



Actuarial Valuation in Employee Benefits: Accounting (AS15, Ind AS19) and Auditing Aspects

Presentation at Western India Regional Council of ICAI

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Date: 21-12-2022 Time: 5pm to 7pm

Agenda

Introduction to Actuarial Valuation

Regulatory requirements of Gratuity and Leave, it's provision

Actuarial Valuation Assumptions

Actuarial Valuation - Calculation Example

Practical aspects of Actuarial Valuation

Sample Audit Check Points

Q&A and Open Forum Discussion

Types of Employee Benefits

Classification of employee benefits

Short-term Benefits

Examples:

- Salary & Wages
- ST Compensated Absences like:
 - 1.Paid annual leave
 - 2.Paid sick leave
 - 3.Short-term disability
 - 4.Maternity leave
- ST Profit-sharing & Bonus
- Non-monetary benefits:
 - 1.Access to medical care
 - 2.Housing

Post-Employment Benefits

Defined Benefit:

- Gratuity
- Pension
- Post-employment life insurance
- Post-employment medical care

Defined Contribution:

- EPF Contribution to RPFC
- NPS
- DC Pension

Other Long-term Benefits

Examples:

- Long-term Paid Absences
- Long-term disability benefits
- Long-term Bonus
- Deferred Incentive
- Phantom Stock

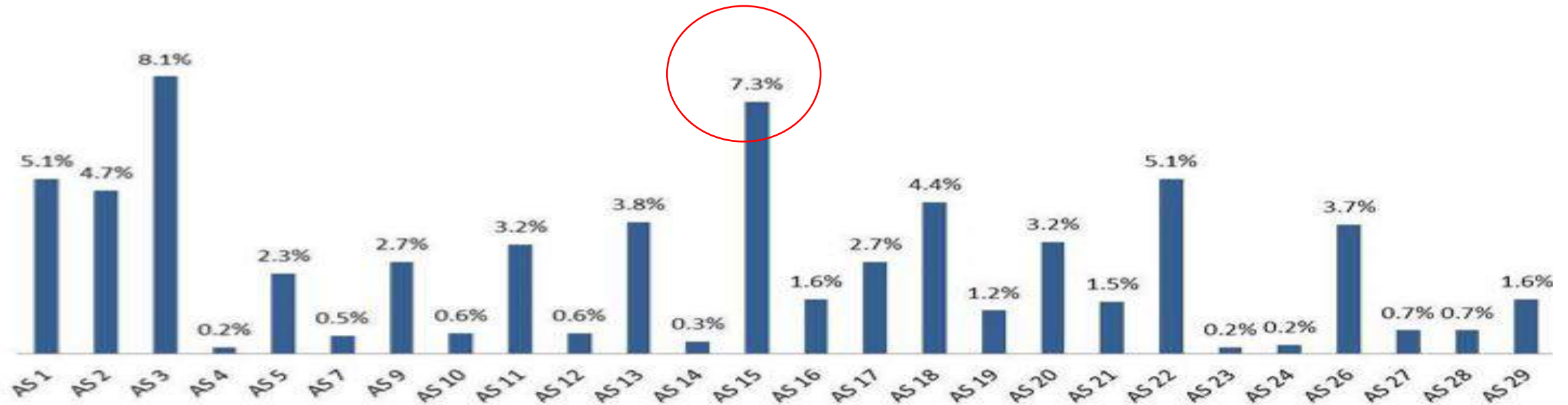
Termination Benefits

Examples:

- Voluntary Retirement

AS Deficiencies identified by Financial Reporting Review Board of ICAI

Graphical Presentation of Accounting Standards



Summary of AS 15 Applicability – “Companies”

Type of Benefits	Provision Required	Provision as per Actuarial Valuation – PUCM Method	Detailed Disclosure in Notes to Accounts
A. Short-Term	✓	✗	✗
B. Post-Employment – Defined Benefits (e.g. Gratuity, Pension)			
Non-SMC Company	✓	✓	✓
SMC Company	✓	✓	✗
C. Other Long-Term (e.g. Leave, Long Service Award)	✓	✓	✗
D. Termination Benefit	✓	✗	✗

