IND-AS 19
EMPLOYEE BENEFITS

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Learning Objectives for today

- Understand the scope of the standard
- Categorise the different types of employee benefits and apply the appropriate accounting treatment
- Determine whether a plan is defined contribution or defined benefit
- Understand an actuarial report and challenge assumptions
- Enhance understanding on various terms used in calculating defined benefit obligations
- Present information as per required disclosures

What we will cover today . . . .

- General introduction & Basic Concepts
- All types of Employee Benefits
- Compensated Absences
- Provident Fund
- Gratuity
- Actuarial Standards
- Disclosures & Accounting Policies
- Recent Amendments
- AS vs IND-AS vs IAS
- FRRB / Case Studies / Expert Opinions / Guidance Note ICAI

Why do we need a Standard for Employee Benefits

- Employee costs form a major part of expenses (IT/ ITES / Service Co.)
- Different and varied types of benefits are now available to the employee
- Compliance to Labour Laws require proper accounting
- Fair value principles are now envisaged
- More disclosures for certain types of employee benefits

Following not covered in the Standard:

- Employee share based payments (scope out)
- Accounting & reporting by Employee Benefit Plans (scope out)

History of Employee Benefits

- From Retirement Benefits to Employee Benefits
  - **01-04-1974: '**Statement on the Treatment of Retirement Gratuity in Accounts'
  - **01-04-1995:** AS 15 (issued 1995) - 'Accounting for Retirement Benefits in the Financial Statements of Employers'
  - **01-04-2006:** AS 15 (revised 2005) 'Employee Benefits'
  - **01-04-2016/ (MCA Roadmap):** Ind AS 19 'Employee Benefits'
- Scope of Standard increased
- One of the First Standards in ICAI which brought in the Fair Value measurement concepts
- In India : AS 15 to AS 15R to IND-AS 19
- Internationally – many amendments (April 1980 to February 2018)

What kinds of employees covered?

- The Standard does not define the term employee
  - Behavioral control – what to do / how to do
  - Financial control – business aspects of the worker – how he is paid etc.
- Applicable to all forms of employer-employee relationships : formal relationship not required (full-time, part- time, permanent, casual or temporary basis) E.g. Driver of Managing Director paid salary in cash by Company
- Contract for Service (no control; limited direction) vs Contract of Service (control exists - the person is obliged to obey orders in the work to be performed and as to its mode and manner of performance.)
- limited direction and control vs employer-employee relationship
- Generally ‘outsourcing contracts’ may not meet the definition of employer-employee relationship

Principal Employer may be Required to pay Gratuity to Contract Employees

- **Superintending Engineer, Mettur Thermal Power Station, Mettur vs. Appellate Authority, Joint Commissioner of Labour, Coimbatore & Anr, 2012 LLR 1160**
- The employee concerned worked at the Power Station between 1988 and 1999, as a contract employee. In 1999, the employee was directly hired by the Power Station and he continued to be so employed till 2003.
- Upon termination of his services, the employee claimed gratuity payments for a period of sixteen years, between 1988 and 2003.

Contract Employee….

- The Power Station claimed that its responsibility to pay gratuity would lie only in respect of the period during which the employee was employed directly by the Power Station (i.e., 1999 – 2003) and not for the period when he was a contract employee.
- The Madras High Court held that gratuity, being a termination payment required to be paid under a law, would constitute ‘wages’ under the CLRA and in accordance with section 21(4) of the CLRA, the Power Station (being the principal employer for the period between 1988 and 1999) would be responsible for the payment of gratuity to the contract employee.

Contract employee….Analysis & Conclusion..

- This decision reiterates that a contract employee, working for a principal employer at the time of termination of his services by a contractor, may have a strong claim for the payment of gratuity directly from the principal employer in the event of a contractor’s failure.
- Therefore, it is advisable for all principal employers engaging contract labour through man power agencies and other contractors, to not only focus on ensuring contractor compliance towards routine payment of wages and benefits, but also towards terminal payments (such as gratuity) when a contract employee is exited during the period of his or her engagement.

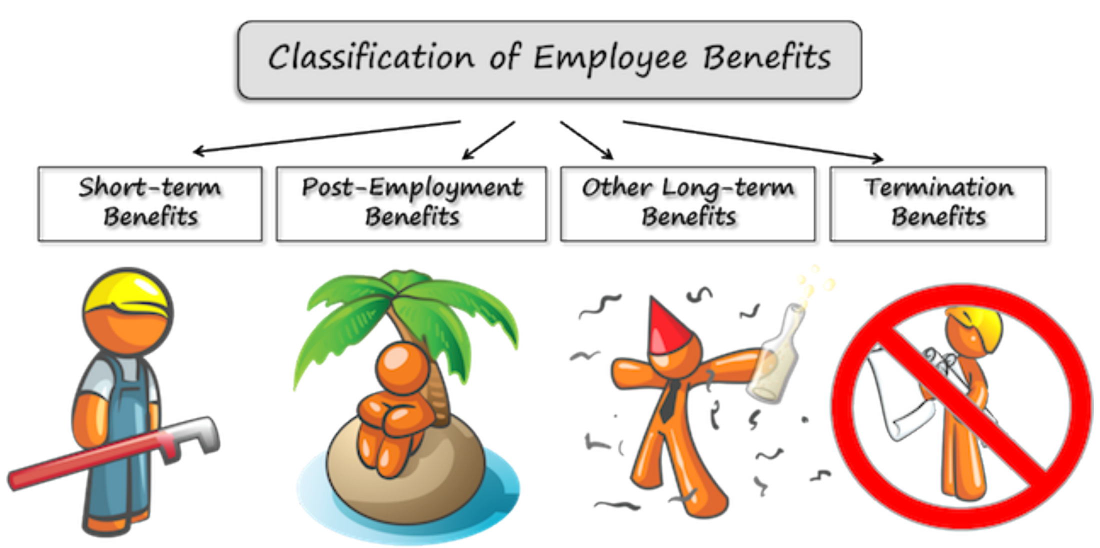
Fixed-term contract staff to get gratuity benefits like permanent employees

- In a first, workers hired under fixed-term contracts will be entitled to gratuity at any time of leaving the job.
- Till now, no one hired on a contract for a fixed period was entitled to any gratuity.
- Under recently notified rules, workers hired through a fixed-term contract will get all the statutory benefits that permanent workers in the same establishment are entitled to
- the Union government notified the Industrial Employment (Standing Orders) Central (Amendment) Rules - this category did not formally exist in the rules till now

What are the types of Employee Benefits?

- Short Term
- Post Employment Benefits
  - Defined Contribution Plan
  - Defined Benefit Plan
- Other Long term benefits
- Termination Benefits

- Can we have examples of each?



Examples of Employee Benefits

type	**category**
Salary & Wages	Short term
Social security contributions (ESI)	Short term
Profit sharing	Other Long term
Bonuses	Short term / Other Long term
VRS	Termination Benefit
Gratuity	Defined Benefit Plan
PF	Defined Contribution Plan

Short Term Employee Benefits

- Expected to be settled within 12 months after end of reporting period
- Recognise the undiscounted amount of short-term employee benefits expected to be paid in exchange for that service as cost
- Profit and bonus sharing plans – legal or constructive obligation; past events; reliable estimate; no realistic alternative other than to pay
- If employee has to remain for a specific period; then the probability of some employees leaving in intervening period can be factored

- Termination benefits also short term in most cases – but it is a separate carve-out

Constructive vs Legal Obligation

- A **constructive obligation** is an **obligation** to pay that arises out of conduct and intent rather than a contract. In Ind-AS, a **constructive obligation** may need to be shown on the BALANCE SHEET as a liability. A **constructive obligation** typically occurs from past conduct.
- Legal Obligation : A binding, formal arrangement or an agreement to a liability to pay a specified amount or to do a certain thing for a person or group of persons.

Examples of constructive obligation

- V R S announced to public & media
- Employer giving certain benefits over and above contract terms – if expectation has been set based on past similar actions….

- The historical pattern of granting such benefits, the expectation created and the impact on the relationship with employees in the event such benefit is withdrawn should be considered …

Other Long Term Employee Benefits

- Just 5 paragraphs : 153 to 158
- not expected to be settled wholly before twelve months after the end of the annual reporting period
- Examples?
  - Long term paid absences / sabbatical
  - Jubilee / long term benefits
  - Long term dis-ability benefits
  - Deferred remuneration
  - Profit sharing & bonuses

Other Long Term Employee Benefits

- measurement of other long-term employee benefits is not usually subject to the same degree of uncertainty or volatality as the measurement of post-employment benefits
- So, simplified method of accounting – no impact in OCI
- Measurement principles : Actuarial Valuation
- Service cost; net interest on net defined benefit liability; re-measurements : all go to P&L.
- Long term disability benefit:
  - if depends on length of service – it is to be recognised when service is rendered – with factors like probability, length of time payment need to be made etc.
  - If same for any employee regardless of service, then at time of incident

Termination Benefits

- How is this different from other types of Employee Benefits?
- Separate area since event that gives rise to obligation is the termination of employment rather than employee service
- Termination benefits result from either an entity’s decision to terminate the employment or an employee’s decision to accept an entity’s offer of benefits in exchange for termination of employment
- Mandatory retirement benefits are not termination benefits – they are post employment benefits
- Termination at request of employee – without any offer from employer – is also not Termination Benefit

Exchange for service vs exchange for termination

- Form does not matter
- Termination are typically lump sum payments
- Includes enhancement of post employment plans
- Salary till end of a period though employee renders no service
- Exchange for service if,
  - Benefit is conditional on future service
  - Benefit is in terms of an employee benefit plan

Termination benefits

- Some termination benefits are provided in accordance with the terms of an existing employee benefit plan. (e.g. specifically stated in Union Agreement)
- Some employee benefits are provided regardless of the reason for the employee’s departure (subject to vesting / minimum service requirements). These are post employment benefits and not termination benefits.
- Recognise termination benefits when entity can no longer withdraw the offer (employee accepts or restriction to withdraw due to contractual obligation or statute) / it is part of restructuring costs (IND-AS 37)

Not possible to withdraw offer…

- the entity can no longer withdraw the offer when the entity has communicated to the affected employees a plan of termination meeting all of the following criteria:
  - (a) Actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made.
  - (b) The plan identifies the number of employees whose employment is to be terminated, their job classifications or functions and their locations (but the plan need not identify each individual employee) and the expected completion date.
  - (c) The plan establishes the termination benefits that employees will receive in sufficient detail that employees can determine the type and amount of benefits they will receive when their employment is terminated.

Measurement of Termination Benefits

- If expected to be settled wholly before twelve months after the end of the annual reporting period - like short term employee benefits
- If not expected to be settled wholly before twelve months – like other long term employee benefits

- Because termination benefits are not provided in exchange for service, the attribution of the benefit to periods of service are not relevant

DISCLOSURES :
Short Term; Other Long Term Employee & Termination Benefits

- No specific disclosures required
- IND-AS 24 requires Related Party disclosures. To that extent…
- IND-AS 1 requires disclosure of employee benefits

Whether sitting fees paid to independent director and Non- executive director is required to be disclosed in the financial statements prepared as per Ind AS

- Non- executive directors meeting this criteria (see below) are covered under the definition of key management personnel. The sitting fees paid to directors will fall under the definition of "Short-term employee benefits" as per Ind AS 19 and is required to be disclosed in accordance with the paragraph 17 of Ind AS 24
- Para 7; IND-AS 19: An employee may provide services to an entity on a full-time, part- time, permanent, casual or temporary basis. For the purpose of this Standard, employees include directors and other management personnel.

Case Study : BEL's Scheme

- Contributory health scheme for retired employees. Primary objective is to provide medical facilities to employees who have superannuated or taken VRS. Applicable to members and their spouses. Company takes insurance cover for in-patient treatments. 60% of medicine costs; 75% of diagnostic tests for outpatient treatments and 100% costs for specified diseases are taken care of by Company.
- Is this long term / retirement benefits / termination benefit?
- If retirement benefit – contribution or benefit plan?

What BEL Accounting Policy says:

- Incremental liability under BEL Retired Employees Contributory Health Scheme (BERECHS) is determined annually on actuarial basis using Projected Unit Credit Method and provided for.

- Another Question . . . . .
- How is Leave Travel Allowance to be considered for IND-AS 19 compliance?

