As companies prepare to move over from the existing Indian GAAP AS 15 to the new IFRS-adapted Ind AS 19 for Employee Benefits from financial year 2016-17, could the transition effort and cost be optimised?

Mayur Ankolekar argues for an efficient alternative to measure, recognise and disclose employee benefits cost to deter dual reporting in FY 2015-16

The first phase of IFRS adaptation to employee benefits i.e. Ind AS 19 applies to companies with net worth over Rs 500 crores. Such companies would ordinarily report under the present AS 15 for FY 2015-16, and move over to Ind AS 19 in FY 2016-17.

Elements of Transition

Whilst applying Ind AS to employee benefits for the first time it is essential to appreciate the transition provisions. Under Ind AS 101 titled "First Time Adoption of Indian Accounting Standards", in the first year of the new IFRS adapted accounting regime, the previous year's figures need to be re-classified as per Ind AS 19. Clause 7 of Ind AS 101requires entities to use the same accounting policies in opening Ind AS Balance Sheet and for comparative purposes, throughout all periods presented in its first Ind AS financial statements.

Each entity that adopts Ind AS 19 "Employee Benefits" needs to apply the principles of Ind AS 101 for first-time adoption.

The accounting of employee benefits is not listed in the exceptions to retroactive application of Ind ASs as outlined in Appendix B of Ind AS 101. Each entity that adopts Ind AS 19 "Employee Benefits" needs to apply the principles of Ind AS 101 for first-time adoption.

In the example elucidated under clause 8 of Ind AS 101, an entity required to apply the Ind ASs for periods ended 31 March 2017 needs to:

a) prepare and present its opening Ind AS balance sheet at 1 April 2015; and
b) prepare and present its balance sheet for 31 March 2017 (including comparative amounts for the year ended 31 March 2016), statement of profit and loss, statement of changes in equity and statement of cash flows for the year to 31 March 2017 (including comparative amounts for the year ended 31 March 2016) and disclosures (including comparative information for the year ended 31 March 2016).

Reporting in the Transition Year

As per the transition provisions enshrined in Ind AS 101, companies that transition to Ind AS 19 in FY 2016-17 would need to report even the figures of FY 2015-16 under Ind AS 19. Would it occasion pension actuaries to issue two sets of numbers for FY 2015-16 i.e., one under AS 15 and the other under the looming Ind AS 19? Is there an efficient alternative to measure employee benefits cost? The discussion hereon highlights how actuaries could work with employers to economise the effort, rather preclude dual reporting in FY 2015-16.

Is there an efficient alternative to measure employee benefits cost? The discussion hereon highlights how actuaries could work with employers to economise the effort, rather preclude dual reporting in FY 2015-16.

Ind AS 19 differs from AS 15 on two dimensions: first, the quantitative and second, the qualitative. The qualitative list has new disclosures viz. Asset Liability Matching Strategies, Sensitivity Analysis of Significant Actuarial Assumptions, and Information of Future Cash Flows. The quantitative lineup sprawls new treatment viz. all of Actuarial Gains and Losses and Asset Ceiling Charge to Other Comprehensive Income, and Past Service Cost to Profit and Loss Account.

Quantitative grammar of Ind AS 19

In the vital grammar of quantitative dimension, if all the numerical results that comprise actuarial gains and losses, past service cost and asset ceiling are identical between AS 15 and Ind AS 19 in FY 2015-16, it would be unnecessary to issue two sets of reports. Rather only a

	Recognition		Measurement
	AS 15 (R)	Ind AS 19	Differences between AS 15 (R) and Ind AS 19
Past Service Cost	P&L, to the extent vested	P&L irrespective of vesting	No change
Asset Ceiling Charge	P&L	OCI	No change
Actuarial gains and losses - liabilities	P&L	OCI	No change
Actuarial gains and losses - assets	P&L	OCI	The company sets the "expected rate of return on assets" assumption in AS 15 (R). Expected rate of return equals the discount rate at start of year in Ind AS 19.

Box 1: Significant measurement and recognition differences between AS 15 (R) and Ind AS 19

re-classification between the Profit and Loss Account (P&L) and Other Comprehensive Income (OCI) would suffice. The assumptions and methodologies underlying calculation of actuarial gains and losses and past service cost in the defined benefit obligation and the asset ceiling calculation are identical between AS 15 and Ind AS 19.

