

GN 27: Accounting for Compensatory Absence under Accounting Standards 15 (Revised).

Classification:

Practice Standard within the meaning of Section 4 “Breach of Professional Guidance” of **Professional Conduct Standards (PCS) Ver. 2.0.**

Legislation or Authority:

1. Accounting Standard (AS) 15 Employee Benefits (Revised 2005) issued by the Institute of Chartered Accountants of India – referred to herein as AS 15 (R).
2. ASB Guidance on Implementing AS 15 (R) issued by Accounting Standards Board of the Institute of Chartered Accountants of India.
3. Guidance Note: 26 (GN 26)
4. Professional Conduct Standards (PCS Ver. 2.0 / 27th May 2003) issued by Institute of Actuaries of India.

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Application:

This Guidance Note applies to any actuary advising on actuarial valuation relating to Compensatory Absence prepared as a requirement under AS 15 (R) and others who might be relied upon by a client/ employer/ insurer as a professional actuary giving professional advice.

Compliance:

Members are reminded that they must always comply with the PCS and this GN imposes additional requirements under specific circumstances.

Status:

Exposure Draft issued under due process in accordance with the “Principles and Procedures of Guidance Notes (GNs) (Ver2.00) [adopted by EC on 04032003]

Version

Effective From

0.1(1st Draft)

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Objective:

This Guidance Notes provides guidance to actuaries in making actuarial valuations and preparing actuarial reports related to compensatory absences as a requirement under AS 15 (R). The valuation methods, assumptions required and related reports are not discussed in this guidance and actuaries are required to refer GN 26.

Background:

Paragraph 7.2 of AS 15 (R) defines short-term employee benefits as those which fall due within twelve months after the end of the period in which the employees render the service. But paragraph 8(b) of AS 15(R) illustrates the term short-term benefits to include

short-term compensated absences (such as paid annual leave) where the absences are expected to occur within twelve months after the end of the period in which the employees render the related employee service. Hence there is a need for providing guidance for classification of the compensatory absences that fall due within twelve months but not expected to occur within twelve months after the end of the period in which the employees render the service.

Guidance:

1. Compensatory Absence as discussed in AS 15 (R) falls in to various categories as below:
 - a. Accumulating compensatory absences; and
 - b. Non-accumulating compensatory absences.
2. Non-accumulating compensatory absences do not carry forward and 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 enterprise. An enterprise recognizes no liability or expense until the time of the absence, because employee service does not increase the amount of benefit.

The maternity leave and paternity leave benefits fall under this category.

3. Accumulating compensatory absences: Accumulating compensatory absences may be vesting when the employees are entitled to a cash payment for unused entitlement on leaving the enterprise or non-vesting when employees are not entitled to a cash payment for unused entitlement on leaving. Some companies could have rules which make a leave remain in an accumulating status for a defined period and thereafter lapse so that from such point of time it would become non- accumulating.
4. The valuation of the compensatory absences has to be done according to principles of valuation under AS 15 (R) and GN 26.
5. The list of compensatory absences seen in India is given below. [This is not an exhaustive list]:
 - a. Casual Leave (CL);
 - b. Annual Leave / Privilege Leave/ Earned leave;
 - c. Sick Leave;
 - d. Maternity / Paternity Leave;
 - e. Other leave;

6. Any leave has to be classified in to a short-term employee benefit or a long-term employee benefit for the purpose of valuation as the principles depend very much on this classification.
7. **Short-term compensatory absences:** Short-term employee benefits include only those compensatory absences which accrue to the employees and are expected to be availed or encashed within twelve months after the end of the period in which the employees render the related service. Compensatory absences which satisfy this condition are to be classified as short-term compensatory absences.

Measurement

Short-term compensatory absences require measurement on an Actual basis rather than Actuarial basis. Measurement is based on leave at credit which needs to be availed within twelve months, Cost to Company (CTC) and probability that some portion of leave will lapse without giving rise to any liability.

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

Disclosures:

No disclosures are required.