Leave Travel Concession (LTC)

- An employee usually becomes eligible for an LTC every, say 4 years.
- This means that this benefit is earned over 4 years and at any given date, an employee would be accruing their next LTC benefit.
- Therefore an actuarial valuation will be required for the current block of LTC benefit.
- It is important to note that the accrual of the next LTC benefit has not yet started and therefore no liability in respect of the next block needs to be recorded.
- Conclusion : Other long term benefit; actuarial valuation required

Restructuring

- **Memorandum of settlement entered into under Section 12(3) of Industrial Dispute Act, 1947**
- Consequent to the change in technology and the limitations imposed by the Pollution Control Board, Company A has concluded the planned closure of operations of its Assembly Plant R at Coimbatore effective June 2022. Towards this, the Company has successfully concluded an agreement dated February 2020, to cease employment in June 2022 with the employees' Union without any increase in wages till that date on condition that a certain number obtain VRS before 31 March 2020.
- Based on the agreement, a Voluntary Retirement Scheme (VRS) has been offered and part of the work force agreed to the same before 31.3.2020

Perspectives on the Restructuring ….

- The Settlement under Section 12(3) (“**Settlement**”) envisages payments to workmen who have opted for the Voluntary Retirement Scheme which has been effected as on 31.03.2020. The Settlement also creates an obligation on the part of the Company to make payments under the Scheme to employees who are presently continuing in service and will exit its services as on June 2022.
- The Settlement itself, being under Section 12(3) of the Industrial Disputes Act, 1947, has statutory force and the dues payable in accordance thereof are akin to statutory dues.

Perspectives on the Restructuring . . .

- In the light of the above, it is clear that in terms of Paras 165(b) and 166(a) and (b) of the Indian Accounting Standard – 19, the liability of the Company for the termination benefits is required to be recognised
- There is thus a "present obligation" on the Company by virtue of the Settlement under Section 12(3) and the aforesaid Accounting Standard
- In the context of the present situation, it is clear that there is a present legal obligation resting on the Company as a result of the Settlement. The Company will face the outflow of resources embodying economic resources to settle the obligation. Finally, the extent/value of the obligation is capable of being determined presently (Net Present Value – noncurrent liability). Therefore a provision is required to be recognised in the books of the Company

Compensated Absences

[Can be short term or other long term]

Compensated Absences

- Accumulating paid absences are those that are carried forward and can be used in future periods if the current period's entitlement is not used in full
  - Vesting : employees are entitled to a cash payment for unused entitlement on leaving the entity
  - Non-vesting : employees are not entitled to a cash payment for unused entitlement on leaving
- An obligation arises as employees render service that increases their entitlement to future paid absences.
- The obligation exists, and is recognised, even if the paid absences are non vesting, although the possibility that employees may leave before they use an accumulated nonvesting entitlement affects the measurement of that obligation
- Cost of vesting and non-vesting may be different

Non-accumulating leave

- Non-accumulating paid absences do not carry forward: they lapse if the current period's entitlement is not used in full and do not entitle employees to a cash payment for unused entitlement on leaving the entity. This is commonly the case for sick pay (to the extent that unused past entitlement does not increase future entitlement), maternity or paternity leave and paid absences for jury service or military service.
- An entity recognises no liability or expense until the time of the absence, because employee service does not increase the amount of the benefit
- Now, should we provide for unencashable carry forward leave which can only be utilised as a "comp-off"?

Expert opinion

- The querist has sought the opinion of the Expert Advisory Committee as to whether the company is required to create provision for accumulated half pay leaves which are not encashable. If so, how the provision is to be operated on each balance sheet date, since the half pay leaves are not to be encashed?
- from an accounting angle, the nature of unencashable leave is similar to that of the encashable leave insofar as the former provides a right to an employee to receive salaries and wages for the period for which he avails leave as during that period he does not render any services to the employer.

Expert opinion

- The Committee is of the view that accumulating half pay leave creates an obligation on the enterprise because any unused entitlement increases the employee's entitlement to avail leave in future periods. Thus, a provision should be recognised for all these benefits and recorded as part of the cost of service rendered during the period in which the service was rendered which resulted the entitlement.
- Hence, liability is to be created

Understanding Leave Valuations

- often different rules apply to different kinds of leave benefits, for example encashment during service may or not be allowed, encashment upon termination of employment may or may not be allowed for certain kind of leaves, different salaries may be used for valuing encashment and availing of leaves, etc.
- often companies are not very clear on how the liability is arrived at and the reasons for its movement year-on-year
- The leave policy first needs to be understood !!

Understanding Leave Valuations

- Understanding consumption pattern : The first step in carrying our actuarial valuation is projecting ***how an employee is likely to 'consume' the leaves*** that are lying to his / her credit on the date of valuation – based on what policy allows
- **Ascribe / determine assumptions for leave consumption :** LIFO basis; *Rate of Leave Availment during Employment:*
- *Valuation of the leave consumption*
  - *Is comp-off (leave utilised) and leave encashment at the same cost?*
  - *Refer Policy*

Availed during employment
How can leaves be consumed?
Encashed upon termination of employment
Encashed during employment

Sick Leave accumulating?

<u>If yes, liability needs to be recognised (Para 13 of AS15)</u>	If no, liability does not needs to be recognised

Determine Rate of Leave Availment (Key Assumption)

LIFO basis used. Determine assumption based on formula above. **Liability sensitive to this assumption**.	Projected availments valued on Gross / CTC salary.

Ensure reflecting in actuarial report

Assumptions i.e. **rate of future leave availment**, salary growth rate, discount rate and attrition rate	Data i.e. **number of leaves valued**, salary used for valuing availments etc.

Compensated absences – Actuarial Gains/Losses – Treatment – OCI ?

- OCI - Remeasurements of defined benefit plans (see Ind AS 19, *Employee Benefits)*
- Situation where Actuarial Valuation is needed for Compensated Absences – "Other Long Term" category
- Hence, this cannot be reflected in OCI but only in P&L

Importance Guidance

Employee benefits from informal practices

- An employer has a practice of making a lumpsum payment on the occasion of a festival or regularly grants advances against informal benefits to employees
- Should this be provided for?

What the Guidance says . . . .

- Careful judgement should be applied in assessing whether an obligation has arisen particularly in instances where an enterprise's practice is to provide improvements (increments) only during the collective bargaining process and not during any informal process.
- If the employer has not set a pattern of benefits that can be projected reliably to give rise to an obligation there is no requirement to provide for the benefits.
- However, if the practice established by an employer was that of a consistent benefit granted either as part of union negotiations or otherwise that clearly established a pattern (e.g., a cost of living adjustment or fixed rupee increase), it could be concluded that an obligation exists and that those additional benefits should be included in the measurement of the benefit obligation.

Employees who have worked less than 5 yrs

- Payment of Gratuity Act is applicable for employees who have finished 5 full years of service
- In this case, the employee's right to receive the benefit is conditional on future employment for a period of five years.
- there is a possibility that the benefit may not vest …. . … ….

- Also, should companies which are less than 5 years old provide for gratuity at all? When it is not statutorily payable . . . . .

Less than 5 years case study……

- there is also a probability that the employee would serve for the minimum period of five years and become eligible for gratuity.
- An obligation exists even if a benefit is not vested.
- The obligation arises when the employee renders the service though the benefit is not vested.
- The measurement of this obligation at its present value takes into account the probability that the benefit may not vest and this is appropriately factored in the calculation of the present value of the defined benefit obligation.
- An enterprise should, therefore, create a provision in respect of gratuity payable during the first five years of service of an employee.
- Even in first 5 years of the Company (Going Concern Basis).

Carry Forward of Earned Leave

- Whether an entitlement to earned leave which can be carried forward to future periods is a short-term employee benefit or a long-term employee benefit
- Existing rules + the pattern of actual utilisation / encashment by employees, although reflective of the behavioral pattern of employees, does determine the status of the benefit, i.e., whether 'short term' or 'long term'. [not individual basis but entity level]

Costing Earned Leave …

- What is an appropriate measure of cost of compensated absences which can be carried forward for their availment and/or encashment in future period(s)?
- In some enterprises the amount payable to an employee on encashment would not be the same as the compensation and other benefits the employee would be paid in case the leave is availed.
- Necessary to consider the pattern of relative proportion of encashment and availment in order to estimate the likely amounts payable in the future periods

Availment during employment	**Valued at Gross / CTC**
Encashment during employment	**Valued as per Policy** (usually basic salary)
Encashment upon termination of employment	**Valued as per Policy** (usually basic salary)

Unutilised Employee Benefits

- In case an enterprise allows unutilised employee benefits, e.g., medical care, leave travel, etc., to be carried forward, whether it is required to recognise a provision in respect of carried forward benefits
- A provision should be recognised for all benefits (conditional or unconditional) which an employee becomes entitled to as a result of rendering of the service and should be recorded as part of the cost of service rendered during the period in which the service was rendered which resulted the entitlement.
- In estimating the cost of such benefit the probability of the employee availing such benefit should be considered

In Interim Periods….

- How to measure Employee Benefits in Interim Periods?
- Same principles as used in annual FS to be used - the frequency of reporting should not affect the measurement of annual results.
- ● Therefore, short term employee benefits in the interim periods should be reckoned as benefits payable within twelve months from the end of the financial year.

Post Employment Benefits

Post Employment Benefits

- Retirement benefits and other post employment benefits
- Defined Benefit Plans or Defined Contribution Plans
- This depends upon the Economic Substance of the Plan – derived from its Terms & Conditions
- Defined Contribution Plan – the Entity's Legal & Constructive obligation is limited to the amount it agrees to contribute to the Fund. This means that the risk is with Employees
    - actuarial risk - that benefits will be less than expected
    - investment risk (that assets invested will be insufficient to meet expected benefits)

Defined CONTRIBUTION Plan

- Straight forward accounting
- Obligation for each period is determined by the amounts to be contributed for that period
- no possibility of any actuarial gain or loss.
- the obligations are measured on an undiscounted basis, except where they are not expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related service (which is rarely the case - statutorily liable to make payments to third party)
- If more than 12 months, to use discount rate and get NPV. [reference to market yields at the end of the reporting period on government bonds]

Provident Fund – Contribution or Benefit Plan?

- Depends on whether the Company contributes to PF Authorities or has its Own PF Trust
- Where, in terms of any plan the enterprise's obligation is to provide the agreed benefits to current and former employees and the actuarial risk (that benefits will cost more than expected) and investment risk, fall, in substance, on the enterprise, the plan would be a defined benefit plan.
- Accordingly, provident funds set up by employers which require interest shortfall to be met by the Employer would be in effect defined benefit plans in accordance with the requirements of paragraph 29(b) of IND-AS 19

Conclusion on Contr. To PF Trusts

- Accordingly, it was viewed that any provident fund scheme administered through trust ***should be treated as defined benefit plan rather than defined contribution plan***, and in view of the same, the liabilities towards such benefit should be based on actuarial valuation. Further, the disclosure requirements for such defined benefits should be made as required under relevant paragraphs of IND-AS 19

Fair Valuation of PF Trust Assets

- *AS 15, 'Employee Benefits' requires fair valuation of the Planned Assets on the balance sheet date for all defined benefit plans. However, AS 15 does not specifically detail any prescriptive method for fair valuation of investments held by Exempted PF Trust which have a unique investment objective. The investments of Exempted Provident Fund are normally held to maturity as mandated by Employees Provident Fund and Miscellaneous Provisions Act, 1952.*
- *The Exempted Trust Fund is expressly prohibited from selling these securities except under exceptional conditions and only with specific permission of EPFO. Accordingly, market prices are not good reflectors of fair value for such held to maturity investments. The company has therefore followed the valuation principle envisaged in AS 30: Financial Instruments – Recognition and Measurement and Ind AS 39: Financial Instruments – Recognition and Measurement which specifically stipulate that for held to maturity investments face value must be used and market prices may not be a good indicator.*

Statutory Auditor’s Report

- The statutory auditors of the company have drawn attention to the note referred above in their report to members stating that “...the valuation of plan assets of the provident fund administered by a Trust set up by the company (a defined benefit plan) at the face value instead of using the fair value, which in our view is not in compliance with Accounting Standard (AS) 15, Employee Benefits”.
- Accordingly, they have qualified their opinion in this regard
- Also, earlier, Actuaries did not have methodologies to execute in this scenario
- Now, Guidance is available for Actuarial Valuation

Institute of Actuaries of India : GN 29
Guidance Note on Valuation of Interest Rate Guarantees on Exempt Provident Funds under AS15 (Revised)

- This Guidance Note provides guidance to actuaries in performing actuarial valuations and preparing actuarial reports related to interest guarantee on Exempt Provident Funds. This Guidance Note briefly covers the valuation methods, assumptions and reporting requirements.

