Common Errors Found by FRRB in Implementation of AS 15 *Employees Benefits*

Financial Statements are the paramount source in hands of the stakeholders to understand the financial well-being of an enterprise. The users are highly reliant on the information depicted in the financial statements and therefore the preparers ought to ensure that the information presented in the financial statement is correct, complete, relevant and in adherence to the regulatory requirements. Financial Reporting Review Board (hereinafter referred as FRRB or Board) reviews the General Purpose Financial Statements (GPFS) of enterprises with the view to identify the non-compliances with Accounting and Auditing Standards, CARO, Companies Act, and other statutory requirements applicable in preparation and presentation of the financial statements. The non-compliances observed by the Board are compiled from time to time and published under the name of "Study on Compliance with Financial Reporting Requirement", till date three volumes of the aforesaid publication has been released by the Board. In addition, the Board also publishes articles in the 'Journal' of the Institute on non-compliances with various reporting requirements to disseminate the awareness amongst the members as well as general masses. This article deals with the non-compliances, observed by the Board, with disclosure requirements prescribed under Accounting Standard – 15.

1. Non-provisioning of Gratuity

Case

In the notes to the accounts, related to 'Employee Benefits', of one of the company following was mentioned regarding Provident Fund and Gratuity:

"The Company has a scheme of provident fund for its employees, registered with the Regional Provident Fund Commissioner. The Company's contributions to provident fund and employees' state insurance are charged to the Profit and Loss Account. The Company also has a scheme of employees' state insurance for its employees, registered with the Employees State Insurance Corporation. The company had no voluntary retirement scheme during the period under report. None of the employees have completed five years, hence gratuity has not been provided."

Accordingly, the company has not provided for the gratuity stating that none of its employee has completed the mandatory period of five years.

Contributed by Financial Reporting Review Board (FRRB) of the ICAI. Comments can be sent to frrb@icai.in

Principle

Matching Concept: All costs relating to financial period should be recognised in the books when related revenue is recognised.

Observation

The Board, while reviewing the financial statement has concluded that company ought to create a provision for gratuity liability irrespective of the fact that none of the employee has completed the mandatory period of five years. It was viewed that the employee's right to receive the benefit is conditional on future employment for a period of five years. Although there is a possibility that the benefit may not vest, there is also a probability that the employee would serve for the minimum period of five years and become eligible for gratuity. ***Under matching concept 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. A similar view was taken in Guidance on Implementing AS 15, Employee Benefits (revised 2005), issued by the Accounting Standard Board.

2. Inadequate disclosure in policy pertaining to liability for superannuation fund

Case

Accounting Policy on Employee Benefits of one of the company included following:

"Defined Contribution Plan: Liability for superannuation fund on the basis of premium paid to insurance company in respect of employees covered under superannuation Fund Policy."

Principle

It may be noted that the recognition and measurement requirement of Paragraph 45 of AS 15, Employee Benefits requires:

"45 When an employee has rendered service to an enterprise during a period, the enterprise should recognise the contribution payable to a defined contribution plan in exchange for that service:

(a) as a liability (accrued expense), after deducting any contribution already paid. If the contribution already paid exceeds the contribution due for service before the balance sheet date, an enterprise should recognise that excess as an asset (prepaid expense) to the extent that the prepayment will lead to, for example, a reduction in future payments or a cash refund; and

(b) …."

Observation

Accordingly, it was observed that the liability for superannuation fund was being provided for on the basis of premium paid to insurance company. However, **it had not been disclosed by the company as to whether the said premium is the appropriate accrual of the liability for the year or not. The company had also not indicated as to whether the scheme covers all past as well as present liabilities or it covers only the present liability for the current year**. It was felt that in the absence of specific mention to this effect, one may conclude that the scheme does not cover past liabilities and / or that the premium charged is not the appropriate accrual of the liability. Therefore, if that being the case, the company ought to create a provision for past liability in the books and/ or additional liability for the year, as appropriate. However, in case the company has ignored this aspect, then it would be considered as non-compliance of Paragraph 45 of AS 15, Employee Benefits as well as accrual basis of accounting.

3. No disclosure or inadequate disclosures pertaining to para 120

Case

In many of the cases it was observed that although the company has recognised the defined benefits obligations in the financial statement, however, disclosures required under paragraph 120(a) to 120(o) of AS 15 were not made. One of such example is given below:

"Accounting Policy on Retirement Benefits of one of the company read as follows:

Employee Benefits:

a. Liability for Gratuity: Company's liability towards Gratuity in respect of employees is worked out on actuarial basis. The total liability as on 31.03.20XX is ₹ 150.77 lakhs. Out of which ₹ 54.38 lakhs has been funded and balance ₹ 96.39 lakhs is yet to be funded.

b. Contributions to Provident Fund are made as per the provisions of Employees' Provident Funds and Miscellaneous Provisions Act, 1952 and remitted to the provident Fund Commissioner."