The differences across measurement and recognition of various items are shown in Box 1. The only relevant quantitative or measurement difference between AS 15 and Ind AS 19 rests in the calculation of return on plan assets and thus, the actuarial gain or loss on plan assets.

If the expected rate of return on plan assets equals the previous year's discount rate, the numerical results would be just that: indistinguishable between AS 15 and Ind AS 19.

Whilst employers have no choice in setting the rate of return on plan assets from FY 2016-17, for FY 2015-16 they need to set the expected rate of return on plan assets. Juxtapose the Clause 108 of AS 15 (Revised 2005) as applicable to FY 2015-16 on one hand and Clause 123 of Ind AS 19 as applicable to FY 2016-17 on the other: the former states that the expected return on plan assets is based on market expectations at the beginning of the period while the latter prescribes the discount rate at the start of the period for calculating the net defined benefit liability.

If the expected rate of return on plan assets equals the previous year's discount rate, the numerical results would be just that: indistinguishable between AS 15 and Ind AS 19. Only the re-classification between Profit and Loss Account and Other Comprehensive Income would have to be performed!

	FY 2016-17	FY 2015-16	FY 2014-15
Discount Rate	7% p.a.	7.5% p.a.	8% p.a.
Expected Rate of Return on Assets (Scenario 1)	7.5% p.a.	9% p.a.	NA
Expected Rate of Return on Assets (Scenario 2)	7.5% p.a.	8% p.a.	NA

Table 1: Parameters under Scenarios 1 and 2

	FY 2016-17	FY 2015-16
Fair Value of Plan Assets at start of year	430	400
Contributions by Employer	60	60
Benefits Paid	(80)	(50)
Expected Return on Plan Assets	34	36
Actuarial (Loss)/Gain	16	(16)
Fair Value of Plan Assets at end of year	460	430

Table 2: Scenario 1 (FY 2015-16's EROA ≠ FY 2014-15 discount rate)

	FY 2016-17	FY 2015-16
Fair Value of Plan Assets at start of year	430	400
Contributions by Employer	60	60
Benefits Paid	(80)	(50)
Expected Return on Plan Assets	34	32
Actuarial (Loss)/Gain	16	(12)
Fair Value of Plan Assets at end of year	460	430

Table 3: Scenario 2 (FY 2015-16's EROA = FY 2014-15 discount rate)

A Tale of Two Scenarios

Tables 2 and 3 set out two scenarios for FY 2015-16: the first, when expected rate of return on plan assets doesn't equal to the previous year's discount rate, and the second, when it is equivalent. Table 1 populates the parameters.

Assume a company finalizes its financial statements as per the first scenario i.e., the FY 2015-16's expected rate of return on plan assets does not equal to the FY 2014-15's discount rate. In such a case, while the company adopts Ind AS 19 in FY 2016-17, the figures for FY 2015-16 have to be re-worked in line with the principle that the return on plan assets equals the previous year's discount rate. However, if the company had adopted the principle enunciated in the second scenario, the actuarial loss would not have to be re-worked.

Simplistically, the actuarial loss of 12 would have to be re-classified from 'Profit and Loss Account' to 'Other Comprehensive Income' – hitting the spot with no additional reporting effort. If the company had followed the first scenario, a re-working of the actuarial loss from 16 to 12 would have been necessary on transition to Ind AS 19.

Expected Returns in Indian DB plans

When would it be plausible for the expected rate of return anticipated at the start of the year to exactly match the discount rate measured from the end of the previous year? Expected return on assets is drawn from the yield expectation of the carrying value of an asset to the owner's expected holding period. It needs to allow for credit quality, duration and the holder's and issuer's options, if any.

From an unpublished research of the asset strategy of defined benefit employee funds, my co-authors and I have found that 30 of the NSE 50 companies either manage assets in-house or use conventional insurer plans. In-house management of assets, being driven by investment norms applicable to tax-exempt funds, is dominated by Central and State Government bonds. Historically, conventional insurer plans also declared returns that veered around the prevailing Government bond yields. Arguably, a large section of Indian companies could be sensitized to set the FY 2015-16's assumption of expected return on plan assets at FY 2014-15's discount rate – indeed the market yield on government bonds at the valuation date.

Epilogue

Confucius had famously remarked, "He who does not economise, would agonise." I encourage my colleagues in the profession to see how we could work with clients and their auditors to influence a resource-optimal transition where the employee benefits cost' measurement would not change between the Indian GAAP and IFRS adapted regimes, but only the recognition would.

About the Author

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