The Company operates two plans for its employees to provide employee benefits in the nature of provident fund. Eligible employees receive benefits from a provident fund, which is a defined benefit plan. Both the employee and the Company make monthly contributions to the provident fund plan equal to a specified percentage of the covered employee's salary. The Company contributes a part of the contributions to the "Bharat Forge Company Limited Staff Provident Fund Trust". The rate at which the annual interest is payable to the beneficiaries by the trust is being administered by the government. The Company has an obligation to make good the shortfall, if any, between the return from the investments of the trust and the notified interest rate.

The cost of providing benefits under above mentioned defined benefit plan is determined using the projected unit credit method with actuarial valuations being carried out at each balance sheet date, which recognizes each period of service as giving rise to additional unit of employee benefit entitlement and measures each unit separately to build up the final obligation.

Remeasurements, comprising of actuarial gains and losses, the effect of the asset ceiling, excluding amounts included in net interest on the net defined benefit liability and the return on plan assets (excluding amounts included in net interest on the net defined benefit liability), are recognised immediately in the balance sheet as an asset/liability with a corresponding debit or credit to retained earnings through OCI in the period in which they occur. Remeasurements are not reclassified to profit or loss in subsequent periods. The employees which are not covered under the above scheme, their portion of provident fund is contributed to the government administered pension fund which is a defined contribution scheme. The Company has no obligation, other than the contribution payable to the provident fund. The Company recognizes contribution payable to the provident fund scheme as expenditure, when an employee renders the related service. If the contribution payable to the scheme for service received before the balance sheet date exceeds the contribution already paid, the deficit payable to the scheme is recognized as a liability after deducting the contribution already paid. If the contribution already paid exceeds the contribution due for services received before the balance sheet date, then excess is recognized as an asset to the extent that the pre-payment will lead to, a reduction in future payment or a cash refund.

(c) Provident fund

In accordance with the law, all employees of the Company are entitled to receive benefits under the provident fund. The Company operates two plans for its employees to provide employee benefits in the nature of provident fund, viz. defined contribution plan and defined benefit plan.

Under the defined contribution plan, provident fund is contributed to the government administered provident fund. The Company has no obligation, other than the contribution payable to the provident fund.

Under the defined benefit plan, the Company contributes to the "Bharat Forge Company Limited Staff Provident Fund Trust". The Company has an obligation to make good the shortfall, if any, between the return from the investments of the trust and the notified interest rate.

Defined BENEFIT Plan

- Where entity has to further contribute if the assets are insufficient to meet the benefits in the plan benefit formula
- a guarantee, either indirectly through a plan or directly, of a specified return on contributions
- those informal practices that give rise to a constructive obligation
  - E.g. entity has a history of increasing benefits for former employees to keep pace with inflation

Defined Benefit Plan

- Defined benefit plans may be unfunded, or they may be wholly or partly funded by contributions by an entity,
- 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 entity's ability, and willingness, to make good any shortfall in the fund's assets
- Therefore, the entity is, in substance, underwriting the actuarial and investment risks associated with the plan.
- Consequently, the expense recognised for a defined benefit plan is not necessarily the amount of the contribution due for the period

Why do we need Actuarial Valuation?

- For Accounting Compliance - AS 15R / IND-AS 19
- Assess level of assets held to back the Employee Liability
- Assess Contributions to be made
- Ascertain costs in a merger / acquisition
- Liability settlement for discontinuance of operations

How is Actuarial Valuation done?

- The purpose of an actuarial valuation is to calculate the 'present value' of payments that would be made to employees in future as part of an employee benefit plan
- Actuaries start by making assumptions about future salary increment rates, attrition and mortality rates. The assumptions are then used to project the benefit payments that will be made form the employer to its employees, as per the rules of the plan
- Actuaries choose another assumption called the discount rate, to convert the future payments into a present value. This is the liability that you will need to disclose in your financial statements
- Actuarial valuation is generally meant to include not just an estimate of liability, but extended disclosures in the form of an actuarial report

Gratuity – Defined Benefit Plan

- Projected Unit Credit Method (sometimes known as the accrued benefit method prorated on service) to be used for discounting
- Actuarial Assumptions
  - Demographic assumptions deal with matters such as mortality, rate of employee turnover, etc
  - Financial assumptions dealing with items such as the discount rate, future salary, future medical costs, the expected rate of return on plan assets, etc
  - Estimates of future salary increases take account of inflation, seniority, promotion and other relevant factors, such as supply and demand in the employment market
  - Assumptions about medical costs should take account of estimated future changes in the cost of medical services, resulting from both inflation and specific changes in medical costs.

AS 15 R vs IND-AS 19

- From a situation of requiring actuarial valuation only once in 3 years….. We are moving to a scenario where an actuary compulsorily needs to be involved annually…
- AS 15 – para 58 : The detailed actuarial valuation of the present value of defined benefit obligations may be made at intervals not exceeding three years.
- IND-AS 19 para 59 : This Standard encourages, but does not require, an entity to involve a qualified actuary in the measurement of all material post-employment benefit obligations....

Disclosure in respect of defined benefit plans

A. Gratuity (Funded)

Change in Defined Benefit Obligation

Defined Benefit Obligation at the beginning of the Year
Interest cost
Current service cost
Past service cost
Benefits paid
Actuarial (Gain)/ Loss
Defined Benefit Obligation at the end of the Year

Changes in fair value of plan assets

Fair value of plan assets at the beginning of the Year
Interest income on plan assets
Contributions
Benefits paid
Actuarial (Gain)/ Loss
Fair value of plan assets at the end of the Year

Amount recognized in the Balance sheet

Defined Benefit Obligation at the end of the Year
Fair value of plan assets at the end of the Year
Net liability/(Asset) recognized in Balance sheet
* included under short-term provisions - Note 24

Expenses recognized in the Statement of Profit and Loss and OCI

Current service cost
Past service cost
Interest cost
Interest income on plan assets
Expenses recognized in P & L Account (Note 30)
Re-measurement - Actuarial (Gain)/Loss recognised in OCI (Note 33)
Total Defined Benefit Cost recognized in P & L and OCI
* Included under Contribution to Provident & Other Funds - Note 24

Composition of Plan Asets

Insurer managed funds
With scheduled bank

Important Terms in Gratuity

- **The** present value of a defined benefit obligation **is the present value, without deducting any plan assets, of expected future payments required to settle the obligation resulting from employee service in the current and prior periods.**
- Current service cost **is the increase in the present value of a defined benefit obligation resulting from employee service in the current period.**
- Interest cost **is the increase during a period in the present value of a defined benefit obligation which arises because the benefits are one period closer to settlement.** Net interest on the net defined benefit liability (asset) is the change during the period in the net defined benefit liability (asset) that arises from the passage of time.
  - Interest cost is computed by multiplying the discount rate as determined at the start of the period by the present value of the defined benefit obligation throughout that period, taking account of any material changes in the obligation.

Important Terms in Gratuity

- Plan Assets : assets held by a long-term employee benefit fund; and qualifying insurance policies
  - ***legally separate from the reporting enterprise and exists solely to pay or fund employee benefits***

- A qualifying insurance policy **is an insurance policy* issued by an insurer that is not a related party (as defined in Ind AS 24 Related Party Disclosures) of the reporting entity, if the proceeds of the policy:**
  - **(a) can be used only to pay or fund employee benefits under a defined benefit plan; and**
  - **(b) are not available to the reporting entity's own creditors (even in bankruptcy) and cannot be paid to the reporting entity, unless either:**
    - **(i) the proceeds represent surplus assets that are not needed for the policy to meet all the related employee benefit obligations; or**
    - **(ii) the proceeds are returned to the reporting entity to reimburse it for employee benefits already paid.**

Important Terms in Gratuity

- Assets held by a long-term employee benefit fund **are assets (other than non-transferable financial instruments issued by the reporting entity) that:**
  - **(a) are held by an entity (a fund) that is legally separate from the reporting entity and exists solely to pay or fund employee benefits; and**
  - **(b) are available to be used only to pay or fund employee benefits, are not available to the reporting entity's own creditors (even in bankruptcy), and cannot be returned to the reporting entity, unless either:**
    - **(i) the remaining assets of the fund are sufficient to meet all the related employee benefit obligations of the plan or the reporting entity; or**
    - **(ii) the assets are returned to the reporting entity to reimburse it for employee benefits already paid**
- ***Return on Plan Assets :*** The return on plan assets is interest, dividends and other revenue derived from the plan assets, together with realised and unrealised gains or losses on the plan assets, less any costs of administering the plan and less any tax payable by the plan itself

Important Terms in Gratuity

- Plan amendment : the introduction or withdrawal of, or changes to, a defined benefit plan
- Plan curtailment : a significant reduction by the entity in the number of employees covered by a plan. A curtailment may arise from an isolated event, such as the closing of a plant, discontinuance of an operation or termination or suspension of a plan
  - Termination costs can trigger and is a red flag for audit enquiry
- A settlement is a transaction that eliminates all further legal or constructive obligations for part or all of the benefits provided under a defined benefit plan, other than a payment of benefits to, or on behalf of, employees that is set out in the terms of the plan and included in the actuarial assumptions.

Important Terms in Gratuity

- Actuarial gains and losses **comprise:**
  - **(a) experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred); and**
  - **(b) the effects of changes in actuarial assumptions.**
- Past Service Cost
  - Past service cost is the change in the present value of the defined benefit obligation for employee service in prior periods, resulting in the current period from the introduction of, or changes to, post-employment benefits or other long-term employee benefits.
  - **Past service cost may be either positive (when benefits are introduced or changed so that the present value of the defined benefit obligation increases) or negative (when existing benefits are changed so that the present value of the defined benefit obligation decreases).**
  - Recognise past service cost as an expense on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits are already vested recognise past service cost immediately. (AS 15 only) – in IND-AS : write off in P&L

Example for treatment of Past Service Costs (AS 15)

- The increase in Present Value of Obligation ("PVO" or "liability") due to increase in gratuity limit shall be recognised as follows:
  - Increase in PVO attributable to employees who have completed vesting criteria (usually 5 years) shall be recognised immediately in the statement of Profit and Loss;
  - Increase in PVO attributable to employees who have not completed the vesting criteria shall be recognised in the statement of Profit and Loss over the remaining period to the vesting.
- In the above example, the Present Value of Obligation increases from Rs. 10,00,000 to Rs. 15,00,000 due to the increase in limit. Thus, the total Past Service Cost is Rs. 5,00,000.
- Out of the total Past service cost of Rs. 5,00,000, the Past service cost of Rs. 4,00,000 arising in respect of employees with past service of 5 years or more will be recognized as an expense immediately in the statement of Profit or Loss, whereas, past service arising in respect of employees with service of less than 5 years will be recognized as an expense in Profit or Loss Statement over 2 years (i.e. the remaining period to the vesting).

Particular	Scenario 1 (10 Lakhs limit)	Scenario 2 (20 Lakhs limit)	Past Service Cost
Present value of Obligation (PVO)	10,00,000	15,00,000	5,00,000
- PVO of employees with past service of 5 years or more (**vested liability**)	8,00,000	12,00,000	4,00,000
- PVO of employees with past service of less than 5 years (**un-vested liability**)	2,00,000	3.00,000	1,00,000
Average Past service of Unvested liability (in years)	3	3	
Vesting condition (in years)	5	5	

Particulars	AS15	IAS19	US GAAP
Recognition – immediate vs deferred	Immediate for vested Deferred for unvested	Immediate	Optional*
Recognized where?	Profit or Loss	Profit or Loss	Initially OCI with subsequent charging to Periodic Benefit Cost #
Reclassification to profit or loss in case of initial recognition through OCI	Not Applicable	Not Applicable	Yes, as described above

Asset Ceiling

- The net defined benefit liability (asset) is the deficit or surplus, adjusted for any effect of limiting a net defined benefit asset to the asset ceiling.
- The asset ceiling is the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan
- Para 64: When an entity has a surplus in a defined benefit plan, it shall measure the net defined benefit asset at the lower of:
- (a) the surplus in the defined benefit plan; and
- (b) the asset ceiling, determined using the discount rate specified in paragraph 83.

What is Asset Ceiling

- The aim of the pension asset ceiling is to make sure that a company’s balance sheet properly reflects how the value of any defined benefit deficit or surplus is affected by a pensions scheme’s rules and funding requirements.
- These rules and regulations can mean that the ‘normal’ calculation of a pension liability or asset – the difference between the fair value of the scheme assets and the present value of the projected benefit obligation (PBO) – is in adequate.
- This is particularly the case when the scheme rules state that any surplus in the scheme belongs to the scheme members[1], rather than the company.

Asset Ceiling : Reducing a Pension Asset

- The fair value of the scheme assets and the present value of the PBO are volatile numbers.
- Therefore, at certain points in time, it is possible that the value of the scheme assets will exceed the value of the PBO.
- If the scheme rules state that the surplus in the pension scheme belongs to the scheme members, rather than the company, then an asset ceiling adjustment is required to prevent the company recognizing a pension asset on the balance sheet; this ‘asset’ doesn’t benefit the company in any way so it isn’t their asset to recognize.