Definition of SMC and Non-SMC Company (turnover and borrowing are criteria) as Applicable:

- Accounting period till 31.03.2021: http://www.mca.gov.in/Ministry/notification/pdf/Notification_GSR_739.pdf
- Accounting period on or after 01.04.2021: <https://egazette.nic.in/WriteReadData/2021/227890.pdf> (Page 329)

[Link to Definition](#)

*For Small and Medium sized Companies (SMC), Detailed Disclosure are exempted, though provision is required as per “**Actuarial Valuation PUCM Method**”.*

Summary of AS 15 Applicability – “Non Company Entities”

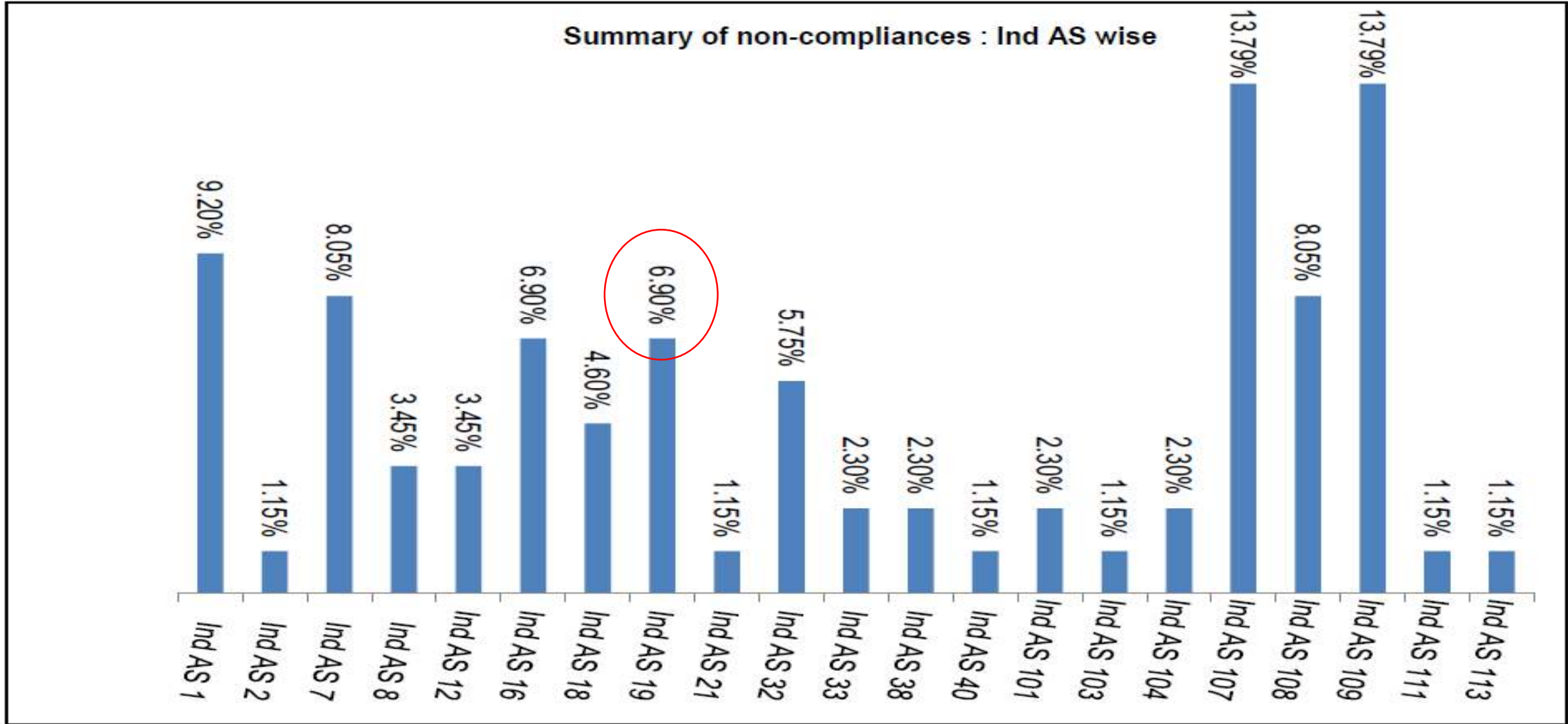
Particulars	Level I	Level II	Level III	Level IV
Applicability of AS 15 - Employee Benefits	Full Applicable	With Exemptions	With Exemptions	With Exemptions
Gratuity/ Leave/ Long Service Award				
A. Provision in accounts Required?	Yes	Yes	Yes	Yes
B. Provision as per <u>Actuarial Valuation PUCM Method</u>?				
Employees <u>50</u> or more:	Yes	Yes	Yes	Exempted
Employees <u>Less than 50</u> :	Yes	Exempted	Exempted	Exempted
C. Detailed Disclosure for Gratuity?	Yes	Exempted	Exempted	Exempted