CL is normally credited to the employees during the leave year and can be utilized during the year. The unutilized leave cannot be carried forward for future periods and will lapse at the end of the period. Hence CL is classified as short-term compensatory absence.

8. **Long-term compensatory absences:** Compensatory absences which can be and also expected to carry forward for any further period cannot be termed as “short-term employee benefits” and are classified as “Other long-term employee benefits”.

The leave rules of the enterprise and behavioral pattern of availment of such leave by all concerned employees are to be considered for classifying the compensatory absences in to “Other long-term employee benefits”.

If leave rules of the enterprise do not allow for full encashment or availment within twelve months after the end of the period in which the employees render the related service then such compensatory absences have to be classified as “other long term employee benefits”.

If leave rules of the enterprise allow for either for full encashment or availment within twelve months after the end of the period in which the employees render the related service but the relevant past behavioral pattern do not indicate availment or encashment within twelve months either partly or in full then the

compensatory absences have to be classified as “other long term employee benefits”.

In carrying out actuarial valuation of long term compensatory absence, it has to be further classified in to the following categories:

- i. Compensatory absence that can only be availed during the service but cannot be encashed at any point of time;
- ii. Compensatory absence that can be availed while in service and any unutilized leave that can be encashed on separation;
- iii. Compensatory absence that can be availed or encashed while in service and any unutilized leave that can be encashed on separation.

Measurement:

Long-term compensatory absences require measurement on an Actuarial basis. Availment of leave should take CTC for measurement purposes whereas encashment of leave should take the components as specified in the leave scheme rules of the enterprise. In respect of encashment, employer’s contribution to Provident Fund may have to be taken in to account.

The measurement basis would be different for each of the above categories and (i), (ii) and (iii) have to be taken care of in the actuarial valuation. The measurement should have regard to past experience, the additional amount the enterprise expects to pay as a result of the unused entitlement and the actuary’s judgment based on his experience of other similar schemes/ enterprises. The rules of the enterprise have to be referred for the expected pay that would be applicable with respect to each of these categories and the accounting practice of enterprise of monthly rated employees. Any assumptions on movements in future salaries will be subject to guidance provided in GN 26.

The actuary should satisfy himself that recognition and measurement principles as laid out in Para 129 and Para 130 of AS 15 (R) have been followed.

Disclosures:

No specific disclosures are required in respect of long-term compensatory absences.

Sick Leave falls in to first category where it can only be availed during the service but may not be encasheable at any point of time. Where encashment is permitted the treatment for valuation will be similar to long term compensatory absence.

Annual leave / Privilege leave/ Earned leave may fall either in to second or third category depending on the rules of the enterprise.

Assumptions:

For valuing sick leave the probability that an employee will avail sick leave and the proportion which could be availed during each year of projection period should be taken in to account. In arriving at the incidence rates the experience of the enterprise is to be considered and allowance should be made for leave that will lapse on separation without giving rise to any liability.

For valuing Annual leave / Privilege leave the probability that an employee availing the leave during each year of projection period should be taken in to account. In arriving at these rates the experience of the enterprise is to be considered and allowance should be made for employees' encashing the leave at the time of separation and/or while in service. The actuary should constantly endeavour to find the factors affecting the probability of availment and the proportion availed at different points of time during service of an employee by application of multiple regression or other suitable techniques and preferably make a brief comment in his report on this aspect.

Other Leave: It is possible that a few enterprises may allow unutilized Casual Leave in to other forms of leave such as Converted Sick Leave. Any such leave has to be taken in to account and the treatment of such leave should be in line with the type of leave to which the Casual Leave is converted. In this case where Casual Leave is converted in to Converted Sick Leave the treatment of this Additional Sick Leave will be similar to that of Sick Leave. However, the rules of the enterprise may specify that this Converted Sick Leave can be utilized by the employees only after exhausting the regular Sick Leave or subject such conversion to certain upper limits and these rules are to be taken in to account while valuing these benefits.

General: the main concepts in GN 26 continue to apply under this GN also. Where an actuary comes across situations not governed by this GN and GN 26, he may use his judgment as to the method to be used for the valuation.