[Actuarial Valuation for Accounting of Gratuity Benefits – Ind AS19 & AS-15]

Why of Actuarial Valuation is required for Accounting of Gratuity Benefits in compliance of IndAS19 & AS 15 (Revised 2005) by Indian Public, Private and Multinational Companies ?

Background

*Indian Public Sector, Private Sector and Multinational Companies needs to prepare the Financial Statement such as Balance Sheet & Profit/Loss Accounts **at the** closure of each financial year as per provisions of **Section 129 of the [Companies Act 2013].** As per provisions of **Section 133 of the Companies Act 2013,** Financial Statements should be prepared in compliance of **Accounting Standards** as stipulated by Ministry of Corporate Affairs so that they can **give a true and fair view of state of affairs of the company**.*

Why Actuarial Valuation for Accounting of Gratuity Benefit?

Gratuity Benefit as an Employee Benefit Falls in the category of **Defined Benefit** and further categorized as **Post Employment Benefit Obligation**. Accounting and Disclosure requirements for Defined Benefit Plan 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.

I produce here in below few para's of AS 15 (Revised 2005) & Guidance Note on the Revised Schedule III to the Companies Act, 2003 which may help CA/CS/Auditors to understand "Why Actuarial Valuation is required by the Public, Private and Multinational Indian Companies with more than 10 employees for compliance of AS 15 (Revised 2005) on Actuarial Valuation Basis instead of any other rational Method" for Compliance of the above Accounting Standard 15 (Revised 2005) – AS 15 (Revised 2005)" 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 recognized 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.

Para 7.3 of Guidance Note on the revised schedule vi to the companies act, 1956

For the purpose of **Revised Schedule VI**, **a company also needs to classify its employee benefit obligations as current and non-current categories**. While AS-15 Employee Benefits governs the measurement of various employee benefit obligations, their classification as current and noncurrent liabilities will be governed by the criteria laid down in the Revised Schedule VI. In accordance with these criteria, a liability is classified as “current” if a company does not have an unconditional right as on the Balance Sheet date to defer its settlement for twelve months after the reporting date. **Each company will need to apply these criteria to its specific facts and circumstances and decide an appropriate classification of its employee benefit obligations.** Given below is an illustrative example on application of these criteria in a simple situation:

(a) Liability toward bonus, etc., payable within one year from the Balance Sheet date is classified as “current”.

(b) In case of accumulated leave outstanding as on the reporting date, the employees have already earned the right to avail the leave and they are normally entitled to avail the leave at any time during the year. To the extent, the employee has unconditional right to avail the leave, the same needs to be classified as “current” even though the same is measured as ‘other long-term employee benefit’ as per AS-15. However, whether the right to defer the employee’s leave is available unconditionally with the company needs to be evaluated on a case to case basis – based on the terms of Employee Contract and Leave Policy, Employer’s right to postpone/deny the leave, restriction to avail leave in the next year for a maximum number of days, etc. In case of such complexities the amount of **Non-current and Current portions of leave obligation should normally be determined by a qualified Actuary**.

(c) Regarding funded post-employment benefit obligations, amount due for payment to the fund created for this purpose within twelve months is treated as “current” liability. Regarding the unfunded postemployment benefit obligations, a company will have settlement obligation at the Balance Sheet date or within twelve months for employees such as those who have already resigned or are expected to resign (which is factored for actuarial valuation) or are due for retirement within the next twelve months from the Balance Sheet date. Thus, the amount of obligation attributable to these employees is a “current” liability. The remaining amount attributable to other employees, who are likely to continue in the services for more than a year, is classified as “non-current” liability. **Normally the actuary** should **determine the amount of current & non-current liability** for unfunded post-employment benefit obligation based on the definition of Current and Non-current assets and liabilities in the Revised Schedule VI.

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

As per payment of Gratuity Act 1972 (amended), All Indian Private and Multinational Companies with more than 10 employees covered under the preview of this Act. CA, CS & Auditors should follow the following criteria to know the Accounting and Disclosure requirement for Provision of Gratuity Benefit Liabilities in the Financial Statements of 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 query or clarification on the above subject you may call me at 9211637063 or email your requirements at *tikaramchaudhary@gmail.com.*