AS15: Employee Benefits

A) New disclosure requirements under Schedule VI

B) Journey through Plan Assets

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Current Issues in Retirement Benefits
April 28, 2012 - Mumbai

Schedule VI and Accounting Standards

Overriding Nature of Accounting Standards	**Clause 1 of Schedule VI: … Accounting Standards require any change in treatment or disclosure … the same shall be made and requirements of Schedule VI shall stand modified accordingly.**
Banking, Insurance, Asset Management and Electricity Companies	**Schedule VI format applies to all companies registered under the Companies Act, 1956 except banks, insurers, asset management companies and electricity companies: these report under respective regulatory formats.**
Broad Layout under Schedule VI	**Parts I and II depict the broad layout for Balance Sheet and P&L respectively.**

Schedule VI and Accounting Standards

Schedule VI complements Accounting Standards on disclosures	**Clause 2 of Schedule VI: Disclosure requirements of Parts I and II to Schedule VI are in addition to, and not a substitution of Accounting Standards**
Accounting Standards inform the disclosure guidance	**Accounting Standards address the detail, particularly how the Notes to the Accounts should be constructed**

Disclosure of Funded Defined Benefit Plans

Accounting Standards guide detailed disclosure	Paragraph 120 informs the structure and disclosure for statutory accounts.
Liability/ Asset on a Net Basis	Funding is an 'Application of the liability', so should reduce liability to a net basis[1].
Trust covenants and guiding legislation viz. recognition by Commissioner of Income-tax, are instructive to disclose Liability/ Asset on Net Basis	**Schedule IV to Income-Tax Act, 1961 and Income-tax Rules** **Rule 3:** Fund is established as an irrevocable trust **Rule 91:** Fund's money shall not be receivable by employer under any circumstances, nor shall employer have a lien on the funds **Rule 94:** Trust to be wound up only if trade or undertaking of the employer is wound up or discontinued.

[1] ICAI ASB Guidance (May 2007); .. Response to Q11: **The asset and liabilities of the trust individually would not appear in the separate financial statements of the Enterprise**

Short-term provisions/ Current liabilities: Guidance

As per MCA Notification SO 447(E) dated 28 Feb 2011, general instructions to prepare Balance Sheet state:

A liability is classified as current when it satisfies any of the following criteria:

1. It is expected to be settled in the Company's normal operating cycle; or
2. It is held primarily for the purpose of being traded; or
3. It is due to be settled within twelve months after the reporting date; or
4. the Company ***does not have an unconditional right to defer its settlement for at least 12 months after the reporting date***.

All other liabilities shall be classified as non-current

Short-term Provisions: guidance .. Contd.

Employee benefits would need to be evaluated for such classification even if they are measured as long-term employee benefits under AS15 if,

1. It is due to be settled within 12 months of the reporting date; or
2. The Company does not have an unconditional right to defer settlement for 12 months from the Balance Sheet date

We evaluate these conditions for funded and unfunded DB plans

Value of Short-term Provisions: Unfunded Plans

1. It is due to be settled within 12 months of the reporting date; or

2. The Company does not have an unconditional right to defer settlement for 12 months from the Balance Sheet date

Consistency in Valuation Principles

- DBO is the Expected Present Value (EPV) using Projected Unit Credit (PUC) Method

- Short term Provisions/ DBO should also be the EPV of 1 year payout using PUC Method i.e. consistent with the remit (box above)

- The short-term provisions would be a part of the total DBO; so it is appropriate to be consistent in both approaches viz. quantifying short-term provisions and long-term provisions.

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Example on Valuation Consistency for Short-term Provision

Leave benefits

DBO or full provision is given by EPV (Age ‘x’). Terms: No cashing, employee aged ‘x’, retirement age R, with decrement of death ‘d’ and withdrawal ‘w%’ p.a.

$$EPV(Age'x') = \sum_{j=1}^{j=R} {}_j p_x^{w,d} . v^j$$

Short-term provision will have only one term with j=1

Value of Short-term Provisions: Funded Plans

1. It is due to be settled within 12 months of the reporting date; or
2. The Company does not have an unconditional right to defer settlement for 12 months from the Balance Sheet date

In funded plans, the obligation to pay expected payouts lies first with the Trust

(Reference: Income-tax Rules

Rule 3: Fund is established as an irrevocable trust;

Rule 91: Fund's money shall not be receivable by employer under any circumstances, nor shall employer have a lien on the funds)

Consistent with PUC Method Valuation Principles, the EPV of 1 year payout would be the short-term DBO;

First, of the trust

And

Only otherwise, if the trust is not funded at least for the EPV of 1 year payout, of the employer

Value of Short-term Provisions: Funded Plans

Conclusion

If the Trust has funds enough to meet EPV of the succeeding 1 year's DBO, then in the company books, the resulting net liability (i.e. DBO minus Trust Assets at Fair Value) would be 'Long-term Provision.'