Asset Ceiling : Increasing the Size of a Pension Liability

- Pension regulation in most countries (including the UK and US) requires periodic assessment of pension scheme funding (typically every 3 years). If the scheme is underfunded, the company is required to commit to additional funding payments over a number of years to eliminate the deficit (this is often referred to as a recovery plan).
- However, in the years between the funding assessments, changes in the value of the scheme assets or the value of the PBO may result in the committed recovery payments exceeding the size of the pension deficit.
- If the scheme rules prevent the company from avoiding these payments AND any surplus in the pension scheme belongs to the scheme members, rather than the company, then the asset ceiling would increase the size of the pension liability to reflect the PV of the remaining recovery payments, as these are now considered onerous payments.

Important points on asset ceiling

- remember that the asset ceiling will only have an effect when the scheme is already in surplus, or the current recovery plan would result in a surplus
- pension assets benefiting from buoyant equity markets
- it's important to note that the asset ceiling applies only where a surplus 'belongs' to the scheme members. If the scheme rules allow the <u>company to benefit from the surplus</u>, then the asset ceiling would not be relevant

When company can benefit from surplus

- An entity shall determine the availability of a refund or a reduction in future contributions in accordance with the terms and conditions of the plan and any statutory requirements in the jurisdiction of the plan
- An economic benefit, in the form of a refund or a reduction in future contributions, is available if the entity can realise it at some point during the life of the plan or when the plan liabilities are settled. In particular, such an economic benefit may be available even if it is not realisable immediately at the end of the reporting period.

What are Actuarial Gains or Losses?

- When performing actuarial valuation of employee benefit scheme (such as gratuity valuation), we perform movement analysis of the liability i.e. reconcile opening PVO (Present Value of Obligation) to the closing PVO. Similarly, a movement analysis of Fair Value of Plan Assets is also performed. One item which figures out in these reconciliations is Actuarial Gain or Loss.
- Actuarial gain or loss refers to an increase or decrease to a company's estimate of the Present Value of Obligation or the Fair Value of Plan Assets as a result of either change in assumption or experience adjustments / variance.
- Actuarial gains and losses do not include changes in the present value of the defined benefit obligation because of the introduction, amendment, curtailment or settlement of the defined benefit plan, or changes to the benefits payable under the defined benefit plan. Such changes result in past service cost or gains or losses on settlement.

Actuarial Gain or Loss

Impact of Change in Assumptions

Experience Adjustments / Variance

Assumptions

- Financial Assumptions
  - Discount rate
  - Salary escalation rate
- Demographic Assumptions
  - Attrition rate
  - Mortality rate

Experience Adjustments / Variance

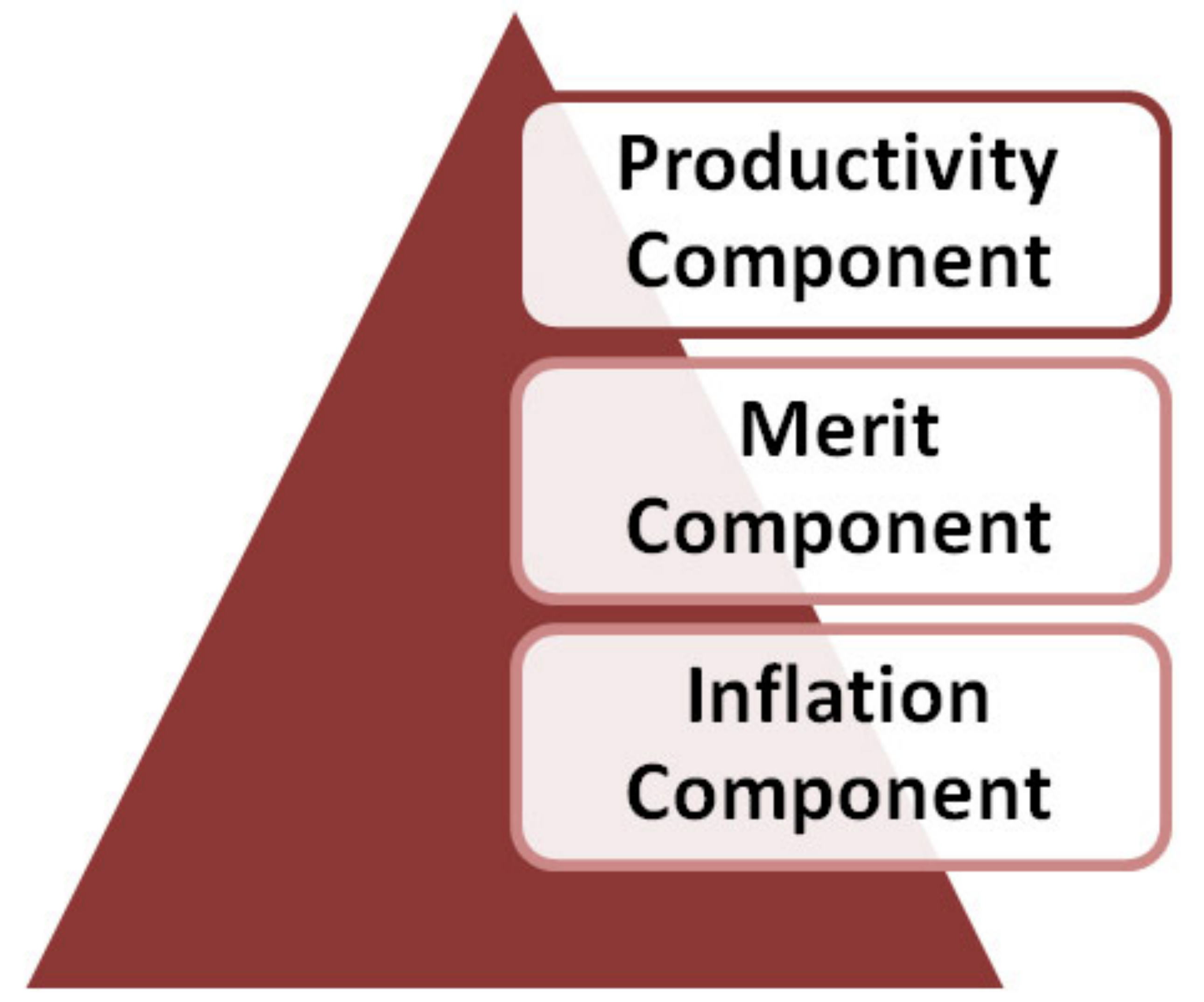
- the impact on closing liability of any deviation during the accounting period between the valuation assumptions taken in the opening valuation and the actual experience is reflected as "Experience Adjustments / Variance", which also contributes to the actuarial gain / loss
- For example, if the salary escalation assumption adopted in the opening valuation was 5.0% p.a. whereas the actual increments in the salary were, say, 12.0% p.a., then the increase in liability at the end because of high salary growth during the period will be reflected as experience loss arising during the period.
- experience adjustments are a measure of efficiency of assumptions employed in actuarial valuations

Sensitive Assumptions

- Salary growth rate and discount rate are the two most important assumptions for actuarial valuation of salaried employees
- Both have high sensitivity – a 1% change may impact liability to the extent of 10%
- There is a need to have benchmarks – practical approach
- Various salary growth assumptions for various categories?
- Companies can have salary growth assumptions varying by year of projection (rather than a single rate for future years)

Salary Growth Rate

- salary growth rate should ***take into account inflation, seniority, promotion and other relevant factors, such as supply and demand in the employment market***
- it is ultimately the responsibility (as well as the right) of the management of the reporting enterprise to determine the assumptions to be used in the valuation. Role of Actuary is only to Advice.


Productivity Component
Merit Component
Inflation Component

Three Components of Salary Growth Rate

- Inflation Component – Cost of living factor – closely linked to Consumer Price Inflation
- Merit Component - denotes the individual-based productivity gains achieved by the employee over his working career. This is increase in salaries on promotions + increase without promotions also
- Productivity Component – Labour's share of economies of scale. Typically higher in newer companies and stabilises in older companies
- The common practice in determining salary growth rate assumption is to choose expected long-term rate rather than currently observed rates – can be chunks of years also.

Company Name	Salary Growth rate assumption for actuarial valuation at the end of FY 2013-14
Dr. Reddy's Laboratories td.	11% p.a. for first two years & 10% p.a. thereafter
Asian Paints Ltd.	**Management**: 1st Year: 13% p.a., next two years: 12% p.a., next three years: 10% p.a. and thereafter: 8% p.a.
	Non-Management: 1st Year: 13% p.a., next five years: 12% p.a. and thereafter 8% p.a.

Should salary escalation rate of Gratuity Assumption be the same as Compensated Absences?

Discount Rate

- The rate used to discount post-employment benefit obligations (both funded and unfunded) shall be determined by reference to market yields at the end of the reporting period on government bonds.
- The currency and term of the government bonds shall be consistent with the currency and estimated term of the post- employment benefit obligations
- This means that these valuations are essentially Mark-To- Market (MTM) valuations, which can result in fluctuations in the valuation of liability if the underlying yield on government bonds fluctuates.
- As per para 80 of AS15, the discount rate is supposed to reflect the estimated timing of benefit payments

Name	Yield on government bond as at end of September 2018
India 1-Year	7.90%
India 2-Year	8.02%
India 3-Year	8.12%
India 4-Year	8.17%
India 5-Year	8.23%
India 6-Year	8.26%
India 7-Year	8.30%
India 8-Year	8.30%
India 9-Year	8.26%
India 10-Year	8.18%
India 11-Year	8.39%
India 12-Year	8.34%
India 13-Year	8.28%
India 14-Year	8.41%
India 15-Year	8.45%
India 19-Year	8.48%
India 24-Year	8.43%
India 30-Year	8.42%

Choosing a discount rate

- To ensure the same, the entity should determine the average estimated timing of benefit payments, allowing for expected attrition and deaths and then decide, based on above table, a single weighted average discount rate that reflects the average expected timing of benefit payment

Discount Rate

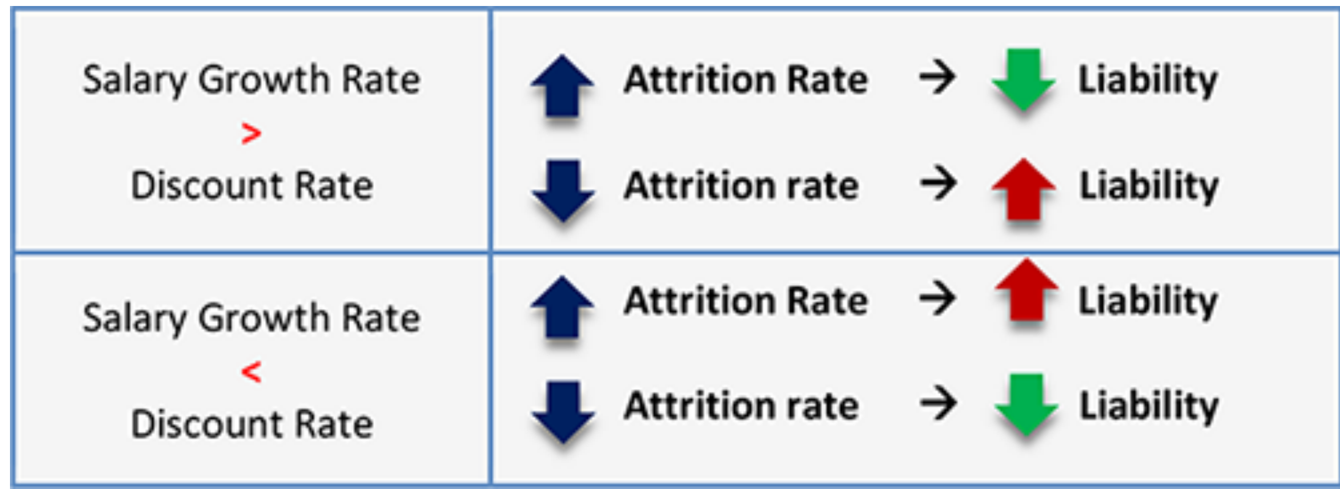
- What is the meaning of the phrase ‘market yields at the balance sheet date on government bonds’ in the context of the discount rate?
- The discount rate reflects the time value of money. It does not reflect the company’s own credit rating.
- The purpose of using the words ‘market yields at the balance sheet date’ is to ensure that the yields prevalent on that date are considered instead of a long-term average rate, based on past experience over a number of years or any other rate during the financial year

Attrition rate

- Usually entities provide a flat rate of attrition but it has been observed that attrition rate is dependent on the service or age of the employee. For example, the entity can use x% for service below 5 years, and y% for above 5 years instead of a flat rate of z%.
- Attrition rate is significant in deciding the future expected cash flows and has a direct impact on obligation
- Attrition assumption is the most difficult assumption as it dependent upon the age and service slab, sex, geography, industry and the pay scale of a particular employee. Thus the choice of the appropriate level of overall attrition is of decisive importance.