Definition for Applicability of Level I/II/III/IV - Non Corporate Entities for Accounting periods commencing on or after April 1, 2020 as Issued by ICAI: <https://resource.cdn.icai.org/64269asb51535.pdf>

[Link to Definition](#)

In case *Actuarial Valuation is exempted* for specific class of entities, such entities may calculate and account for the accrued liability under the defined benefit plans by reference to some other rational method.

Ind AS Deficiencies identified by Financial Reporting Review Board of ICAI



Summary of Ind AS 19 Applicability

Type of Benefits	Provision Required	Provision as per Actuarial Valuation – PUCM Method	Detailed Disclosure in Notes to Accounts
A. Short-Term	✓	✗	✗
B. Post-Employment			
Defined Contribution (e.g. Contribution to EPFO, NPS)	✓	✗	✗
Defined Benefits (e.g. Gratuity, Pension)	✓	✓	✓
C. Other Long-Term (e.g. Leave, Long Service Award)	✓	✓	✗
D. Termination Benefit	✓	✗	✗

In case of Ind AS 19 - No exemption from Detailed Disclosure



Regulatory requirements of Gratuity and Leave, it's provision

Actuarial Valuation of Employee Benefits

Gratuity Eligibility as per 10 Employees (Post employment)

Leave Provisions as per Shops Establishment Act (Other long term)

Para 72 of Ind AS 19/ Para 70 of AS 15 – Gratuity Provision even service less than 5 years

Ind AS 19/ AS 15 - Provision as per Projected Unit Credit Method

Ind AS 19/ AS 15 - Detailed Disclosure to Notes to Accounts

Gratuity Actuarial Valuation

Regulation

- Gratuity Act, 1972
- All Organisations
- More than 10 Employees
- 5 Years vesting
- 20 lakhs limit

Accounting

- Accrual Principle
- AS 15/ Ind AS 19
- Actuarial Valuation as per PUC method
- **Mandatory for all size Companies**
- Provision **even if** service **less than 5 years**

