Accounting of Compensatory Absences (Leave Encashment Obligations)

This note is based on my understanding whilst providing support services in the matter of financial reporting in compliance of AS 15 (Revised 2005), IndAS 19 & IAS 19 (Revised 2005) . The note reflects only my personal understanding and perception of the subject. **The readers should apply their own judgement in the matter.** This note is an attempt in the matter of accounting provisions to be made in financial reporting of enterprises for Compensatory Absences (Leave Encashment Obligations) in compliance of Accounting Standard AS -15 (Revised 2005) issued by Accounting Standard Board of the Institute of Chartered Accountant of India.

Most common types of Compensatory Absences (Leaves) are as under:-

- Annual Leave/Privileged Leave/Earned Leave
- Sick Leave,
- Casual Leave,
- Maternity/Paternity Leave,
- Any other Leaves.

Maternity/Paternity leave is generally a non-accumulating absence and is not carried forward. This leave commonly lapses if current period entitlement is not used in full and does not entitle an employee to a cash payment for unused entitlement on leaving the enterprise. An enterprise recognizes no liability or expense until the time of the absence because employee service does not increase the amount of benefits. Any other leaves are to be dealt with according to

(i) rules of the enterprise and

(ii) behavioral pattern of their consumption.

Rest of this note deals with the most common situations in the Indian context which covers the following types of absences (Leave):-

- Annual Leave/Privileged Leave/Earned Leave
- Sick Leave
- Casual Leave

1. Classification of Compensatory Absences (Leaves)

For the purpose of valuation Compensatory Absences (Leaves) are classified as:-

(a) Long Term Compensatory Absences.

Most common Compensatory Absences which fall in this category are:-

- Annual Leave/Privileged Leave/Earned Leave and
- Sick Leave.

These Compensatory Absences are clubbed under – “**Other Long-term Employee Benefits”** (Refer paragraph 127 of the Accounting Standard)

(b) Short Term Compensatory Absences.

Most common Compensatory Absence which falls in this category is **Casual Leave.**

2. Long Term Compensatory Absences (Leaves)

(i) Identification

Those Compensatory Absences expected time of settlement of which (Availing of Leave or Encashment of Leave) can be carried forward beyond twelve months after the end of the period in which the employees render the related service and are expected to be availed /used or encashed in future are classified as Long Term Compensatory Absences (Leaves). These Long Term Compensatory Absences (Leaves) fall in the category of "**Other Long term Employee benefits"** [**Refer paragraph 127 of AS15 (Revised)**]

(ii) Paragraph 67 of the Accounting Standard

Once it is decided that leave is long term, then the entire leave is to be measured as such. In this connection it is pertinent to note paragraph 67 of revised AS-15 which states that "An enterprise discounts the whole of post-employment benefit obligation, even if part of the obligation falls due within twelve months of the balance sheet date."

(iii) Methodology

Projected Unit Credit Method (PUC) is to be used to determine the present Value of the obligation.

(iv) Other Points:-

(a) **Availment of Leave on Cost to Company Salary**

Measurement of availment of leave should be based on **Cost to Company Salary (CTC).** Employer's contribution to Provident Fund should be a component of **CTC Salary**.

- **Encashment of Leave on Qualifying Salary**
  Qualifying Salary for Encashment of Leaves may be a different from Cost to Company Salary or Same Salary depending upon the rules of the enterprise.

(c) **Assumptions**

- Demographic Assumption for availment and encashment of leaves with due considerations to (a) **behavioral pattern** about consumptions of leave including past experience (b) **rules** of the enterprise (c) **nature of leave**
- Financial Assumptions particularly the **rate of salary escalation**, **rate of discount** etc.

(v) Recognition and Measurement

Paragraphs 129 and 130 of AS-15 (Revised 2005) have to be followed. The following Actuarial Inputs in this context are relevant.

- **Present Value of Obligation**
- **Current Service Cost**

- **Actuarial Gain/Losses**
- **Employer Expenses**
- **Interest Cost**
- **Expected Return on Plan Assets**
- **Experience Adjustments on Plan Liabilities-(Loss/Gain)**
- **Experience Adjustments on Plan Assets-(Loss/Gain)**
- **Current & Non-Current Liability**

1. Short Term Compensatory Absences

Those Compensatory Absences which **accrue** to employees and are **expected to be availed or encashed within twelve months after the end of the period in which the employees render the related service** are short-term compensatory absences.

These Compensatory Absences require measurement on an **actual basis** and not on **actuarial basis.** Measurement should take into account the following points:-

(i) Leave at credit needs to availed/encashed within twelve months

(ii) Cost to Company (CTC) and

(iii) Probability that a portion of leave may lapse without giving rise to any Liability.

For interim valuations short-term benefits should be treated as benefits payable within twelve months from the end of the financial year and not from present valuation date.

Also, Check to leave encashment rules.

Casual Leave (CL) is normally classified as Short-term Compensatory Absence.

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