Presentation

Employee Benefits AS-15

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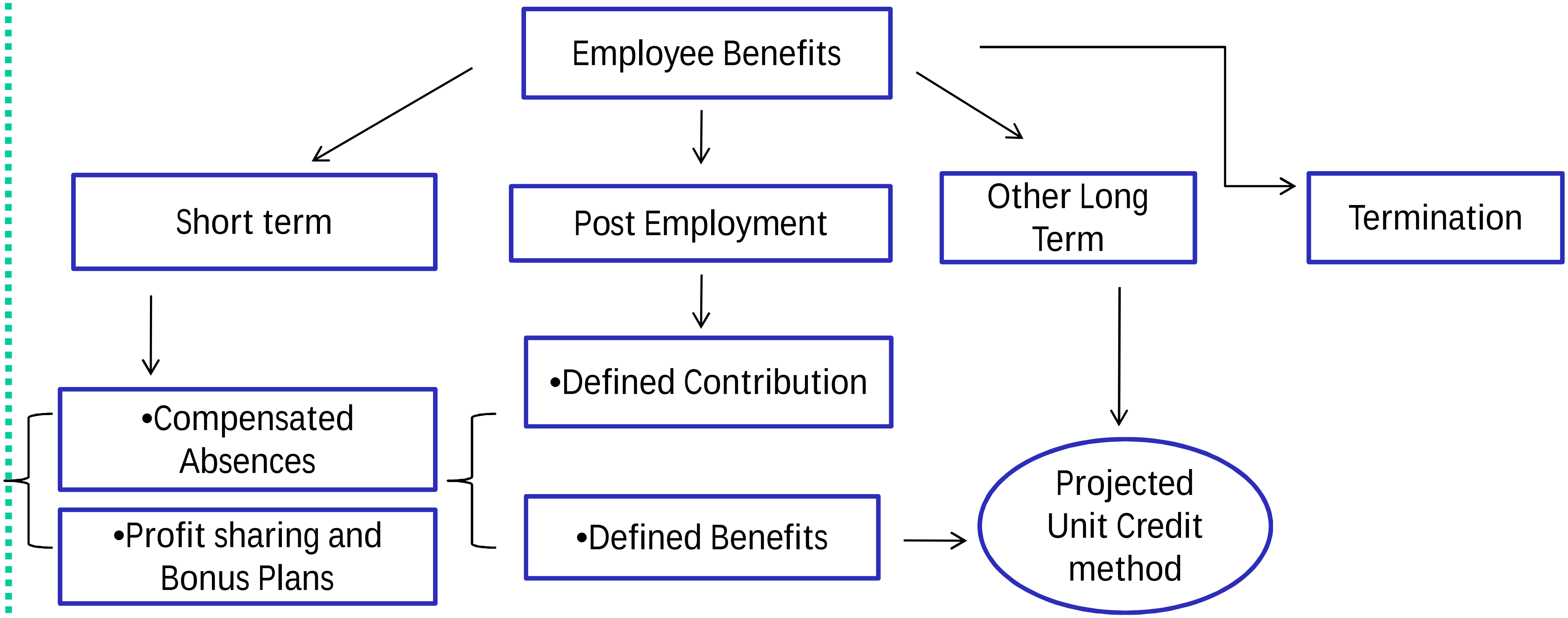
Employee Benefits under AS-15



Applicability of AS-15

AS-15 is applicable in its entirety to the following

Enterprises

- Whose Equity or Debt securities are listed or are in the process of being listed
- Carrying on Insurance biz.
- Whose turnover > than 50 cr
- Whose borrowings > than 10 cr
  - Banks (incl co-operative banks)
  - Financial Institutions
  - Holding & subsidiary of any one of the above

For Small and Medium Enterprises (SMCs) following paras are not mandatory:

Paras that pertain to the Recognition and Measurement of

- Non-vesting short term accumulating compensated absences
- Defined Benefit Plans
- Other long term benefits
- Discounting of amounts that fall due beyond 12 months of B/S date

*Prior to Central Government notification, SMEs were categorised on the basis of number of employees - greater than 50 and less than 50

Short Term Employee Benefits

Definition:

Employee benefits which fall due wholly within 12 months after the end of the period in which the employee renders the related service