Taxation

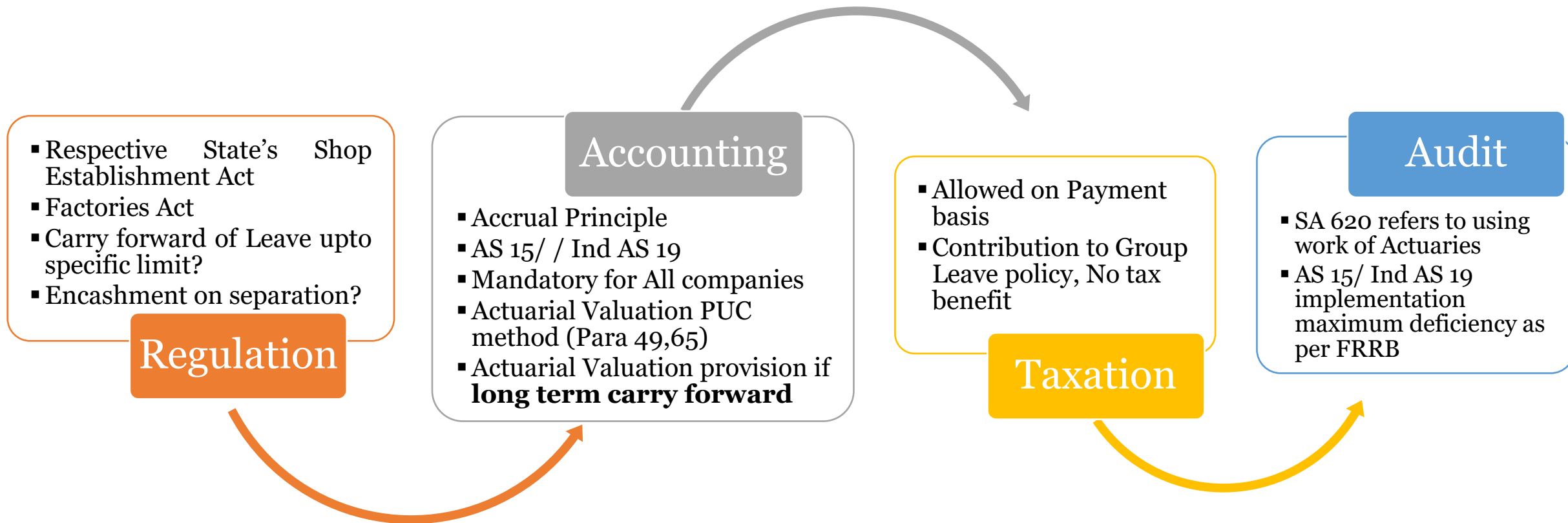
- Allowed on Payment basis
- Contribution to 'Approved Gratuity Fund' Allowed [36(1)(v)]
- Contribution limit 8.33% (Rule 103)

Audit

- SA 620 refers to using work of Actuaries
- AS 15/ Ind AS19 implementation maximum deficiency as per FRRB

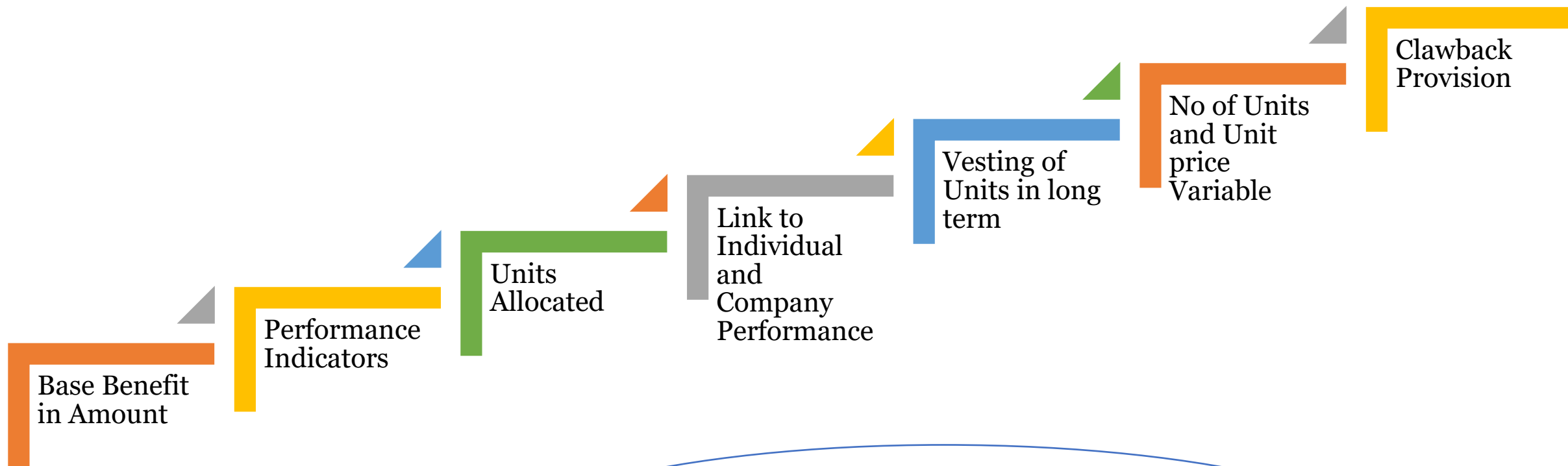
*All companies having 10+ Employees need to make Provision for **Gratuity** as per Actuarial Valuation method **PUCM** to comply with AS15/ Ind AS19.*