Principle

It may be noted that as per Accounting Standard 15, if the employer provides retirement benefit viz. gratuity to its employees then the company is required to disclose certain information as specified under paragraph 120 of the AS 15, Employee Benefits, notified under the Companies (Accounting Standards) Rules, 2006:

"120. An enterprise should disclose the information about defined benefit plan as mentioned in clause (a) to (o)"

Observation

It was observed from the accounting policy relating to gratuity for employees that the company is providing benefits in the nature of defined benefits plans, accordingly, **it was viewed that the disclosures requirements prescribed under paragraph 120 of AS 15 should have been complied with in context of both liabilities for gratuity. However, it was observed from Notes to Accounts that no disclosures have been made with regard to the same**. It is again a non-compliance of AS 15.

4. Defined Benefit Plan wrongly treated as Defined Contribution Plan

Case

Abstract of the accounting policies of enterprises is reproduced below:

i. Accounting policy on employee benefits of one of the company stated as follows:

"Post- employment benefits: *Defined Contribution plans*

Defined contribution plans are provident fund scheme and part of the pension fund scheme for eligible employees. The Company's contribution to defined contribution plans are recognised in the profit and loss account in the financial year to which they relate. The Company makes specified monthly contribution towards employee provident fund and pension fund to respective trusts administered by the Company. The minimum interest payable by the provident fund trust to the beneficiaries every year is notified by the Government. The company has an obligation to make good the shortfall, if any, between the return on investments of the trust and the notified interest rate."

ii. Accounting Policy of one of the company stated as follows:

"Contribution to Defined Contribution Schemes such as Provident Fund etc., are charged to the Profit & Loss Account as and when incurred. In respect of certain employees who have not opted for Pension Benefits, Provident Fund Contributions are made to a trust administered by the Bank."

Principle

While reviewing the above cases, Board viewed that **the provident fund scheme administered through trust should be treated as defined benefit plan rather than defined contribution plan**. It may be noted that while answering the question "Whether a provident fund which guarantees a specified rate of return is a defined benefit plan or a defined contribution plan", the ASB Guidance on Implementing AS 15, Employee Benefits (revised 2005) states that "Section 17 of the Employees Provident Funds (EPF) Act, 1952 empowers the Government to exempt any establishment from the provisions of the Employees' Provident Scheme, 1952, provided that the rules of the provident fund set up by the establishment are not less favourable than those specified in section 6 of the EPF Act and the employees are also in enjoyment of other provident fund benefits which on the whole are not less favourable to the employees than the benefits provided under the Act. *The rules of the provident funds set up by such establishments (referred to as exempt provident funds) generally provide for the deficiency in the rate of interest on the contributions based on its return on investment as compared to the rate declared for Employees' Provident Fund by the Government under paragraph 60 of the Employees' Provident Fund Scheme, 1952 to be met by the employer. Such provision in the rules of the provident fund would tantamount to a guarantee of a specified rate of return.* ***As per AS 15, 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".***

Observation

Accordingly, it was viewed that any provident fund scheme administered through trust where shortfall in the interest rate is met by the company would be a defined benefit plan rather than defined contribution and therefore company ought to comply various requirements of AS 15 pertaining to defined benefits plan.

5. Non-Disclosure pertaining to para 47

Case

In many of the instances the amount of expense for defined contribution were not disclosed by the enterprises.

Principle

It may be noted that Paragraph 47 of AS 15 requires as follows:

"An enterprise should disclose the amount recognised as an expense for defined contribution plan."

Observation

Accordingly, it was viewed that **since paragraph 47 explicitly requires the disclosure of amount recognised as an expense for defined contribution plan**, the same should be shown in the financial statements making appropriate disclosures.

6. Inadequate disclosure pertaining to para 65

Case

In many of the instances it was noted that although the accounting policy on employee benefits stated that defined benefit obligations has been determined using the services of qualified actuary, however, no disclosure was made regarding whether the projected unit credit method was followed in determination of defined benefit obligations or not.

Principle

It may be noted that **Paragraph 65 of AS requires the use of projected unit credit method for determining the present value of defined benefit obligations.** Requirements of Paragraph 65 is reproduced below:

"An enterprise should use the Projected Unit Credit Method to determine the present value of its defined benefit obligations and the related current service cost and, where applicable, past service cost."

Observation

Accordingly, it was viewed that enterprises should be encouraged to give appropriate disclosures in the financial statement so as to enable the readers to understand that projected unit credit methods was followed for determining the defined benefits obligations. ■

Never ruin an apology with an excuse. – Benjamin Franklin