Actuarial Valuation Services for Accounting of Defined Benefit Plans

Why Actuarial Valuation Services are needed by Indian and Multinational Companies for Accounting of Defined Benefit Plans (i.e. Gratuity, Leave Encashment, Long Service Award Plan, etc.) in compliance of AS 15 (Revised 2005) & Ind AS 19?

I hope the below email may help you in understanding the requirement of Actuarial Valuation Services by Indian and Multinational Companies for Accounting of Employee Benefits such as Gratuity, Leave Encashment, Pension and Other Long-Term Employee Benefits in compliance of IndAS19 & AS 15 (Revised 2005).

Background

As per provisions of ***Section 129 of the Companies Act 2013****, Indian and Multinational Companies Operating India needs to prepare the Financial Statement such as Balance Sheet & Profit/Loss Accounts* ***at the*** *closure of each financial year in compliance of* ***Accounting Standards*** *as stipulated in* ***Section 133 of the Companies Act 2013****, so that they can* ***give a true and fair view of state of affairs of the company****.* Accounting and Disclosure requirements for Employee Benefits Plans is laid down in the following 2 Accounting Standards as issued by ***The Institute of Chartered Accountants of India (ICAI)***:-

1. Accounting Standard 15 (Revised 2005) – AS 15 (Revised 2005)

2. Indian Accounting Standard 19 – IndAS 19

The main objectives of the above Standards *are to* ***prescribe the guidelines*** *and* ***disclosures*** *for Accounting* ***for Defined Benefit Plans (i.e. Gratuity, Leave Encashment, Pension etc.).*** *In order to comply with above standards a company is required to recognize: –*

(a) a liability when an employee has provided service to company in exchange for defined benefits to be paid in the future; and

(b) an expense when the company consumes the economic benefit arising from service provided by an employee in exchange for defined benefits.

The Para 49, Para 50 and Para 51 of AS 15 (Revised 2005) prescribes requirements of Actuarial Valuation Method for Accounting of Defined Benefits and Steps for Computation of Defined Benefit Plans. These paras are produced herein below –

Para 49. – Post-employment Benefits: Defined Benefit Plans

Accounting for Employee Benefit Plans falls in the category of Defined Benefit is complex because actuarial assumptions are required to measure the obligation and the expense and there is a possibility of actuarial gains and losses. Moreover, the obligations are measured on a discounted basis because they may be settled many years after the employees render the related service. While the Standard requires that it is the responsibility of the reporting enterprise to measure the obligations under the defined benefit plans, it is recognized that for doing so the enterprise would normally use the services of a qualified actuary.

Para 50. – Recognition and Measurement

Defined benefit plans may be unfunded, or they may be wholly or partly funded by contributions by an enterprise, and sometimes its employees, into an entity, or fund, that is legally separate from the reporting enterprise and from which the employee benefits are paid. The payment of funded benefits when they fall due depends not only on the financial position and the investment performance of the fund but also on an enterprise's ability to make good any shortfall in the fund's assets. Therefore, the enterprise is, in substance, underwriting the actuarial and investment risks associated with the plan. Consequently, the expense recognised for a defined benefit plan is not necessarily the amount of the contribution due for the period.

Para 51. – Accounting by an enterprise for defined benefit plans involves the following steps:

(a) 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 (see paragraphs 68-72) 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 (see paragraphs 73-91);

(b) discounting that benefit using the Projected Unit Credit Method in order to determine the present value of the defined benefit obligation and the current service cost (see paragraphs 65-67);

(c) determining the fair value of any plan assets (see paragraphs 100102);

(d) determining the total amount of actuarial gains and losses (see paragraphs 92-93);

(e) where a plan has been introduced or changed, determining the resulting past service cost (see paragraphs 94-99); and

(f) where a plan has been curtailed or settled, determining the resulting gain or loss (see paragraphs 110-116).

Where an enterprise has more than one defined benefit plan, the enterprise applies these procedures for each material plan separately.

Defined Benefit Plans for which Actuarial Valuation Certification/Reports are Needed by Indian and Multinational Companies

Actuarial Valuation Reports for the following Defined Benefit Plans is needed by the Indian and Multination Companies for compliance of IndAS 19 & AS 15 (Revised 2005) :-

- *Gratuity Plan.*
- *Earned Leave Plan.*
- *Sick Leave Plan.*
- *Defined Benefit Pension Plans.*
- *Post -Retirement Medical Benefit Plans.*
- *Settlement Allowances on Retirement.*
- *Long Service Award Plans/Incentive Plans.*
- *Interest Rate Guarantee for Exempted Provident Funds.*
- *Any other long term employee benefit , where actuarial inputs are needed.*

Components of Fully Compliant Actuarial Valuation Certification/Reports

Actuarial reports fully compliant with requirement of IndAS 19 & AS 15 (Revised 2005) ***have following components:***

- ***Data*** *– Summary of employee data as received from Company as Actuarial Input*
- ***Assumptions –*** *Demographic and Financial Assumptions as received from Company as Actuarial Input.*
- ***Methodology –*** *PUC Method*
- ***Results –*** *Present Value of Obligation, Expense for the year, Experience Adjustment etc.*
- ***Disclosures –*** *As given Paragraph 120 of AS 15 (Revised 2005) and various Paragraphs of IndAS19* ***(For more details you may visit my Tax-guru Profile at*** **https://taxguru.in/author/tikaramchaudhary@gmail.com/)**

How to Identify the Compliance requirement for Indian and Multinational Companies ?

The following criterion is followed by the CA, CS & Auditors to know the applicability of Accounting Standards and disclosure requirement by the Companies: –

(i) SME Companies *– SME requires to give disclosures as per* ***Clause L of Para 120*** *of AS 15 (Revised 2005) – (For more details refer MCA notification dated 07.12.2006)*

(ii) Non SME Companies *– Non SME requires to give disclosures as per* ***Para 120*** *of AS 15 (Revised 2005)*

(iii) Listed Companies & their subsidiaries with Net-worth more 250 cr*. – In this case, companies and their subsidiaries has to give disclosure of in compliance of* ***IndAS 19.***

(iv) NBFC (Non-Banking Financial Company) with Net-worth more 250 cr. *– In this case,* **NBFC** *has to give disclosure of in compliance of IndAS 19 with comparative numbers of previous 2 years.*

Why Non-Compliance of AS 15 (Revised 2005) & IndAS19 needs to be observed by the CA, CS & Auditors of the Indian and Multinational Companies ?

MCA vide its notification dated ***13th November 2018*** *notified* ***National Financial Reporting Authority (NFRA) Rules 2018.*** *The main functions NFRA Authority* **are:-**

1. Monitoring and enforcing the compliance with ***accounting standards*** *and auditing standards,* *2. Overseeing the quality of Audit service and suggesting measures for improvement,*

3. Power to investigate,

4. Disciplinary proceedings, Manner of enforcement of orders passed in disciplinary proceedings, Punishment in case of non-compliance etc.

In view of above provisions, it becomes mandatory for **Finance Professionals (i.e. CA, CS, CMA, Finance Professionals & Directors) involved in finalization of Financial Statements to** check the proper compliance and provisions of these Accounting Standards.

In case of any clarification or requirement for compliance of above services, you may contact me at 9211637063 or email me your queries at tikaramchaudhary@gmail.com