Leave Actuarial Valuation



*Maharashtra, Karnataka, Delhi shop act – limit 45 days
Factories Act 1948, Rajasthan shop act – limit 30 days
Gujarat shop act– limit 63 days
(encashment in all above)*

Deferred Incentive Scheme



*Customized company specific schemes to provide variable benefit.
Expense is recognised as per AS 15/ Ind AS 19 as other long term benefit obligation.*



Actuarial Valuation Assumptions

Salary Escalation & Attrition Rate

Can be based on past trend and allow for future outlook

Assumption analysis at regular intervals

Category wise?

Short term/ long term

Service Specific/ Age Specific

Discount Rate

Based on *Expected* Working Term of Obligation/ Expected Future Service

Source – **FBIL** (mostly used by RBI regulated entities)

‘Fixed Income Securities’ tab under ‘GSEC’

Select required date in from and to, download G-sec excel file

Go to sheet >>Par-Yield. We need to select annualized rates.

While in Service Leave Availment Rate

Expected leave utilisation in the future years out of the accumulated leave

Should be valued on CTC

Can be based on past trend and allow for future outlook

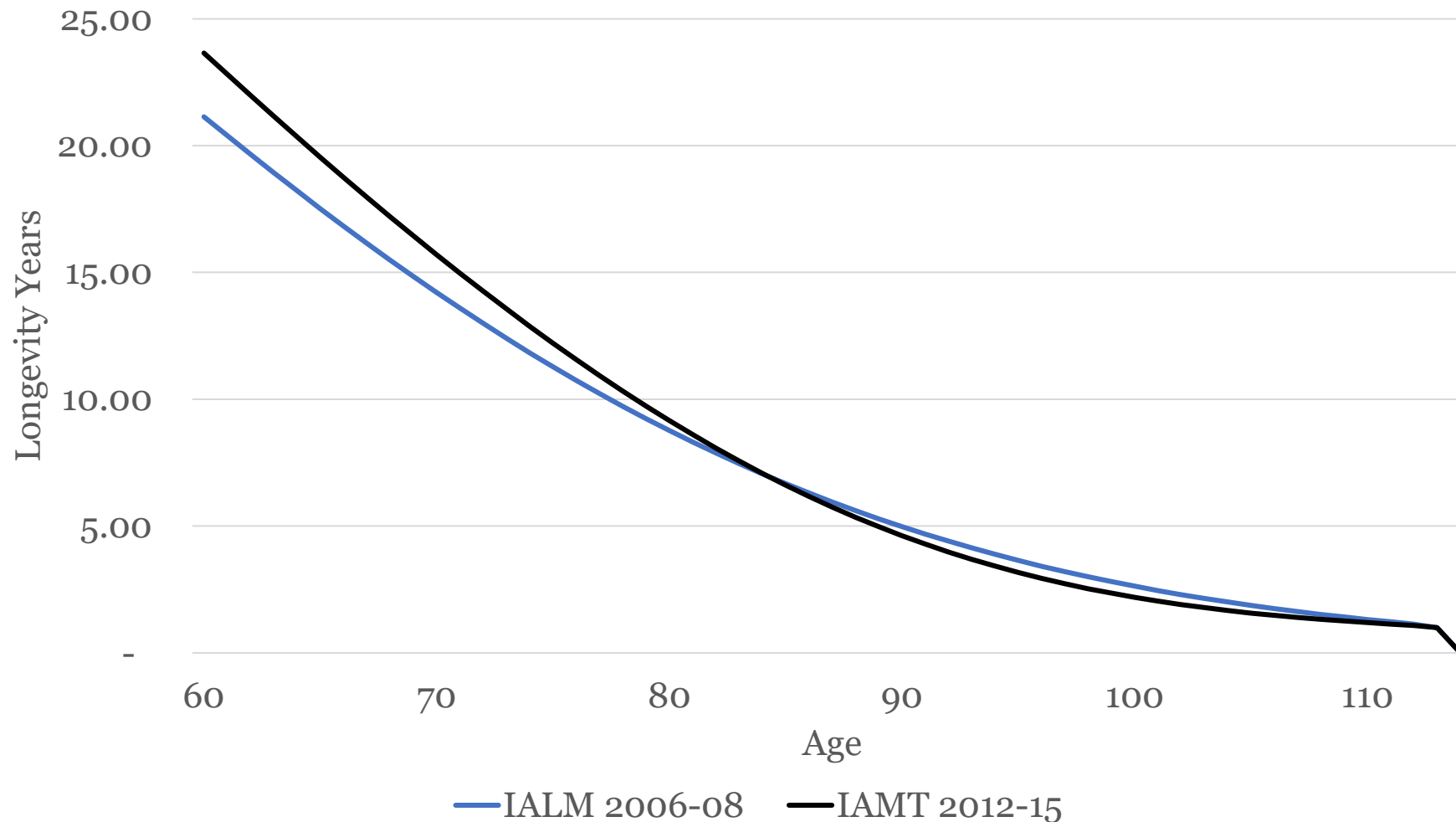
$(\text{Leave Availed} - \text{Leave Credited}) / \text{Opening Leave Balance}$

(Applicable only when availed days are greater than the current leave credited, else availment rate is 0%)

Alternative method - $(\text{Closing Leave Balance} - \text{Opening Leaves Balance}) / \text{Opening Leaves Balance}$ (if while in service encashment not allowed)

Mortality Rate : Post-Retirement

Comparison of Longevity (Life Expectancy)
IALM 2006-08 and IAMT 2012-15 over ages 60 and above



**Indian Assured
Lives Mortality
2006-08 Ultimate**

**Indian Individual
Annuitant's
Mortality Table
(2012-15)**



- All Genders
- Effective From 1st April, 2021
- Longevity increase by 2.61 years at age 60 years



Actuarial Valuation Calculation Example

Actuarial Valuation Method - PUCM



Calculated for each:

- Type of benefit payment
- Projected year till retirement age
- Employee

$$\text{Obligation} = \text{Projected Benefit} \times \text{Probability} \times \text{Discounting}$$

Actuarial Valuation Calculation Example

Example

- Monthly Eligible Salary: INR 100,000
- Age: 30 years
- Service: 2 years
- Retirement Age: 58 years

