Post employment benefits	Recognition & Measurement	Disclosure
Define contribution plan (Provident fund, superannuation)	➢ Record the amount to be contributed for the period ➢ No actuarial assumptions are required to measure the obligation or the expense and there is no possibility of any actuarial gain or loss. ➢ Measured on undiscounted basis, except where they do not fall due within twelve months ➢ Actuarial risk and Investment risk borne by the employee	➢ An enterprise should disclose the amount recognised as an expense For defined contribution plans. ➢ Where required by AS 18 Related Party Disclosures an enterprise discloses information about contributions to defined contribution plans for key management personnel.
Define benefit plans (Gratuity, pension, medical care)	**At Balance sheet date** 1) **Liability** = present value of defined obligation – (past service cost not recognised + fair value of plan assets) 2) **Assets** = if (1) is negative than assets to be lower of: amount determined under (1) above and present value of refunds or of reduction in future contributions. **Profit & Loss Statement** ➢ Current service cost ➢ Interest cost ➢ Expected return on any plan assets ➢ Actuarial gains or losses ➢ Past service cost ➢ Effect on any curtailments or settlements	➢ An enterprise should disclose information that enables users of financial statements to evaluate the nature of its defined benefit plans and the financial effects of changes in those plans during the period.

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Note:

I. Defined benefit plans may be unfunded, or they may be wholly or partly funded. The standard requires an enterprise to:

(a) Account those all other post-employment benefits not only for its legal obligation under the formal terms, but also for any other obligation that arises from the enterprise's informal practices.

(b) Using actuarial techniques to make a reliable estimate of the amount of benefit that employees have earned in return for their service in the current and prior periods. This requires an enterprise to determine how much benefit is attributable to the current and prior periods and to make estimates (actuarial assumptions) about demographic variables (such as employee turnover and mortality) and financial variables (such as future increases in salaries and medical costs) that will influence the cost of the benefit.

(c) Use the Projected Unit Credit Method to measure its obligation and related cost.

(d) Determine the present value of defined benefit obligation and the fair value of any plans assets.

(e) Determining the total amount of actuarial gains and losses.

3. Other Long Term employment

Regarding the other long-term employment benefits, the standard required a simpler method of accounting for other long-term employment benefits than for post-employment benefits by requiring that past service cost should be recognised immediately.

Long term employment benefits	Recognition & Measurement	Disclosure
Long term employment benefits (long service leave, sabbatical leaves)	**At Balance sheet** Liability = Present value of defined benefit obligation – fair value of plan assets **Profit & Loss Statement** ➢ Current service cost ➢ Interest cost ➢ Expected return on any plan assets ➢ Actuarial gains or losses ➢ Past service cost ➢ Effect on any curtailments or settlements	➢ Does not require specific disclosures about other long-term employee benefits. ➢ Other Accounting Standards may require disclosures, for 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 (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.

4. Termination Benefits

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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.

Termination benefits	Recognition & Measurement	Disclosure
Terminated employee, voluntary retirement	Recognise as an expenses immediately when and only when: (a) Company has a present obligation as a result of past event (b) Outflow of resources required to settle obligation and (c) Reliable estimate of the amount of obligation When termination benefit fall more than 12 months, after the balance sheet, should be discounted using the discount rate	**AS 29-** Where there is uncertainty about the number of employees who will accept an offer of termination benefits, a contingent liability exists. **AS 5**- an enterprise discloses the nature and amount of an expense if it is of such size, nature or incidence that its disclosure is relevant to explain the performance of the enterprise for the period. Termination benefits may result in an expense needing disclosure in order to comply with this requirement. **AS 18-** an enterprise discloses information about termination benefits for key management personnel.

Difference between IAS-19 & AS-15 (Revised)

There is some key difference between AS15 (R) & IAS-19 which is as follow:

(a) Recognition of Actuarial Gains and Losses

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

(i) by following a 'Corridor Approach', which results in deferred recognition of the actuarial gains and losses, or
(ii) immediately in the statement of profit and loss, or
(iii) 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.

(b) Recognition 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 unrecognised 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.

(c) 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 on the basis of detailed formal plan for the termination and without realistic possibility of withdrawal 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 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 crystalised 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*.

(d) Transitional Provisions

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. Thus, the expenditure so deferred should be written off over (a) the pay-back period or (b) the period from the date expenditure on termination benefits is incurred to 1st April, 2010, whichever is shorter. IAS 19 does not provide such a transitional provision."

Case Study- Accounting for leave liability

A. Facts of Case

1. A public sector company is engaged in the manufacture of power equipments. The company has manufacturing units, power sector regions, service centers and regional offices besides project sites spread all over India and abroad. The shares of the company are listed in stock exchanges at NSE and BSE. The turnover of the company was Rs. 34,154 crore in the year 2009-10. The company had employee strength of 46,274 Nos. as on 31.03.2010.

2. The summary of the rules of the company relating to the leaves are as below:

Particulars	Encashable Earned Leave(EEL)	Non encashable Leave (NEL)	Half Pay Leave
Accrued during the year (days)	16 to 22	6 to 8	20
Maximum accumulation limit (days)	300 days both for EEL & NEL put together.		No limit
Encashable during the service	Yes- once in a year without any restriction	No	No
Encashable limit on superannuation (days)	300 days EEL & NEL both put together.		480 half days. (240 full days).
Availment restriction at any time during service	No	No	No

3. The accounting practice of the company in respect of leave liability from 1.4.2006 is stated by the company as below:

   Liability for encashable earned leave (EEL), non-encashable earned leave (NEL) and half pay leave (HPL) is provided for in the books on accrual basis for the value of leave outstanding at the end of the year. According to the company, provision for half pay leave is made for the total leave balance at the yearend without restricting it to 480 half days (240 full days) per employee in line with the requirements of AS 15(revised).