That is, no short-term provision if the EPV of succeeding 1 year DBO can be paid from the trust.

Formulaically

Short term provisions for Employee Benefits for Schedule VI disclosure

A) Unfunded Plans

→ **EPV of 1 year DBO**

B) Funded Plans

→ **Max [EPV of 1 year DBO *less* Fair Value of Trust Assets, 0]**

Short-term Provision: where to disclose?

Reconciliation of Defined Benefit Obligation (DBO)

	2012
Present value of DBO at start of year	
Current service cost	
Interest cost	
Actuarial loss/(gain)	
Present value of DBO at end of the period	
Of which, Short term DBO at end of the period	**??**

Net Liability/ (Asset) recognised in the Balance Sheet

	2012
Present Value of DBO	
Fair Value of Plan Assets	
Net Liability/ (Asset)	
Less: Unrecognised Past service cost	
Liability/ (Asset) recognised in the Balance Sheet	
Of which, Short term Liability	**??**

Short-term Provision: where to disclose?

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	2012
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Liability/ (Asset) recognised in the Balance Sheet	
Of which, Short term Liability	**??**

Entity Classification for AS 15 (R)

Companies are classified under three levels:

Level I – companies which are not Small and Medium Enterprises

Level II & III – companies which are Small and Medium Enterprises

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The following accounting standards apply to all of Level I, II and III enterprises in their entirety: AS 1, 2, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 22 and 26

AS-15 (R): Proportionate Applicability

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 business
- Whose turnover > than Rs 50 cr
- Whose borrowings > than Rs 10 cr
  - Banks (incl. co-operative banks)
  - Financial Institutions
  - Holding or subsidiary of any one of the above

For **Small and Medium Enterprises (SMEs)** 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 categorized on the basis of number of employees - greater than 50 and less than 50

Applicability of Actuarial Valuation to Defined Benefit Plans

Classification of Companies Under AS 15 (R)

If Equity or Debt securities are listed or are in the process of being listed, or
In Insurance business, or
Turnover > than Rs 50 crores, or
Borrowings > than Rs 10 crores, or
Banks (incl. co-operative banks), or
Financial Institutions, or
Holding or subsidiary of any one of the above
Not a Small and Medium Sized Company (Non SMC)

Valuation by an Actuary with full disclosures of AS 15 (R)

If any of the criteria does not apply, then company will be a
Small and Medium Sized Company (SMC)

More than 50 employees

Valuation by an Actuary; limited disclosures

(AS 15 paras 50 to 123 i.e. detailed disclosures are not applicable to SMC)