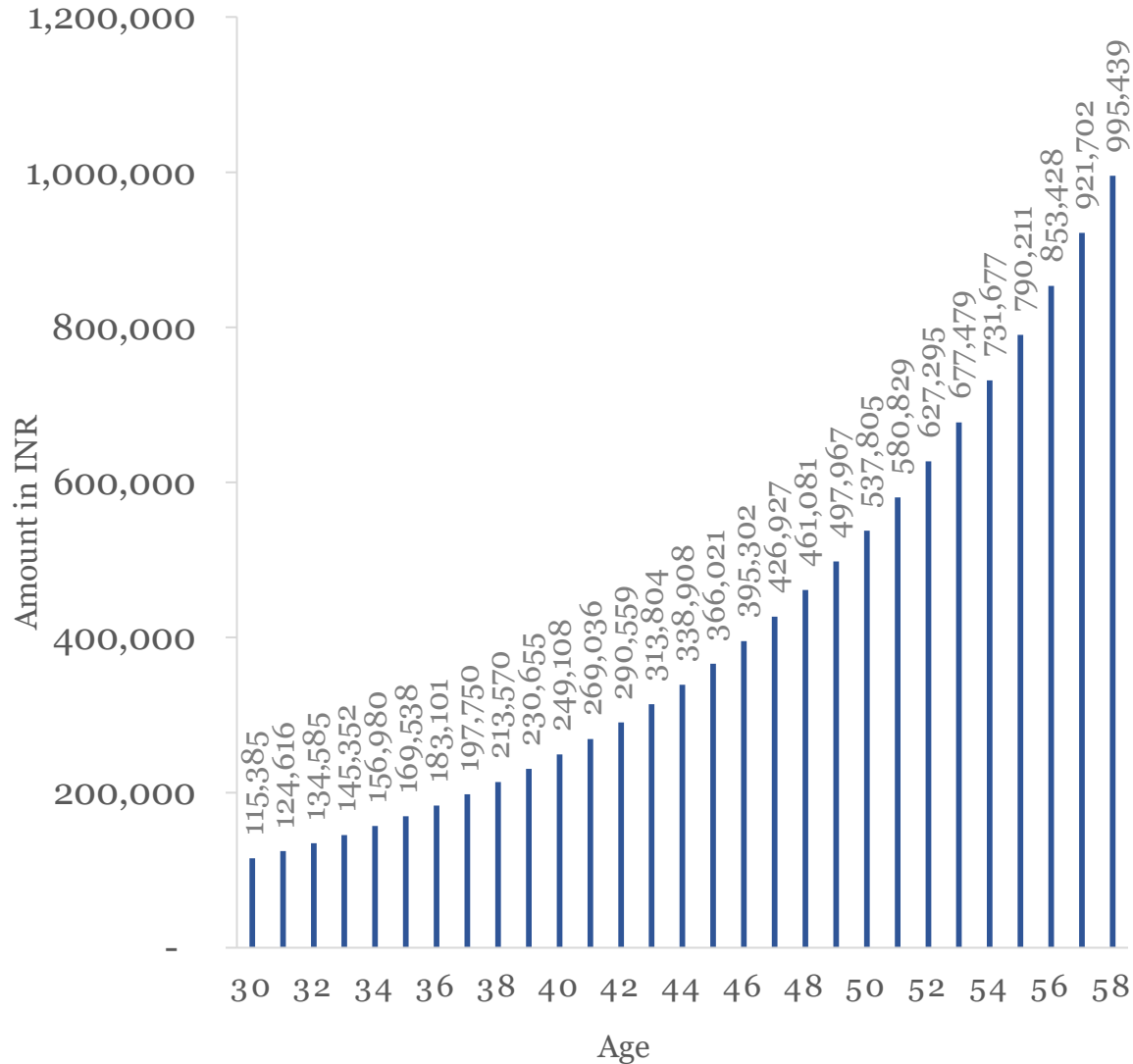
Gratuity as per Gratuity Act, 1972

- Financial Assumptions
 - Discount Rate : 6.90% p.a.
 - Salary Escalation : 8.00% p.a.
- Demographic Assumptions
 - Mortality Rate – IALM (2012-14)
 - Attrition Rate – 10.00% p.a.