Recognition

- As a liability (accrued expense) after deducting any amount already paid
- As an expense

Short term Benefits

•Compensated Absences

•Profit sharing and Bonus Plans

Disclosures

No specific disclosures, unless required by other accounting standards

Short Term Employee Benefits:
Compensated Absences

Accumulating Compensated Absences e.g. privilege leave which can be accumulated for 1 year only	when services rendered increase their entitlement to future compensated absences
Non-accumulating compensated absences e.g. maternity and paternity leave	when absences occur

Expected cost of accumulating compensated absences - additional amount that the enterprise expects to pay as a result of the unused entitlement that has accumulated at the balance sheet date.

Short term Benefits: Profit Sharing and Bonus Plans

Expected cost of profit-sharing and bonus payments should be recognised when

- the enterprise has a present obligation to make such payments as a result of past events and
- a reliable estimate of the obligation can be made, say of attrition rate

context: MD's commission u/s 309 of the Companies Act, 1956

- An Example

A profit-sharing plan requires an enterprise to pay a specified proportion of its net profit for the year to employees who serve throughout the year. If no employees leave during the year, the total profit-sharing payments for the year will be 3% of net profit. The enterprise estimates that staff turnover will reduce the payments to 2.5% of net profit.

The enterprise recognises a liability and an expense of 2.5% of net profit.

Post Employment Benefits

Post Employment Benefits include:

•Retirement Benefits e.g. Gratuity and Pension

•Other Benefits e.g. Post employment life insurance and medical care

They are classified as

Defined Contribution Plans	Defined Benefit Plans
1. Obligation is limited to the amount contributed to the fund 2. Risk (Actuarial and Investment) fall on the employee	1. Obligation is to provide agreed benefits to the employees 2. Risk (Actuarial and Investment) falls on the enterprise
E.g. Superannuation, Provident Fund	E.g. Pension, Gratuity, Leave Encashment

Defined Contribution Plan: Recognition and disclosure

Contribution should be recognised

- as a liability (accrued expense), after deducting any contribution already paid
- as an expense

➢Contributions not falling due wholly within 12 months should be discounted (SMCs may not discount)

➢Disclosure: Amount recognised as an expense should be disclosed

Defined Benefit Plans

Defined Benefit Liability is equal to:

Defined Benefit Obligation (DBO) at the balance sheet date → Actuary

Less: Any Past Service cost (PSC) not yet recognised → Actuary

Less: Fair value of Plan Assets

*Calculation of the DBO is the first step in Actuarial Valuation

What is DBO?

- DBO is the Present Value of the obligation of the company towards its employees for their services rendered over a period of time

Actuarial Assumptions for DBO Calculation

Financial Assumptions	Demographic Assumptions
discount rate	mortality
salary increases	turnover
expected return on assets	disability

- Discount rate should be determined by reference to market yields on government bonds

- Salary increases should consider inflation, promotion, seniority and market-based salary review

- Attrition rate is based on Industry Standards/Company Experience. Rates may vary by employee vintage

Costs leading to an increase/decrease in DBO

- Current Service cost
- Interest Cost
- Past Service cost
- Actuarial gain/losses

Current Service cost & Interest Cost

Current Service cost:

It is the increase in the DBO resulting from employee service in the current period

Current Service cost	Dr	19.17
To DBO		

Interest cost:

It is the increase during the period in the DBO which arises because the benefits are one period closer to settlement

Interest Cost	Dr	23.91
To DBO		

So, The Current Service cost and the Interest cost increase the Company obligation as well as the expense for the current year.

Past Service Cost (PSC)

Past service cost is the change in the DBO for employee service in prior periods as a result of changes in benefits

PSC

vested

Unvested

Recognise PSC immediately

Recognise PSC as an expense on a straight line basis over the average period until the benefits get vested.

Past service cost (P&L) Dr. 12.15

To DBO

In this case, the Past Service cost that arose was fully vested. So it was recognised immediately in P&L and it also contributed to an increase in DBO.