Attrition ~ Discount ~ Salary Growth

- **longer the payout period, lower will be the liability if the salary growth rate assumption is lower than the discount rate**. Conversely, a longer payout period will result in a higher liability if the salary growth rate assumption is higher than the discount rate.



Salary Growth Rate > Discount Rate	↑ Attrition Rate → ↓ Liability ↓ Attrition rate → ↑ Liability
Salary Growth Rate < Discount Rate	↑ Attrition Rate → ↑ Liability ↓ Attrition rate → ↓ Liability

Recent Amendments in Gratuity

- Second Amendment Rules – 31st Mach 2019 – applicable from 1 April 2019
- Use updated assumptions, if any, made during the year – due to any planned amendment, curtailment or settlement – for the remainder period fo the year
- Prior to this amendment, the earlier year assumptions were only taken and the “middle of year” evaluation was dis-regarded. Not anymore…..
- This may impact the P&L / OCI components.
- Accounting policies may also be suitably updated

Gratuity Valuation: Impact of limit of Rs. 20 L

- Section 4 of the Payment of Gratuity Act, 1972, lays down the amount of gratuity benefit an entity needs to pay to its employees. Sub section (3) of Section 4 of the Act prescribes the maximum limit on the gratuity as:
  - “(3)The amount of gratuity payable to an employee shall not exceed ten lakh rupees.”
- The Act, however, does not stop an entity from paying a higher benefit than that stipulated in Section 4. This aspect is clarified in Sub Section (5) to Section 4, which reads as under:
  “(5) Nothing in this section shall affect the right of an employee to receive better terms of gratuity under any award or agreement or contract with the employer.”

Impact of Rs. 20 lakhs

- younger companies which are yet to experience actual gratuity pay outs or relatively smaller companies, are not sure of whether to get actuarial valuations done with or without the limit of Rs. 20 lacs. In fact, many do not fully appreciate that having or not having a limit on gratuity payout can have a significant impact on the actuarially valued liability.
- Issues :
  - No Gratuity Written Policy / Policy is silent
  - Inconsistencies with policy / practice and what is done in valuation
  - Liability may be over / under valued.

How to go about …?

- Be sure of your policy: It is important that you are sure of the gratuity policy being followed in your organization before getting the valuation done. Where there is no written policy, looking at past practices also becomes important factor in determining whether the limit should be applied in the valuation or not.
- Ensure that the policy is correctly captured in report: Make sure that you clearly communicate whether the valuation is required with limit or without limit. Also, look at the actuarial valuation report carefully to ensure that your policy is correctly reflected in the report.
- Look at employee wise liability: And to be completely sure, you can ask your actuary to share the employee wise liability. Where the limit is applicable, no employee should have a liability of more than Rs. 20 lacs.

Auditor ~ Actuary : Using work of expert

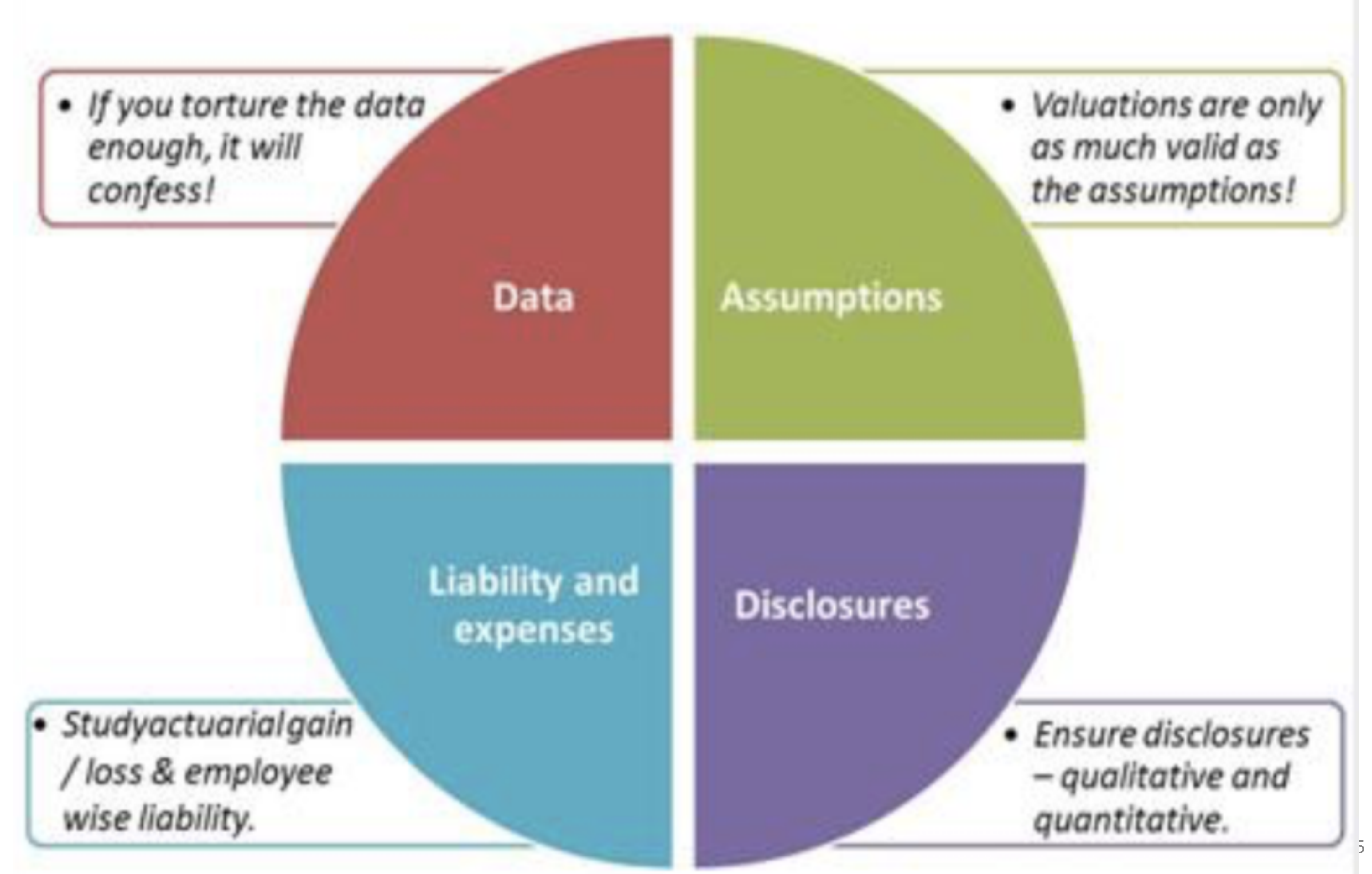
- GENERAL CLARIFICATION :(GC)–AASB/1/2002 ON SA 620
- the issue to be considered is whether it is sufficient for the auditor to rely on the certificate given by insurer or actuary without establishing the reasonableness of the assumptions made by the actuary or the insurer based on the auditor's knowledge of the client's business.
- It is clarified that the auditor should, while using the certificate issued by the actuary or the insurer, obtain an understanding of the methods used by the actuary or the insurer in determining the liability and should also judge the appropriateness and reasonableness of assumptions
  - (i) Rate of Return(ii) Number of Employees (iii) Retirement Age (iv) Salaries(v) Promotion Policies (vi)Age of Employees

Are LIC Gratuity Reports sufficient ?

- Accounting standards mention to use the services of an Actuary
- Actuarial Practice Standard 26 states: Qualified Actuary means Fellow Member of the Institute of Actuaries of India
- LIC uses "Industry Averages" - not Company specific
- Complete Disclosures not available
- Report mentions : "The above report is not a certification under AS 15 read with Actuaries Act, 2006. It is simple a report generated to help companies for proper accounting of employee liabilities".

The 4-way test …

- Data quality – complete / accuracy / consistency
- Appropriateness of assumptions
- Liability and expenses (movement analysis)
  - Reconciliation of liability movement, in particular actuarial gain / loss Ratio of actuarial liability to discontinued / wind up liability
  - Employee wise liability / workings
    - [Related party note: Does not include gratuity and leave encashment since the same is considered for all employees of the Company as a whole. – can be avoided]
- Appropriate Disclosures in Notes to Accounts



• If you torture the data enough, it will confess!
Data
Assumptions
• Valuations are only as much valid as the assumptions!
Liability and expenses
Disclosures
• Studyactuarialgain / loss & employee wise liability.
• Ensure disclosures – qualitative and quantitative.

Why you should ask for employee-wise liability?

- Better analysis and comfort on accuracy of valuation
  - Spot checks – senior employees
  - Age and years of service analysis
  - Ratio of actuarial liability to discontinued liability
- Use in case of Transfer of Employees from one entity to other within the same group or in case of Mergers and Acquisitions
- It is a great Audit Evidence

Is Valuation from LIC sufficient for accounting purpose?

- In general, when a company has created a fund with LIC or a private player, the company is under an impression that the report provided by LIC / Private player serves as the statutory audit requirement of valuing the liability.
- Firstly, let's have a glance at para 49 of AS-15 (R)*, which states that; **"Post-employment Benefits: Defined Benefit Plans**
- *Para 49. Accounting for defined benefit plans 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 recognised that for doing so the enterprise would normally use the services of a qualified actuary."***
-

LIC Report sufficient? (contd)

- Some companies even calculate the accrued liability at their end for accounting, using the direct formula (eg: gratuity = 15/26 * no of years of services * last drawn salary). However, this calculation ignores the probabilities of death, withdrawal, etc, and is not as per project unit credit method, which is again a statutory requirement. So, with respect to above references it is worth appreciating the fact that the actuaries are recognised professionals to deal with such multifaceted calculations. The fund created with LIC acts as the asset created against the liability, which has to be evaluated by an independent actuary.

LIC Report sufficient? (contd)

- Lastly, one can always check the complete report of LIC, where there is always a comment mentioned in the end, *"Note: the above report is not certification under AS-15 revised 2005 read with Actuaries Act, 2006. It is simply a report generated to help companies for proper accounting of employee liabilities".* So, if the valuations are done with the intention of compliance of audit requirement and assessing the accurate liability, with most relevant assumptions, then knocking the door of an independent Actuary is mandatory.

Control Points - Gratuity

- Direct payments by employers and part settlements from the funds are 'benefits paid.' Provide right information to actuary
- Expenses of the fund (e.g. life insurance premiums, administration charges) are 'employer expense
- Income of the fund apart from investment return (e.g. bonus units) are 'reduction of employer expense
- Assumption setting, particularly for salary escalation and withdrawal – need to understand how experience gains and losses feed into assumption setting
- Large actuarial gains and losses, say beyond 10% of DBO

Control Points

- Do actuarial gains/ (losses) of assets set off actuarial (gains)/ losses of DBO. In that case, does duration of assets and liabilities match and hence an ALM even if restrictive is in place?
- Accounting standard on employee benefits prescribes management's responsibility to set assumptions, but it is the onus of the auditor to express an opinion on annual accounts which should reflect a true and fair view. Therefore they also play a major role in setting assumptions. A discussion between the Company (Finance and HR representatives), the Actuary and the Auditor should occur at an early stage in the valuation process. This ensures all stakeholders are in agreement in this key area.

Aspect	***Actuary***	***Management***	***Auditor***
Data	*Check*	*Provide*	*Check*
Assumptions	*Advise*	*Decide*	*Concur*
Results	*Provide*	*Rely*	*Rely (Can question)*
Disclosures	*Provide*	*Disclose*	*Concur*

What about employees who left the rolls before balance sheet date but paid after balance sheet date?

43B Query

- Under IND AS, gratuity disclosure norms have changed. The debit in P/l represents the gratuity liability for the service period while the gains/losses on valuation assumptions (based on the change in discounting rate/ planned asset return rate etc) are either credited or debited to OCI. Funding is for the gross/net amount inclusive of the OCI figures. Doubt arises over the tax treatment. When funding is done for the gross amount (as required) for the p/l debit as well as the OCI debit (for losses due to valuation), there is an argument that claim under IT would be restricted to amount debited in p/l quoting 43B. This is in spite of the funding being done for the gross amount. Contrarily when there is a gain in valuation & credit to OCI, the claim for IT is restricted to the net amount - being the funded value, though the debit to p/l is higher.