Up to 50 employees

Company can provide on arithmetic/ discontinuance basis

Projected Unit Credit Method

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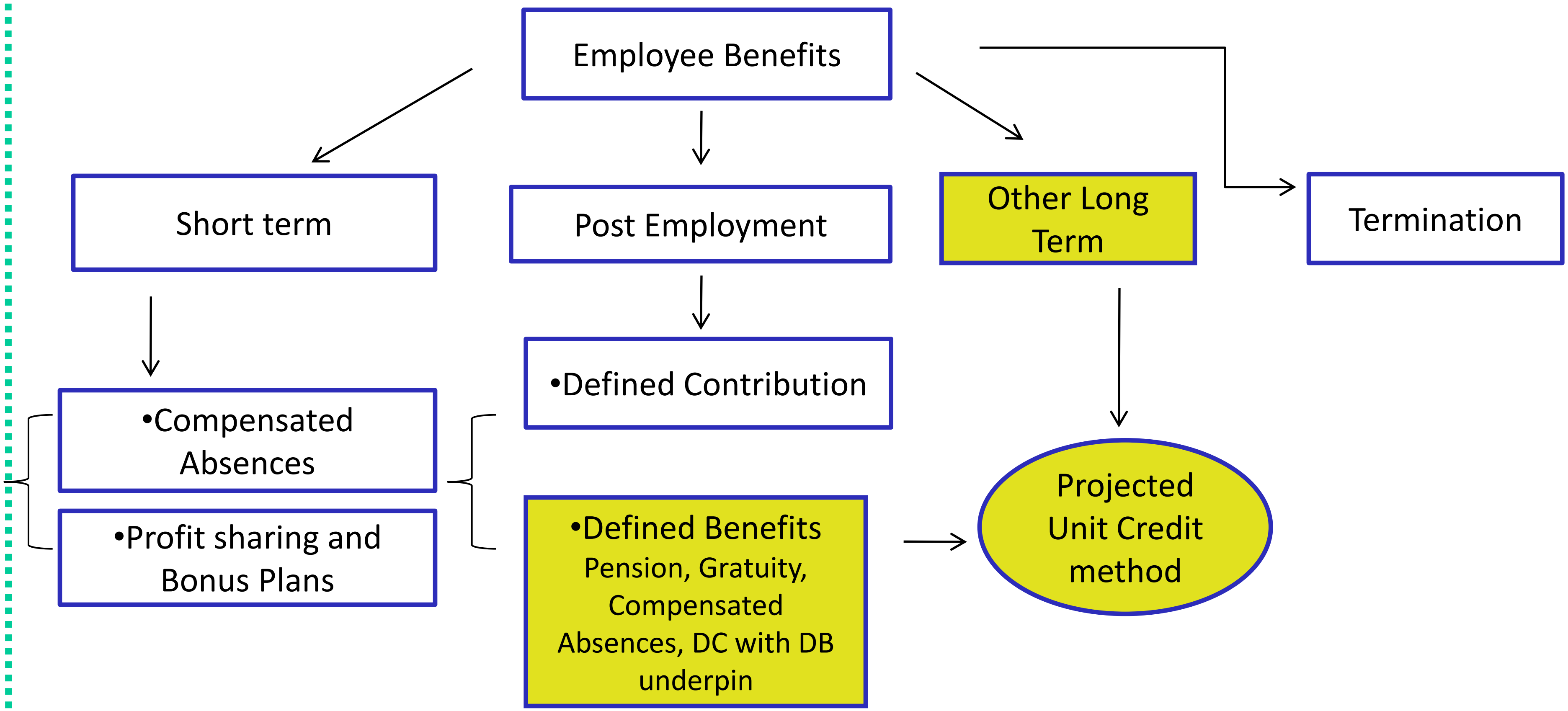
Employee Benefits under AS-15



AS 15: Employee Benefits

A Journey Through Plan Assets

Asset Side disclosures

Fair Value Accounting	*Unit-linked Plans:* no adjustments *Traditional Plans from Insurers:* no adjustments *Independent Investment by Trusts:* Actual assets to be measured at fair value on GRY, term and credit spread basis. Use approved credit spread models
Actuarial Gain/ (Loss) calculations	Compute Money Weighted Rate of Return (MWRR) or daily products from unit statement of assets and apply the 'expected rate of return'? Simple average of opening and closing assets would lead to an erroneous actuarial gain/ loss

Asset Side disclosures … Contd.

Asset Class disclosures (Substance v Form?)	Normally in specified classes viz. equity, debt, etc *Assets with insurers may also have a specific class – valuable information to reader/ investor*
Asset Verification	Basic attest function desired E.g. Verify unit statements, seek a list from employer Ensure value in actuarial certificate agrees with unit statements/ actual assets

Asset Side disclosures .. Contd.

Assets of DC funds with DB underpin	Fair value of assets would become relevant Net assets are relevant **Re-stating the interest rate floor liability at fair value (e.g. implicit guarantee on PF funds) does not portray the full picture (source: own assessment)**
Expected Rate of Return on Assets	Expected Return on Assets is based on market expectation at **start of year for the entire life of the related obligation** (Paragraph 108 of AS 15) It is hence important for the Actuary to **understand the expectations at Start of the Financial Year** **The term is related to the 'benefit obligation' not term of the asset portfolio**

5 year v 2 year disclosures

All disclosures are needed for 2 years as per Schedule VI ***(and not restricted to employee benefits only!)***	Example: Movement in Defined Benefit Obligation, Employer Expense, Movement in Assets, Asset Classification, Actuarial Assumptions
Exceptions to the 2 years' disclosure exist.	
Experience Adjustments **a) Funded Status**	The longer period disclosure aims to provide insights to the reader on 1) What contributes to the Actuarial Gains/ Losses i.e. Experience adjustments or Assumptions Change? 2) What is the medium-term funding policy of the Company as seen from the past?

Q. Should trends on experience adjustments feed into current assumptions?

Financial Statements are like Lamp Posts.

They can either be used for illumination or support.

Producers of financial statements defer to guidance; readers choose how to use.

Thank You

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