Past Service Cost- An Example

Benefits offered	2% of Final Salary
Vesting Period	5 years

On March 31st 2010 the enterprise improves the pension to 2.5% of final salary for each year of service starting from March 31st 2005
At the date of the improvement, the present value of the additional benefits are as follows:

Employees with more than 5 years' service at March 31st 2010	Rs. 150
Employees with less than 5 years' service at March 31st 2010	Rs. 120

(average period until vesting: three years)

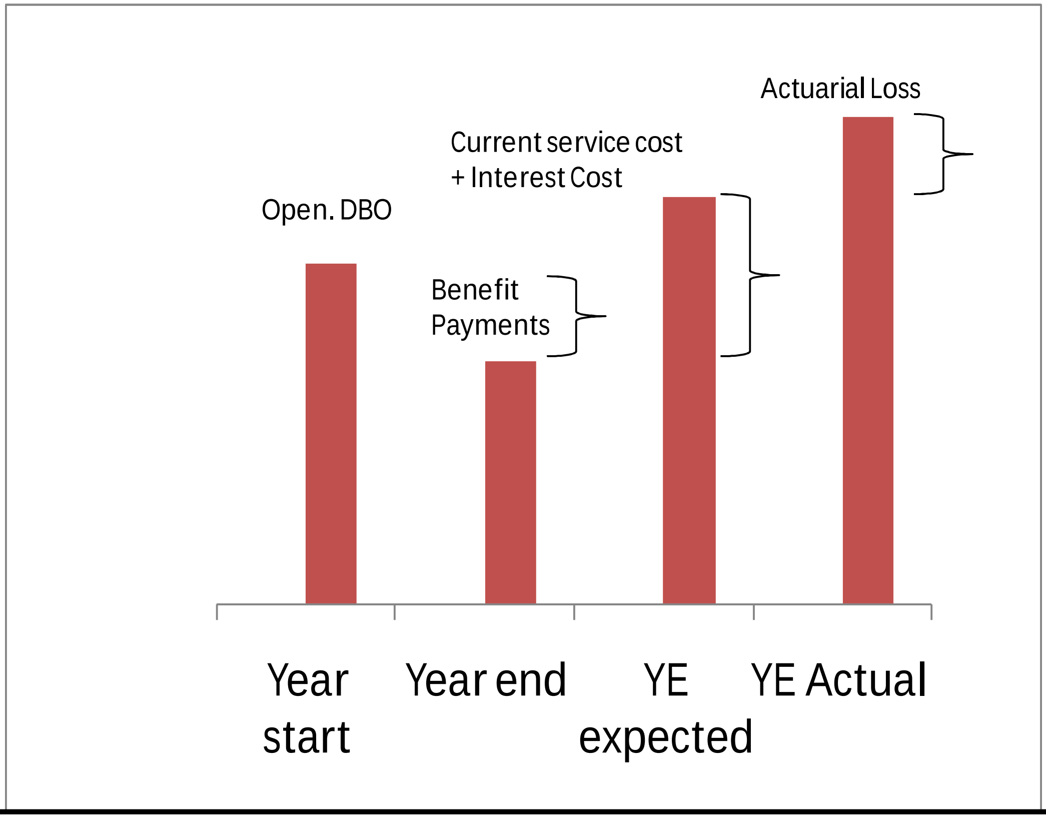
The enterprise recognises Rs. 150 immediately because those benefits are already vested. The enterprise recognises Rs. 120 on a straight-line basis over three years from March 31st 2010.

Reasons for Actuarial Gains/Losses: Liability

- Difference between actual experience and assumptions
- Change in assumptions e.g. Effect of changes in discount rate, withdrawal rate, salary escalation and mortality

Actuarial gain/loss from DBO		
DBO	Dr.	3.17
To Actuarial gain		

Actuarial Loss/Gain: Liability



Actuarial Loss/(Gain)=Closing DBO+ Benefit Payments-(Open. DBO+ Interest Cost + Current Service cost)

Curtailments/Settlements

- Curtailment refers to a reduction in the obligation of the enterprise e g. Enterprise might be required to reduce the number of employees covered by the plan.

- Settlement occurs when an enterprise enters into a transaction that eliminates all further obligations for part or all of the benefits provided under a defined benefit plan.