43B – Answer to Query

- 43B is the section to see for allowability. it talks of provision to be paid and then allowed for tax purpose.
- There is no requirement that the said payment has to be debited to P&L.
- Even if it were to be, (hypothetical case) - OCI is a modified P&L as it ultimately affects the Reserves & Surplus.
- OCI component, like P&L, also has the deferred tax / current tax adjustment therein (either built-in or separate line disclosure).

Lets assume entire liability funded next year in April itself….

- AS 15: 100 debit to P&L
  - Allowed as a deduction in Memo
- INDAS 19 : 80 to P&L; 20 to OCI – total liability is 100
  - Only 80 considered as deduction in Memo – though 100 paid
  - Memo to be adjusted to “allow” further 20 pertaining to liability paid but sitting in OCI
  - OCI will be net of tax based on effective tax rate

- AS 15: 100 debit to P&L
  - Allowed as a deduction in Memo
- INDAS 19 : 120 to P&L; (20) to OCI – total liability is 100
  - 120 considered as deduction in Memo but only 100 paid
  - Memo to be adjusted to “dis-allow” further 20 pertaining to liability paid but sitting in OCI
  - OCI will be net of tax based on effective tax rate

Benefits of Funding Employee Benefits

- Provide Security to employees that benefit will be paid as they are insured and managed by professionals and regulated by competent authority.
- Provide Flexibility to employer to contribute towards accumulation of fund.
- Company may not face liquidity problem when they have to pay huge amount to outgoing employees for benefits to be paid
- Company enjys tax benefits + Provides Tax benefits on investment income of trust fund
- Beneficial in case of employee transfers + Mergers / Demergers

Actuarial Practice Standard

APS – 27 : High Level Overview

Transformation ~ Convergence ~ Globalisation

- the Institute of Actuaries of India has ***introduced a new Actuarial Practice Standard (APS) on Employee Benefits - APS 27***
- applies to all actuarial work relating to employee benefits (including valuations carried out for accounting and reporting purposes)
- new Standard seeks to enhance / strengthen reporting requirements on practitioners whilst providing them with a principle based set of standards to ensure that the user / recipient of actuarial work is able to place a high degree of reliance on the same.
- the introduction of APS 27 is going to enhance quality of reporting carried out by practitioners working in the area of employee benefits. Not only will this improve understandability of actuarial reports by non-practitioners, it will also enable the management and auditors to make better decisions about the choice of assumptions

AP 27 replaces the following – these have now been withdrawn

GN 11	Actuarial Investigations of Retirement Benefit Schemes
APS12	Investigation of Retirement Benefits - Choice of Actuarial Assumptions for the Actuarial Valuations Required under AS 15
APS 13	Investigations of Retirement Benefit schemes: the actuarial reports under FAS 87, FAS 88 and FAS 132
APS 14	Illustrations of Defined Contribution Pension Scheme Benefits
APS 18	Retirement Benefit Schemes - Actuarial Reports
APS 26	Actuarial Reports under Accounting Standard 15 (Revised, 2005) issued by the ICAI
GN 28	Guidance Note on Other Employee Benefits

GENERAL PRINCIPLES contained in APS 27

- Member's role to be clear – Engagement Letter?
- The member must clearly state the extent to which any third party can rely on the actuarial work performed and its limitations for use by third parties
- If there is any uncertainty, for instance, impact of legislation on the calculation of benefits, the member's report should include necessary references to the same
- Reliance on third party / client company data, if placed, needs to be disclosed in the report. Any validations not done should also be disclosed
- The member must include statement of benefits which have been valued and highlighting any changes since the most recent similar investigation
- Summary of input data to be given / sensitivity analysis to be given

Requirements of TECHNICAL APPLICATION SECTION (TAS) of APS 27

- Used for gratuity / leave / pension / long service awards / post employment medical
- ***Data***: The Section specifies the items relating to data which should be reported in an actuarial valuation report
- ***Assumptions***: The Section requires that a valuation report should give details of all the assumptions used in the valuation
- ***Modeling / Model***: The Section requires that the valuation report should include complete description of the required benefits valued
- ***Report / Output***: The Section requires that the member should ensure application of the Projected Unit Credit (PUC) Method in attributing benefit to the service rendered in the past and that his / her report shall clearly and completely spell out all the inputs (data, assumptions and benefit structure) considered for valuation and that the report should include disclosures and disclaimers on the extent each of the inputs have been validated

Gratuity - Disclosures

Macro level disclosures

- Explains characteristics of defined benefit plan and associated risks (para 139)
- Identifies and explains amounts in FS arising from defined benefit plans (para 140 – 144)
- Describe how defined benefit plans may affect amount, timing and uncertainty of entity's future cash flows (para 145 – 147)
- For meeting the above requirements, the level of detail, the emphasis to be placed, amount of aggregation and dis-aggregation as well as whether users need any additional information to evaluate qualitative information needs to be considered

More disclosures….

- If disclosures required as per IND-AS 19 and others Standards are insufficient to meet the macro level objectives of disclosures, more disclosures could be made as needed
  - E.g. an entity may present analysis of present value of the Defined Benefit Obligation between active members, deferred members, pensioners or between vested and accrued but not vested benefits; etc
- Disaggregation – different geographies; different characteristics; different regulatory environments; different funding arrangements
  - Valid for Consolidated Financials

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- Info about the characteristics of the DBP
  - Nature of benefits provided by the plan (final salary based or contributory)
  - Description of regulatory framework in which the plan operates
  - Entity’s responsibilities for governance of the plan
- Description of risks to which the plan exposes the entity – plan specific or entity specific or any concentration of risk
  - E.g. all investments are in one class of invetsments
- Description of plan amendments, curtailments and settlements

140 - 144

- Opening to closing reconciliation of present value of DBO as well as Plan Assets + effect of asset ceiling
- Any reimbursable rights
- The different factors of reconciliation – current service cost; past service costs; effect of forex rates; interest income / expense; *remeasurements of defined benefit liability (asset); contributions to plan; payouts from plan; effect of any business combinations / disposals
- * due to change in return on plan assets / actuarial gains or losses in financial / demographic assumptions separately

140 - 144

- Disaggregate the fair value of plan assets into : cash/cash equivalents; equity instruments; debt instruments; real estate; derivatives; investment funds; asset backed securities and structured debt
- Fair value of entity's own transferrable financial instruments held as plan assets; plan assets used by entity (incl property)
- Disclose significant actuarial assumptions – in absolute terms

145 - 147

- Sensitivity analysis for each significant actuarial assumption of para 144
- Methods and assumptions used in preparing sensitivity analysis
- Any changes in these methods and assumptions from previous periods
- Any asset-liability matching strategies to be described
- Description of funding arrangements; expected contribution in next year; maturity profile of defined benefit obligation – all these to understand the effect of the plan on entity's future cash flows

Another interesting disclosure

- Where required by IND-AS 37, entity to disclose information about contingent liabilities arising from post-employment benefit plans
- Any example scenarios where such disclosure may get trigerred?
  - Assets of the Plan is under litigation – an adverse verdict may increase liability of the Entity
  - Employee litigations

28. Employee benefits expense

In ₹ Million

	Year ended March 31, 2018	Year ended March 31, 2017
Salaries, wages and bonus (including managing and whole time director's remuneration)	3,728.48	3,197.50
Contributions to provident and other funds / scheme	173.20	168.62
Gratuity expense (Refer note 37(a))	54.59	51.41
Special gratuity expense (Refer note 37(b))	6.33	3.59
Employee voluntary retirement scheme compensation	1.31	14.51
Staff welfare expenses	395.09	323.82
Total	**4,359.00**	**3,759.45**

30. Finance costs

In ₹ Million

	Year ended March 31, 2018	Year ended March 31, 2017
Interest on bank facilities	771.14	589.35
Others *	77.24	138.35
Total	**848.38**	**727.70**

* Others includes interest on debentures, advance from customers, net interest expense on defined benefit plans etc.

19. Other financial liabilities

In ₹ Million

	As at March 31, 2018	As at March 31, 2017
Other non-current financial liabilities		
Voluntary retirement scheme compensation	1.98	6.40
Derivative liability *	151.68	-
Total	**153.66**	**6.40**
Other current financial liabilities at amortised cost		
Interest accrued but not due on borrowings	57.10	65.14
Payables for capital goods	444.91	433.32
Security deposits	84.98	82.62
Directors commission	6.25	6.70
Current maturities of long term loans (Refer note 18)	4,333.46	7,244.50
Investor Education and Protection Fund (as and when due) *		
- Unpaid dividend	35.70	33.48
- Unpaid matured deposits	0.04	0.04
Voluntary retirement scheme compensation	5.32	5.99
Total	**4,967.76**	**7,871.79**

* Derivative instruments as fair value through profit or loss reflect change in fair value of those instruments that are not designated in hedge relationships, but are, nevertheless intended to reduce the level of foreign currency risk expected on repayment.

Iincludes unpaid due to litigation

20. Provisions

In ₹ Million

	As at March 31, 2018	As at March 31, 2017
Non-current		
Provision for gratuity (Refer note 37(a))	143.57	190.03
Provision for special gratuity (Refer note 37(b))	51.02	46.78
Provision for employees' provident fund (Refer note 37(c))	-	32.11
Total	**194.59**	**268.92**
Current		
Provision for gratuity (Refer note 37(a))	94.00	80.00
Provision for special gratuity (Refer note 37(b))	10.62	13.62
Provision for leave benefits	263.47	244.58
Provision for expected losses (Refer note 32)	210.00	-
Total	**578.09**	**338.20**

Statement of Profit and Loss

for the year ended March 31, 2018

In ₹ Million

	Notes	Year ended March 31, 2018	Year ended March 31, 2017
Income			
Revenue from operations	24	53,729.44	40,661.28
Other income	25	1,186.93	994.90
Total income [i]		**54,916.37**	**41,656.18**
Expenses			
Cost of raw materials and components consumed	26	19,151.77	13,727.92
(Increase) in inventories of finished goods, work-in-progress, dies and scrap	27	(281.63)	(522.54)
Excise duty on sale of goods		569.80	2,014.65
Employee benefits expense	28	4,359.00	3,759.45
Depreciation and amortisation expense	29	3,067.49	2,948.51
Finance costs	30	848.38	727.70
Other expenses	31	14,562.81	10,955.81
Total expenses [ii]		**42,277.62**	**33,611.50**
Profit before exceptional items and tax [i - ii]		**12,638.75**	**8,044.68**
Exceptional items (loss)/gain	32	(1,332.05)	380.24
Profit before tax		**11,306.70**	**8,424.92**
Tax expense			
Current tax		4,161.42	2,600.04
Deferred tax		72.33	(25.89)
Total tax expense		**4,233.75**	**2,574.15**
Profit for the year		**7,072.95**	**5,850.77**
Other comprehensive income			
Other Comprehensive Income to be reclassified to profit and loss in subsequent period (net of tax)			
- Movement on cash flow hedges	33	(1,692.51)	1,683.66
- Foreign Currency Monetary Items Translation Difference Account	33	181.92	472.42
		(1,510.59)	**2,156.08**
Tax effect		580.08	(582.68)
[a]		**(930.51)**	**1,573.40**
Other Comprehensive Income not to be reclassified to profit and loss in subsequent period (net of tax)			
- Re-measurement gains/(losses) of defined benefit plans	33	55.71	(63.18)
- Gain on FVTOCI equity securities	33	166.47	90.13
		222.18	**26.95**
Tax effect		(19.47)	21.87
[b]		**202.71**	**48.82**
Other comprehensive income for the year (net of tax) [a+b]		**(727.80)**	**1,622.22**
Total comprehensive income for the year (net of tax)		**6,345.15**	**7,472.99**

33. Components of Other Comprehensive Income (OCI)

The disaggregation of changes to OCI for each type of reserve in equity is shown below :

In ₹ Million

During the year ended March 31, 2018	Cash flow hedge reserve	FVTOCI reserve	Foreign currency monetary items translation difference account	Retained earnings	Income tax / Deferred tax effect	Total
Foreign exchange revaluation differences	-	-	181.92	-	-	181.92
Currency forward contracts	440.13	-	-	-	(157.98)	282.15
Reclassified to statement of profit or loss	(2,132.64)	-	-	-	738.06	(1,394.58)
Gain / (Loss) on FVTOCI financial assets	-	166.47	-	-	-	166.47
Re-measurement gains / (losses) on defined benefit plans	-	-	-	55.71	(19.47)	36.24
Total	(1,692.51)	166.47	181.92	55.71	560.61	(727.80)

