



## FEATURES



## APPROPRIATE TO REQUIREMENTS

Want to consciously weigh proportionality in employee benefits actuarial practice?  
Mayur Ankolekar and Nandan Nadkarni scale the dimensions.

### About the Authors



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As the curtains of the financial year get drawn, employee benefits actuaries face numerous reporting milestones. A question often vexes, "Is the approach and effort within the multiple guidance of accounting standards, guidance notes and actuarial practice standards in surplus to requirements?"

This question surfaces from the twin concepts of a) proportionality, and b) materiality. In professional guidance and accounting standards relating to employee benefits valuation, although proportionality and materiality are explicitly stated, they are sometimes also implied.

Materiality usually falls within an auditor's domain; the auditor considers a position with regard to the entity's overall financial statements. Proportionality on the other hand is inseparable from actuarial work.

The Merriam-Webster's online dictionary defines:

**Proportional**

*adj: having a size, number, or amount that is directly related to or appropriate for something*

The Webster's 1913 dictionary interprets:

- 1 Clause 116 of Indian GAAP Accounting Standard (AS) 15 "Employee Benefits" (Revised 2005)
- 2 Clause 4 and 132 of Indian GAAP AS 15 "Employee Benefits" (Revised 2005) and clause 158 of International Accounting Standard (IAS) 19

*Pro'por'tion*

*v: To form with symmetry or suitableness as the parts of the body.*

*Pro'por'tion'al'i'ty*

*n: The state of being in proportion*

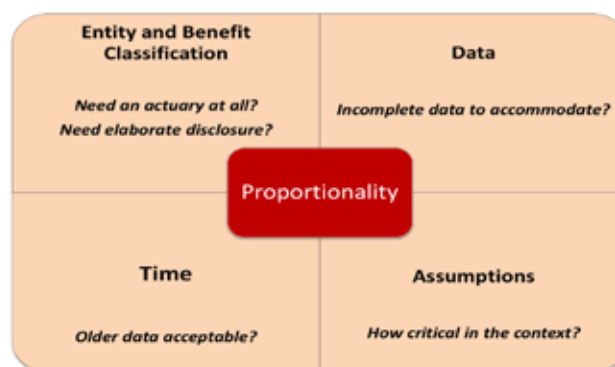
The contours of proportionality are drawn from various sources of guidance viz. accounting standards, guidance notes and actuarial practice standards. Overarching emphasis is on substance over form.

To inquire upon the theme of proportionality, we set the ball rolling on the features of these multiple sources of professional guidance. Proportionality is the spotlight, employee benefits practice the backdrop, and at the core are actuarial practice standards, actuarial guidance notes and accounting standards.

We discuss facets of proportionality (see Fig. 1) across four dimensions: a) Entity and Benefit Classification, b) Data, c) Time, and d) Assumption Setting.

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Fig. 1



### Entity and Benefit Classification

Indian GAAP recognises the need to disclose less financial information on employee benefits for Small and Medium Enterprises (SME). Non-SMEs on the other hand need full financial disclosure.

An SME employing less than 50 may account for the accrued liability under the defined benefit plans using some other rational method, e.g., assuming that benefits are payable to all employees at the end of the accounting year.<sup>1</sup> That is, an SME with less than 50 employees may not need actuarial services.

Similarly post-employment defined benefit obligations need full disclosure, while Other Long term employee benefits may not, unless deemed material under other accounting standards<sup>2</sup>.



Post-employment defined benefit obligations need full disclosure, while Other Long term employee benefits may not, unless deemed material under other accounting standards<sup>1</sup>.

Other long term benefits are relatively short-term and less weighty in nature. They include long-term paid absences, jubilee or other long-service benefits, long term disability benefits, profit sharing, bonuses and deferred remuneration.<sup>3</sup>

missing entries.<sup>8</sup>

Data might be supplemented using additional sources of data, proxies or sampling methods. These sources need to be checked for relevance.<sup>9</sup> In some circumstances adjustments might be made to the assumptions used in models or calculations, or to their results, instead of or in addition to adjusting incomplete or inaccurate data. Any such adjustments will need to be documented and their effects identified.<sup>10</sup>

#### Assumptions

The relative importance of assumptions differs with the benefit type.

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Example, where lump sum benefits are paid at retirement, e.g. gratuity under the Indian Payment of Gratuity Act, 1972, the choice of mortality assumption may have little relevance to the liability<sup>11</sup>.

The salary escalation and withdrawal rate assumed would be critical though and needs rigorous examination.

In pension plans with life annuity benefits, the mortality assumption is significant to results. Adjustments will be needed to be made to published mortality table rates. These need to be justified<sup>12</sup>.

In cash long-term incentive plans, the estimation of benefit payout and business performance parameters is critical. The mortality rate is relatively insignificant to the purpose.

Also, it is acceptable to adopt or adapt assumptions selected for other purposes (such as to determine funding of the employee benefit plan) or demographic assumptions used at a prior measurement date when those assumptions are reasonable at the current measurement date.<sup>13</sup>

#### Time

The time between the Balance Sheet date and audited financial results has crashed. Expectations on time to present audited

results have only seen one direction: up and higher.

Clients hence insist on measuring employee benefit obligations in anticipation of the Balance Sheet date. The exercise starts in advance of the measurement date. This aids in finalising the accounts earlier, provided the actuary has no reason to believe that there have been material changes in the data till the measurement date. How far back in time is the data acceptable? Are there risks of outdated data?

In lieu of collecting new employee census data at the measurement date, an actuary may appropriately adjust results using data collected at a different date when doing so will not materially affect the results.<sup>14</sup> When valuation data are not available annually, the actuary may make suitable approximations provided the client is fully informed and the client is satisfied that the effect of these approximations is not material.<sup>15</sup>

While such an approach eminently suits a periodic benefit like post-employment pension, tugging back too long (say, three months) for business parameter driven incentive plans is inappropriate. The dynamic nature of business changes would substantially render even recent data outdated e.g., while measuring liability for incentive plans.

The question of 'time latitude' is highly relevant for 'other long-term employee benefits' as compared with 'defined benefit post-employment pensions.'

#### Afterword

Proportionality in employee benefits draws from multidimensional sources: actuarial practice standards, guidance notes and accounting standards. Being aware of the various aspects of proportionality continues to be relevant today.

#### References

- International Accounting Standard 19; IASB 2012
- Proposed final International Standard Actuarial Practice 3; International Actuarial Association 2014
- Indian Accounting Standard 15 (Revised); ICAI 2005
- Actuarial Practice Standards 13, 20 & Guidance Note 11; IAI 2012
- Technical Actuarial Standard D: Data; Board for Actuarial Standards (UK) 2009



3 Clause 153 of IAS 19

4 Clause D.4 of APS 20 of the IAI

5 Clause D.4 of APS 20 of the IAI

6 Clause C.5.11 of TAS-D

7 Clause C.5.12 of TAS-D

8 Clause C.5.13 of TAS-D

9 Clause C.5.14 of TAS-D

10 Clause C.5.15 of TAS-D

11 Clause 7.2 of GN 11 of the IAI; Clause 2.3 (a) of ISAP 3 of the IAA

12 Clause 7.9 of GN 11 of the IAI

13 Clause 2.3 c of ISAP 3 of the IAA

14 Clause 2.3 b of ISAP 3 of the IAA

15 Clause 3.3 of APS 13 of the IAI