Sample DBO Reconciliation

Reconciliation of DBO	2010	2009
Present value of DBO at the BEGINNING	300.6	201.8
Addition on account of amalgamation		40.9
Current Service cost	19.17	16.59
Interest Cost	23.91	18.3
Actuarial (Gain)/ loss	-3.17	33.4
Past Service cost		
Vested	12.15	
Unrecognized (Unvested)		
Less: Curtailment		
Settlements		
Add: Contributions by plan participants		
Less: Benefit Payments	18.47	10.34
Present value of DBO at the YEAREND	334.2	300.6

Expenses Recognised in P&L for the y.e	2010	2009
Current Service cost	19.17	16.59
Interest Cost	23.91	18.3
Expected Return on Plan Assets/Reimbursement r	16.23	18.16
Actuarial (Gain)/ loss	-7.69	33.4
Past Service cost		
Vested	12.15	
Unrecognized (to the extent Written off)		
Effect of any curtailment		
Effect of any settlement (Loss/(Gain))		
Total Expense taken in P&L	31.31	50.13

Fair Value of Assets

Reconciliation of Fair value of the Assets	2010	2009
Fair Value of Plan Assets at the BEGINNING	206.14	163.58
Addition on account of amalgamation		29.16
Expected Return on Plan Assets	16.23	18.16
Actuarial Gain/ (loss)	4.52	
Settlement		
Contributions By Employer	57.68	5.58
Contributions by plan participants		
Less: Benefit Payments	18.47	10.34
Fair Value of Plan Assets at the YEAREND	266.1	206.14

- Fair value of Plan Assets - Market Price or discounting cash flows
- Expected Return on Plan Assets- based on market expectations at the beginning of the period
- Contributions increase plan Assets, Benefits reduce them

*Would you like full funding, part funding or over-funding?

Reasons for Actuarial Gain/Loss: Assets

- Difference between actual experience and assumptions

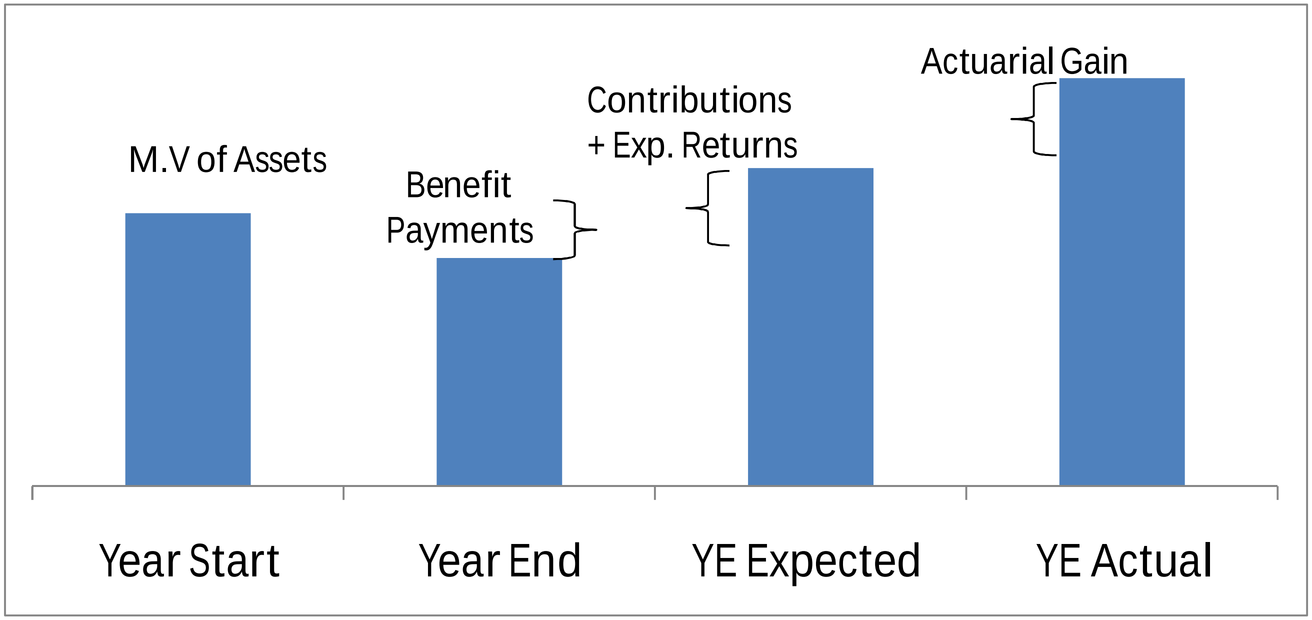
Actuarial Gain/Loss from Plan Assets			
Plan Assets	Dr.	20.75	
To Actuarial Gain			4.52
To Expected Return			16.23

The total Actuarial gain (from Liability and asset) of 7.69 is reflected in P&L that reduces the total expense. Of course the expected return on assets gets added to the Actuarial gain so that the actual return on assets is reflected.