In ₹ Million

During the year ended March 31, 2017	Cash flow hedge reserve	FVTOCI reserve	Foreign currency monetary items translation difference account	Retained earnings	Income tax / Deferred tax effect	Total
Foreign exchange revaluation differences	-	-	472.42	-	-	472.42
Currency forward contracts	3,018.23	-	-	-	(1,044.55)	1,973.68
Reclassified to statement of profit or loss	(1,334.57)	-	-	-	461.87	(872.70)
Gain / (Loss) on FVTOCI financial assets	-	90.13	-	-	-	90.13
Re-measurement gains (losses) on defined benefit plans	-	-	-	(63.18)	21.87	(41.31)
Total	1,683.66	90.13	472.42	(63.18)	(560.81)	1,622.22

Statement of changes in equity

for the year ended March 31, 2018 (Contd.):

B. Other equity (Contd.):

In ₹ Million

	Reserves and Surplus						Items of OCI			
	Security premium	Debenture redemption reserve	Capital reserves	Capital redemption reserve	General reserve	Retained earnings	Equity Instruments through Other Comprehensive Income	Cash flow hedge reserve	Foreign Currency Monetary Item Translation Difference Account (FCMITDA)	Total
Balance at the April 1, 2017	**7,096.48**	**-**	**15.50**	**300.00**	**3,030.48**	**29,309.09**	**120.13**	**2,208.80**	**(226.84)**	**41,853.64**
- Profit for the year	-	-	-	-	-	7,072.95	-	-	-	**7,072.95**
- Other Comprehensive Income	-	-	-	-	-	36.24	166.47	(1,112.43)	181.92	**(727.80)**
	-	**-**	**-**	**-**	**-**	**7,109.19**	**166.47**	**(1,112.43)**	**181.92**	**6,345.15**
Transfer from retained earnings	-	-	-	-	100.00	-	-	-	-	**100.00**
Utilised for issue of bonus shares	(165.59)	-	-	(300.00)	-	-	-	-	-	**(465.59)**
Transfer to retained earnings	-	-	-	-	-	-	-	-	-	**-**
Transfer to general reserve	-	-	-	-	-	(100.00)	-	-	-	**(100.00)**
Transaction with owners in their capacity as owners										
- Equity dividend	-	-	-	-	-	(1,163.97)	-	-	-	**(1,163.97)**
- Tax on equity dividend	-	-	-	-	-	(236.96)	-	-	-	**(236.96)**
- Interim equity dividend	-	-	-	-	-	(931.18)	-	-	-	**(931.18)**
- Tax on interim equity dividend	-	-	-	-	-	(189.56)	-	-	-	**(189.56)**
Balance as at March 31, 2018	**6,930.89**	**-**	**15.50**	**-**	**3,130.48**	**33,796.61**	**286.60**	**1,096.37**	**(44.92)**	**45,211.53**

37. Gratuity and other post-employment benefit plans

(a) Gratuity plan

Funded scheme

The Company has a defined benefit gratuity plan for its employees. The gratuity plan is governed by the Payment of Gratuity Act, 1972. Under the Act, every employee who has completed five years of service is entitled to specific benefit. The level of benefits provided depends on the employee's length of service and salary at retirement age. Employee who has completed five years or more of service gets a gratuity on departure at 15 days salary (last drawn) for each completed year of service as per the provisions of the Payment of Gratuity Act, 1972. In case of certain category of employees who have completed 10 years of service, gratuity is calculated based on 30 days salary (last drawn) for each completed year of service and cap for gratuity is 20 years. The scheme is funded with insurance companies in the form of a qualifying insurance policy.

Risk exposure and asset-liability matching

Provision of a defined benefit scheme poses certain risks, some of which are detailed hereunder, as companies take on uncertain long term obligations to make future benefit payments.

1) Liability risks

a) **Asset-liability mismatch risk**

Risk which arises if there is a mismatch in the duration of the assets relative to the liabilities. By matching duration with the defined benefit liabilities, the Company is successfully able to neutralize valuation swings caused by interest rate movements.

b) **Discount rate risk**

Variations in the discount rate used to compute the present value of the liabilities may seem small, but in practice can have a significant impact on the defined benefit liabilities.

c) **Future salary escalation and inflation risk**

Since price inflation and salary growth are linked economically, they are combined for disclosure purposes. Rising salaries will often result in higher future defined benefit payments resulting in a higher present value of liabilities especially unexpected salary increases provided at management's discretion may lead to uncertainties in estimating this increasing risk.

2) Asset risks

All plan assets are maintained in a trust fund managed by a public sector insurer viz. LIC of India and other insurance companies. LIC and other insurance companies has a sovereign guarantee and has been providing consistent and competitive returns over the years. The Company has opted for a traditional fund wherein all assets are invested primarily in risk averse markets. The Company has no control over the management of funds but this option provides a high level of safety for the total corpus. A same account is maintained for both the investment and claim settlement and hence 100% liquidity is ensured and also interest rate and inflation risk are taken care of.

2) **Unfunded plan risk**

This represents unmanaged risk and a growing liability. There is an inherent risk here that the Company may default on paying the benefits in adverse circumstances. Funding the plan removes volatility in the Company's financials and also benefit risk through return on the funds made available for the plan.

The principal assumptions used in determining gratuity for the Company's plan is shown below:

Particulars	**As at March 31, 2018**	As at March 31, 2017
Mortality table	IALM(2006-08) ult	IALM(2006-08) ult
Discount rate	7.70%	7.20%
Expected rate of return on plan assets	7.20%	7.80%
Rate of increase in compensation levels	7.00%	6.00%
Expected average remaining working lives (in years)	7.44	7.48
Withdrawal rate (based on grade and age of employees)		
Age upto 30 years	12.00%	12.00%
Age 31 - 44 years	12.00%	12.00%
Age 45 - 50 years	8.00%	8.00%
Age above 50 years	8.00%	8.00%

Changes in the present value of the defined benefit obligation recognised in balance sheet are as follows:

In ₹ Million

	As at March 31, 2018	As at March 31, 2017
Present value of obligation as at the beginning of the period	799.68	713.70
Interest expense	55.90	53.92
Current service cost	54.59	51.41
Benefits (paid)	(46.52)	(44.96)
Remeasurements on obligation [Actuarial (Gain) / Loss]	(8.65)	25.61
Closing defined benefit obligation	**855.00**	**799.68**

Changes in the fair value of plan assets recognised in the balance sheet are as follows:

In ₹ Million

	As at March 31, 2018	As at March 31, 2017
Opening fair value of plan assets	529.65	456.14
Interest income	39.84	36.94
Contributions	94.00	79.77
Benefits paid	(46.52)	(44.96)
Remeasurements		
Return on plan assets, excluding amount recognized in Interest Income - Gain / (Loss)	0.46	1.76
Closing fair value of plan assets	**617.43**	**529.65**
Actual return on plan assets	40.30	38.70

(a) Gratuity plan (Contd.):

Net Interest (Income/Expense)

In ₹ Million

	Year ended March 31, 2018	Year ended March 31, 2017
Interest (Income) / Expense – Obligation	55.90	53.92
Interest (Income) / Expense – Plan assets	(39.84)	(36.94)
Net Interest (Income) / Expense for the period	**16.06**	**16.98**

Remeasurement for the period [Actuarial (Gain)/loss]

In ₹ Million

	Year ended March 31, 2018	Year ended March 31, 2017
Experience (Gain) / Loss on plan liabilities	(24.58)	0.95
Demographic (Gain) / Loss on plan liabilities	-	-
Financial (Gain) / Loss on plan liabilities	15.92	24.66
Experience (Gain) / Loss on plan assets	(3.77)	(5.08)
Financial (Gain) / Loss on plan assets	3.32	3.32

Amount recognised in statement of Other Comprehensive Income (OCI)

In ₹ Million

	Year ended March 31, 2018	Year ended March 31, 2017
Remeasurement for the period-Obligation (Gain)/Loss	(8.65)	25.61
Remeasurement for the period-Plan assets (Gain)/Loss	(0.46)	(1.76)
Total Remeasurement cost/(credit) for the period recognised in OCI	**(9.11)**	**23.85**

The amounts to be recognised in the Balance Sheet

In ₹ Million

	As at March 31, 2018	As at March 31, 2017
Present value of obligation as at the end of the period	(855.00)	(799.68)
Fair value of plan assets as at the end of the period	617.43	529.65
Net asset / (liability) to be recognised in balance sheet	**(237.57)**	**(270.03)**

Expense recognised in the statement of profit and loss

In ₹ Million

	Year ended March 31, 2018	Year ended March 31, 2017
Current service cost	54.59	51.41
Net Interest (Income) / Expense (Refer note 30)	16.06	16.98
Net periodic benefit cost recognised in the statement of profit and loss	**70.65**	**68.39**

Reconciliation of net asset/(liability) recognised:

In ₹ Million

	As at March 31, 2018	As at March 31, 2017
Net asset / (liability) recognised at the beginning of the period	(270.03)	(257.56)
Company's contributions	94.00	79.77
Expense recognised for the year	(70.65)	(68.39)
Amount recognised in OCI	9.11	(23.85)
Net asset / (liability) recognised at the end of the period	**(237.57)**	**(270.03)**

The major categories of plan assets as a percentage of the fair value of total plan assets are as follows:

	As at March 31, 2018	As at March 31, 2017
Funds managed by insurer	100.00%	100.00%

Sensitivity analysis :

A) Impact of change in discount rate when base assumption is decrease/increase in Present value of obligation

In ₹ Million

Discount rate	As at March 31, 2018	As at March 31, 2017
Decrease by 1%	904.80	842.25
Increase by 1%	810.03	761.39

B) Impact of change in salary increase rate when base assumption is decrease/increase in Present value of obligation

In ₹ Million

Salary increment rate	As at March 31, 2018	As at March 31, 2017
Decrease by 1%	816.77	766.61
Increase by 1%	896.49	835.79

C) Impact of change in withdrawal rate when base assumption is decrease/increase in Present value of obligation

In ₹ Million

Withdrawal rate	As at March 31, 2018	As at March 31, 2017
Decrease by 1%	854.28	798.63
Increase by 1%	855.77	800.70

The estimates of future salary increases, considered in actuarial valuation, takes account of inflation, seniority, promotion and other relevant factors, such as supply and demand in the employment market.

The sensitivity analysis above has been determined based on a method that extrapolates the impact on defined benefit obligation as a result of reasonable changes in key assumptions occurring at the end of the reporting period.

The followings are the expected benefit payments to the defined benefit plan in future years :

In ₹ Million

Particulars	As at March 31, 2018	As at March 31, 2017
Within one year	177.15	220.98
After one year but not more than five years	392.02	291.68
After five years but not more than ten years	461.88	339.17

Weighted average duration of the plan (based on discounted cash flows using mortality, withdrawal and interest rate) is 6.88 years.

The average duration of the defined benefit plan obligation at the end of the reporting period is 11.17 years.

The Company expects to make a contribution of ₹ 3.72 crores (Previous year ₹ 10.20 crores) to the defined benefit plans during the next financial year.

The major categories of plan assets of the fair value of the total plan assets are as follows:

			(₹ in Crores)
	Gratuity (Funded Plan) As at 31.03.2017	***Gratuity (Funded Plan) As at 31.03.2016***	***Gratuity (Funded Plan) As at 01.04.2015***
Government of India securities (Central and State)	88.05	78.72	66.95
High quality corporate bonds (including Public Sector Bonds)	64.81	61.26	60.51
Diversified equity mutual funds focused on large cap stocks	2.51	1.15	-
Cash (including liquid mutual funds)	1.11	0.46	-
Others	6.49	3.43	1.29

Sch iii : Current vs Non Current

- Provision for gratuity – many times entirely treated as non current liability
- In case of funded post employment plan – amount due to the fund within next 12 months is treated as current liability.
- In case of unfunded post employment plan – settlement obligations on account of resignations, expected retirements / resignations would be classified as current liability and balance would be non-current liability.
    - The actuaries should be requested to provide break-up

Accounting Policies

Provident fund

- The Company operates two plans for its employees to provide employee benefits in the nature of provident fund.
- Eligible employees receive benefits from a provident fund, which is a defined benefit plan. Both the employee and the Company make monthly contributions to the provident fund plan equal to a specified percentage of the covered employee's salary. The Company contributes a part of the contributions to the "Bharat Forge Company Limited Staff Provident Fund Trust". The rate at which the annual interest is payable to the beneficiaries by the trust is being administered by the government. The Company has an obligation to make good the shortfall, if any, between the return from the investments of the trust and the notified interest rate.