4. During the audit of annual accounts for the financial year 2009-10, the Government audit has raised a query stating that the past pattern indicates that the employees are unlikely to avail/encash the entire carried forward leave during the next twelve months and hence, the benefit would not be short-term. Accordingly, they are of the view that keeping in view the behavioral pattern of the employees, the leave benefit should be considered as long-term benefit and the provision should be made based on actuarial valuation.

5. The company has expressed its views as below:

   In the case of the company, leave is accrued when the employee renders his service and there is no restriction on an employee in availing /encashing in the same year in which it has fallen due. The accumulation or encashment is entirely an individual's discretion and the employees can avail/encash the entire accumulated leave balance in one financial year itself.

   The point raised by Government audit for treating the leave benefit as long-term benefit is stated to be based on behavioral pattern of the employees on availing /encashing the leave based on the ASB Guidance on Implementing AS 15, Employee Benefits (revised 2005), issued by the Institute of Chartered Accountants of India (ICAI). Since there is no provision in AS 15 (revised 2005), issued by the ICAI on treatment of benefits based on behavioral pattern, the treatment has to be in line with AS 15 and not based on the said Guidance which clearly states that it is not a part of standard.

B. Query

Based on the above facts, the querist has sought the opinion of the Expert Advisory Committee on the following issues:

i) Whether treatment of leave liability as short-term employee benefit and accounting on accrual basis by the company is correct and is in line with AS 15 (revised 2005) or not.

ii) In case it is not, then how to account for the change during the year 2010-11, i.e., through profit and loss account or through retained earnings (balance sheet approach).

C. Points considered by the Committee

The Committee, while answering this query notes the definitions of the terms 'short-term employee benefits' and 'other long-term employee benefits' as contained in paragraphs 7.2 and 7.8 of AS 15, notified under the Companies (Accounting Standards) Rules, 2006 (hereinafter referred to as 'the Rules') which are reproduced below:

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."***

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."***

The Committee also notes that paragraph 8 of AS 15 notified under the Rules provides as below:

"8. Short-term employee benefits include items such as: …

(b) Short-term compensated absences (such as paid annual leave) where the absences are expected to occur within twelve months after the end of the period in which the employees render the related employee service;

…"

The Committee also notes that although ASB Guidance on Implementing AS 15, Employee Benefits (revised 2005) does not form part of the Standard, by virtue of this Guidance, the Accounting Standards Board has clarified in the context of short-term and long-term employee benefits, vide Issue 3 thereof, which, inter alia, provides as below:

"Paragraph 7.2 of the Standard uses "***falls due"*** as the basis, paragraph 8(b) of the Standard uses "***expected to occur"*** as the basis to illustrate classification of short term compensated absences. A reading of paragraph 8(b) together with paragraph 7.2 would imply that the classification of short-term compensated absences should be only when absences have ***"fallen due"*** and are also "***expected to occur"***. In other words, where employees are entitled to earned leave which can be carried forward to future periods the benefit would be a 'short-term benefit' provided the employee is ***entitled*** to either encash/utilise the benefit during the twelve months after the end of the period when he became entitled to the leave and is also ***expected to do so***. Where there are restrictions on encashment/availment, clearly the compensated absence has not fallen due and the benefit of compensated absences is more likely to be a long term benefit.

6. On the basis of the above, the Committee is of the view that short-term employee benefits include only those compensated absences which accrue to the employees and are expected to be availed (or encashed, as the case may be) within twelve months after the end of the period in which the employees render the related service. In

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other words, where it is expected that the employees will avail/encash the *whole* of the benefit accruing to them on account of earned leave (EEL and NEL) and half-pay leave within the twelve months after the end of the period in which the employees render the related service, the same would fall within the category of 'short-term employee benefits'. However, the Committee notes from the Facts of the Case that both the leave entitlements of the employees of the company can be carried forward for more than twelve months after the end of the period in which employees render the related service. Further, the Committee notes that both the types of leaves, which were accrued, have been accumulated and carried forward by the employees. Therefore, the Committee is of the view that the benefit on account of both types of leaves does not fall within the category of 'short-term employee benefits'. Rather, the entire benefit on account of these leaves should be treated as 'other long-term employee benefits'.

7. With respect to the recognition and measurement of other long-term employee benefits, the Committee notes that AS 15 (revised 2005) provides that the same should be measured on actuarial basis using the Projected Unit Credit Method. The Standard contains detailed requirements in this regard in paragraphs 129 and 130.

8. As regards accounting for the change in the accounting treatment of these types of leaves, the Committee notes the definition of the term 'Prior period items' and paragraphs 15 and 19 from Accounting Standard (AS) 5, 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies', notified under the Rules.

D. Opinion

9. On the basis of the above, the Committee is of the following opinion on the issues raised by the querist in above:

    (i) No, the treatment of leave liability as 'short-term employee benefit' by the company is not correct. Such treatment is not in line with the requirements of AS 15 (revised 2005). Refer to paragraphs 17 and 20 above.

    (ii) The change in the accounting treatment of leave liability, in the extant case, from 'short-term employee benefits' to 'other long-term employee benefits' should be treated as 'prior period item'. Accordingly, the nature and amount thereof should be included and disclosed in the profit and loss account for the period in which such error is revealed.