The DBO is reduced as a result of the actuarial gains due to ,say, the attrition rates were higher than expected.

In effect , the actuarial gain on DBO and the actual return on Plan Assets are reflected in the P&L

Actuarial Gain / Loss: Assets



Actuarial Gain on Assets= Actual market value of assets-Expected value

Disclosures for Defined Benefit Pension Plans

Companies in Category A

1. Enterprise's accounting policy for actuarial gains/ losses
2. General description of the type of plan
3. Reconciliation of open. And closing Balance of Present value of Defined Benefit obligation(DBO) and of fair value of plan assets
4. Expense recognized in P&L with break-down
5. Percent of each major category that contributes to total plan assets
6. Amounts included in the fair value of plan assets for enterprises own financial instruments and other assets used by the enterprise
7. A narrative description of the basis used to determine the overall expected rate of return on assets
8. Actual return on plan assets

9.Principal Actuarial Assumptions like Interest rate, Expected Rate of return, etc

10.Employer's best estimate of contributions to be paid during the following year

… and more

For companies in Category B (SMCs)

Disclosure of principal actuarial assumptions like:

Discount Rate, Expected Rate of Return on any Plan Assets/, Medical cost trend rates etc any (other material actuarial assumptions used)

A Control Check

Reconciliation of Change in DBO with P&L	Funded Plan	
	Gratuity	
	2010	2009
Present value of DBO at the END of the year	334	301
Present value of DBO at the BEGINNING of the	301	202
Add: Benefit Payments	18.5	10.3
Less: Contribution by Plan Participants	0	0
Add:Settlements	0	0
Add: Curtailment	0	0
Add:Unrecognised (Unvested)	0	0
Less: Addition on account of Amalgamation	0	40.9
Add: Unrecognized (to the extent Written off)	0	0
Add: Effect of any curtailment (Loss/(Gain))	0	0
Add: Effect of any settlement (Loss/(Gain))	0	0
Less: Actual Return on Plan Assets	20.8	18.2
	31.3	50.1
	Fine!	Fine!

Other Long Term Benefits- Recog./Measurement/Disclosure

Other long-term employee benefits include

- long-term compensated absences such as long-service or sabbatical leave , jubilee or other long-service benefits, long-term disability benefits etc

Liability is measured as

The PV of DBO

Less: the fair value at the balance sheet date of plan assets

- Recognition----similar to Defined Benefit Plans (except PSC which is to be written off immediately)
- SMCs may not apply the recognition and measurement principles. However the accrued liability has to be arrived at by Projected Unit Credit method

Disclosure

No specific disclosures except when amount is material enough

Termination Benefits

An enterprise should recognise termination benefits as a liability and an expense when:

- the enterprise has a present obligation as a result of a past event
- it is probable that an outflow will be required to settle the obligation and
- a reliable estimate can be made of the obligation.

Termination benefits are employee benefits payable as a result of

Employer's decision to terminate an employee's employment

Employee's decision to accept voluntary redundancy in exchange for those benefits

Measurement

Benefits that fall due 12 months after B/S date should be discounted (SMCs may not discount)

Disclosure:

- When benefit is material enough
- When there is uncertainty about the number of employees who will opt for termination benefits, this contingent liability should be disclosed
- Where required by AS 18, disclose information about key management personnel.

ALM for DB Schemes

Actual return on plan assets and Liability calculation BOTH impact employer expense

In principle, employers will seek to match emerging liabilities with asset performance

Liabilities are inherently REAL in nature. Example, salary escalation depends on inflation as well as economic growth

Assets should hence be REAL in nature and match DURATION of liabilities

Broad level ALM is essential to manage the DB obligation

Thanks