Provident fund

- The cost of providing benefits under above-mentioned defined benefit plan is determined using the projected unit credit method with actuarial valuations being carried out at each balance sheet date, which recognizes each period of service as giving rise to additional unit of employee benefit entitlement and measures each unit separately to build up the final obligation.
- Remeasurements, comprising of actuarial gains and losses, the effect of the asset ceiling, excluding amounts included in net interest on the net defined benefit liability and the return on plan assets (excluding amounts included in net interest on the net defined benefit liability), are recognised immediately in the balance sheet as an asset / liability with a corresponding debit or credit to retained earnings through OCI in the period in which they occur. Remeasurements are not reclassified to profit or loss in subsequent periods.
- The employees which are not covered under the above scheme, their portion of provident fund is contributed to the government administered pension fund which is a defined contribution scheme.

Provident fund

- The Company has no obligation, other than the contribution payable to the provident fund. The Company recognizes contribution payable to the provident fund scheme as expenditure, when an employee renders the related service. If the contribution payable to the scheme for service received before the balance sheet date exceeds the contribution already paid, the deficit payable to the scheme is recognized as a liability after deducting the contribution already paid. If the contribution already paid exceeds the contribution due for services received before the balance sheet date, then excess is recognized as an asset to the extent that the pre-payment will lead to, a reduction in future payment or a cash refund

Gratuity

- The Company operates two defined benefits plan for its employee's viz. gratuity and special gratuity scheme. Payment for present liability of future payment of gratuity is being made to approved gratuity funds. The special gratuity scheme is unfunded. The cost of providing benefits under these plans is determined on the basis of actuarial valuation at each year end. Separate actuarial valuation is carried out for each plan using the project unit credit method.
- Remeasurements, comprising of actuarial gains and losses, excluding amounts included in net interest on the net defined benefit liability and the return on plan assets (excluding amounts included in net interest on the net defined benefit liability), are recognised immediately in the balance sheet as asset / liability with a corresponding debit or credit to retained earnings through OCI in the period in which they occur.

Gratuity

- Remeasurements are not reclassified to profit or loss in subsequent periods.
- Past service costs are recognised in statement of profit and loss on the earlier of:
  - The date of the plan amendment or curtailment, and
  - The date that the Company recognises related restructuring costs
- Net interest is calculated by applying the discount rate to the net defined benefit liability or asset. The Company recognises the following changes in the net defined benefit obligation as an expense in the statement of profit and loss:
- Service costs comprising of current service costs, past-service costs, gains and losses on curtailments and non- routine settlements; and
- Net interest expense or income

Superannuation

- Retirement benefit in the form of superannuation plan is a defined contribution plan. Defined contributions to insurance Company for employees covered under Superannuation scheme are accounted at the rate of 15% of such employees’ basic salary. The Company recognizes expense toward the contribution paid/ payable to the defined contribution plan as and when an employee renders the relevant service. If the contribution already paid exceeds the contribution due for service before the balance sheet date, the Company recognises that excess as an asset (prepaid expense) to the extent that the prepayment will lead to, for example, a reduction in future payments or cash refund. If the contribution already paid is lower than the contribution due for service before the balance sheet date, the Company recognises that difference as a liability. The Company has no obligation, other than the contribution payable to the superannuation fund

Privilege leave benefits

- Accumulated leave, which is expected to be utilized within the next 12 months, is treated as short-term employee benefit. The Company measures the expected cost of such absences as the additional amount that it expects to pay as a result of the unused entitlement that has accumulated at the reporting date.
- The Company treats accumulated leave expected to be carried forward beyond twelve months, as long-term employee benefit for measurement purposes. Such long-term compensated absences are provided for based on the actuarial valuation using the projected unit credit method at the year-end.
- Actuarial gains/losses are immediately taken to the statement of profit and loss and are not deferred. The Company presents the leave as a current liability in the balance sheet, to the extent it does not have an unconditional right to defer its settlement for 12 months after the reporting date. Where the Company has the unconditional legal and contractual right to defer the settlement for a period beyond 12 months, the same is presented as non-current liability.

Termination benefits

- Termination benefits are payable when employment is terminated by the Company before the normal retirement date, or when an employee accepts voluntary redundancy in exchange for these benefits. The Company recognizes termination benefits at the earlier of the following dates: (a) when the Company can no longer withdraw the offer of these benefits; and (b) when the entity recognizes cost for a restructuring that is within the scope of Ind AS 37 and involves payment of termination benefits. In the case of an offer made to encourage voluntary redundancy, the termination benefits are measured based on the number of employees expected to accept the offer. Benefits falling due more than 12 months after the end of the reporting period are discounted to present value.

Compare & Contrast

Difference between IND-AS 19 and IAS 19

- According to Ind AS 19 the rate to be used to discount post-employment benefit obligation shall be determined by reference to the market yields on government bonds, whereas under IAS 19 , the government bonds can be used only where there is no deep market of high quality corporate bonds.
- However, requirements given in IAS 19 in this regard have been retained with appropriate modifications for subsidiaries, associates, joint ventures and branches domiciled outside India.

IND AS 19 INTRODUCES THE CONCEPT OF NET INTEREST COST

- Ind AS 19 net interest cost is the difference between interest on Defined Benefit Obligation (DBO) and interest on assets.
- Interest on DBO, can be directly compared with '**interest cost**' under AS 15, and barring small timing related differences, these two will largely be the same
- Interest on assets can be compared with '**expected return on assets' (ERA) -** While the latter was calculated by making an explicit assumption on the expected rate of return, the corresponding IND AS 19 measure is just based on the opening discount rate.
- Expected rate of return which is a term in AS 15, is removed in IND AS 19 : The return on plan assets to be calculated using a discount rate

expected return vs actual return : on assets

- *ERA plus actuarial gain on assets equals actual return. Both ERA and actuarial gains are reported under P&L statement of AS 15. So effectively, it is the actual return on assets that affects the P&L expense, not the ERA.*

Impact on reporting companies:

- Under AS 15, the interest cost and actual return were two different things, behaving independently of each other. This meant that the impact of a change in discount rate may not be offset by the investment return earned. This caused volatility in the P&L statement. Under Ind AS 19, the finance costs on both assets and DBO are calculated based on discount rate only. This should act to further reduce the P&L volatility.

AS 15 vs IND-AS 19

- Recognition of Actuarial Gains and Losses (re-measurement)
  - AS 15 – P&L
  - IND-AS 19 – OCI
- Asset returns in excess of discount rate
  - AS 15 – P&L
  - IND-AS 19 – OCI
- Past Service Cost
  - AS 15 – over period of vesting / P&L - if vested
  - IND-AS 19 – immediately in P&L
- Asset Liability Matching Strategies
  - AS 15 – not required
  - IND-AS 19 – Description of such strategies, use of annuities and techniques like longevity swaps to manage risks

AS 15 vs IND-AS 19

- Experience history
  - AS 15 – Disclosed separately for liabilities and assets for 5 years
  - IND-AS 19 – Disclosed separately for liabilities and assets for 2 years
- Sensitivity Analysis of Significant Actuarial Assumptions
  - AS 15 - Not required , except for medical benefits
  - IND-AS 19 - Sensitivity analysis showing effect on DBO of each significant assumption reqd; A narrative description of the methods, assumptions and limitations of the above; Changes from previous period in the methods/assumptions to calculate sensitivity
- Information of Future Cash Flows
  - AS 15 - Not required , except next year contribution
  - IN—AS 19 - Description of funding arrangements and policy that affect future contributions; Maturity profile of DBO e.g. weighted average duration reqd.

AS 15 vs IND AS 19

- In IND AS 19, employee benefits arising from constructive obligations are specifically covered whereas AS 15 does not specifically covers the same.
- The term ‘employee’ includes directors in INDAS 19 whereas under AS 15 ‘employee’ includes whole-time directors
- Definitions of short-term employee benefits, other long-term employee benefits and past service cost as per AS 15 have been changed in IND AS 19
- How to deal with surplus in Multi Employer Plan – covered in IND AS 19 but not in AS 15R

AS 15 vs IND AS 19

- Participation in defined benefit plan (multi employer – related parties) may need disclosures of sharing of risks as they are "related party transactions" – this does not exist in AS 15R
- IND AS 19 encourages, but does not require, an entity to involve a qualified actuary in the measurement of all material post – employment benefit obligations ; AS 15 though does not require involvement of a qualified actuary, does not specifically encourage the same.
- AS 19 requires recognition of actuarial gains and losses in other comprehensive income. AS 15 requires recognition of actuarial gains and losses immediately in the profit and loss

AS 15 vs IND AS 19

- Paragraph 80 of IND AS 19 makes it clear that financial assumptions shall be based on market expectations, at the end of the reporting period, for the period over which the obligations are to be settled. AS 15 does not clarify the same
- Paragraph 165 / 166 of AS 19 provides guidance for timing of recognition of termination benefits. No guidance is available under AS 15

Related Parties & Consolidation

Asset/Liabilities of Trust

- In case an enterprise has created a separate trust to administer a defined benefit plan, whether or not the assets / liabilities will appear in standalone Balance Sheet?
- The assets and liabilities of the trust individually would not appear in the separate financial statements of the enterprise
- Where an enterprise has created a separate trust to administer a defined benefit plan, the fair value of the trust assets (net of liabilities) out of which the obligations are to be settled directly would be deducted from the present value of the defined benefit obligation and the net total would be recognised in the Balance Sheet

IND-AS 24 and IND-AS 110

- Should Gratuity Fund be shown as a Related Party transaction?
- Should Gratuity Fund be included in Consolidation of Financial Statements?
- IND-AS 24 : para 9(b)(v) : An entity is related to a reporting entity if any of the following conditions applies - The entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity
- IND-AS 110 : Scope para 4 (b): This Ind AS applies to all entities, except as follows - post-employment benefit plans or other long-term employee benefit plans to which Ind AS19, Employee Benefits, applies

F R R B Related Matters

Case Studies from FRRB for Discussions

- Gratuity and leave encashment are charged to Profit & Loss Account through a provision for accruing liabilities based on the assumption that such benefits are payable to eligible employees at the end of the accounting year
- In accordance with Accounting Standard 15 “Accounting for Retirement Benefits in the Financial Statements of Employers”, the company has made provisions for gratuity and leave encashment on accrual basis. The gratuity liability as on 31.03.2004 has been provided based on the assumption that such benefits are payable to all eligible employees at the end of the accounting year. The provision for leave encashment has been made based on current salary for the entire unavailed leave balance as at the balance sheet date.

Case Studies from FRRB for Discussions

- Post-retirement medical benefits were accounted for on the basis of actual eligible claims passed. No provision was made on this account during the tenure of service of employees.
- Leave encashment benefit is accounted for on a cash basis.
- No provision has been made for employee retirement benefits like gratuity. They will be charged to the Profit and Loss Account in the year of actual payment
- The liability towards Gratuity in respect of eligible employees is covered by a Group Gratuity Scheme with Life Insurance Corporation of India. The premium paid during the year under the Scheme is being charged to Profit and Loss Account.

Case Studies from FRRB for Discussions

- The present value of accrued gratuity liability valued by the Life Insurance Corporation of India on the annual renewal date i.e. 01-04-2004 amounted to Rs. 442.86 lacs. As against these funds available with LIC on renewal date amounted to Rs.1.53 lacs. Therefore, an amount of Rs.441.33 lacs is un- provided. The company expects to meet this liability in due course with enhanced funding of the contribution
- From the Annual Reports of some companies, it has been noted that although the liabilities for gratuity have been provided for but not separately shown in the Profit and Loss Account

Case Studies from FRRB for Discussions

- From the Annual Report of a company, it has been noted from the actuarial assumptions of defined benefit plan that different rates of future salary increases has been assumed for liability of gratuity funded; non-funded and leave encashment
- Provision for gratuity has been made on the basis of actuarial valuation in the accounts in respect of employees who have completed qualifying period of service
- From the Annual Report of a company, it has been noted that although detailed disclosure with respect to employee defined benefit plans have been given, however, corresponding amounts relating to previous year have not been disclosed.

Case Studies from FRRB for Discussions

- The Company extends the benefit of encashment of leave to its employees while in service as well as on retirement. As the company does not have any defined retirement benefit scheme in respect of Accounting Standard (AS) 15 issued by the ICAI is not considered applicable, encashment of leave accumulated while in service is at the option of employees and is accounted for as and when claimed, hence not provided.
- From the Annual Reports of some companies, it has been noted that expenditure incurred under voluntary retirement scheme which is being written off over a period of 5 years

Case Studies from FRRB for Discussions

- From the Annual Report of a company, it has been noted that there was difference between the figures of closing balances at the end of previous year and opening balance at the beginning of next period of defined benefit obligation as well as plan assets
- As per the accounting policy on employees benefits, the gratuity fund is administered through the scheme of insurance companies and the contribution to the above fund is charged against revenue

THANK YOU !!