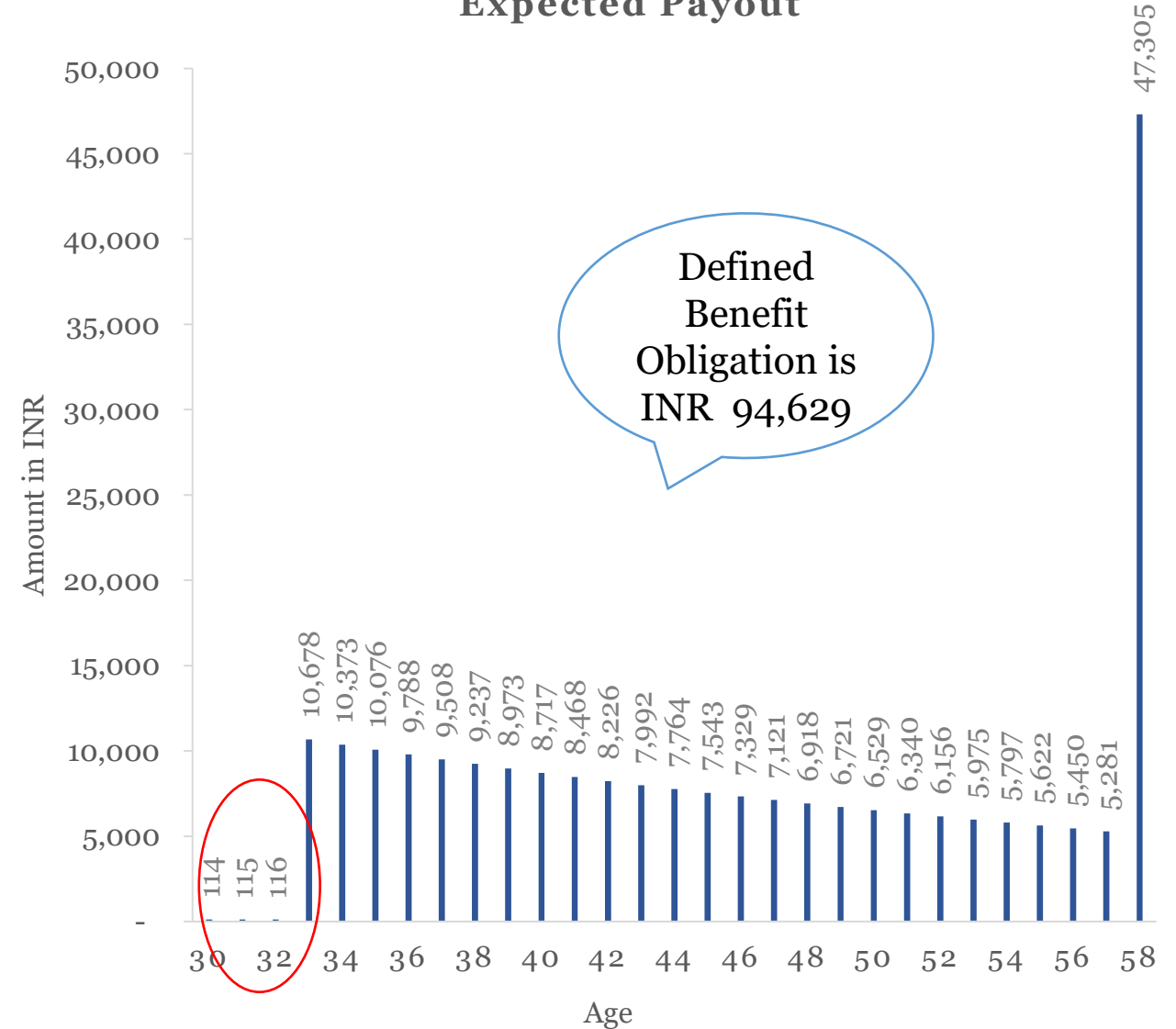
Accrued Amount = $15/26 * 2 * 100,000$ capped at INR 20 Lakhs = INR 115,385

Actuarial Valuation Calculation Example

Projected Accrued Amount



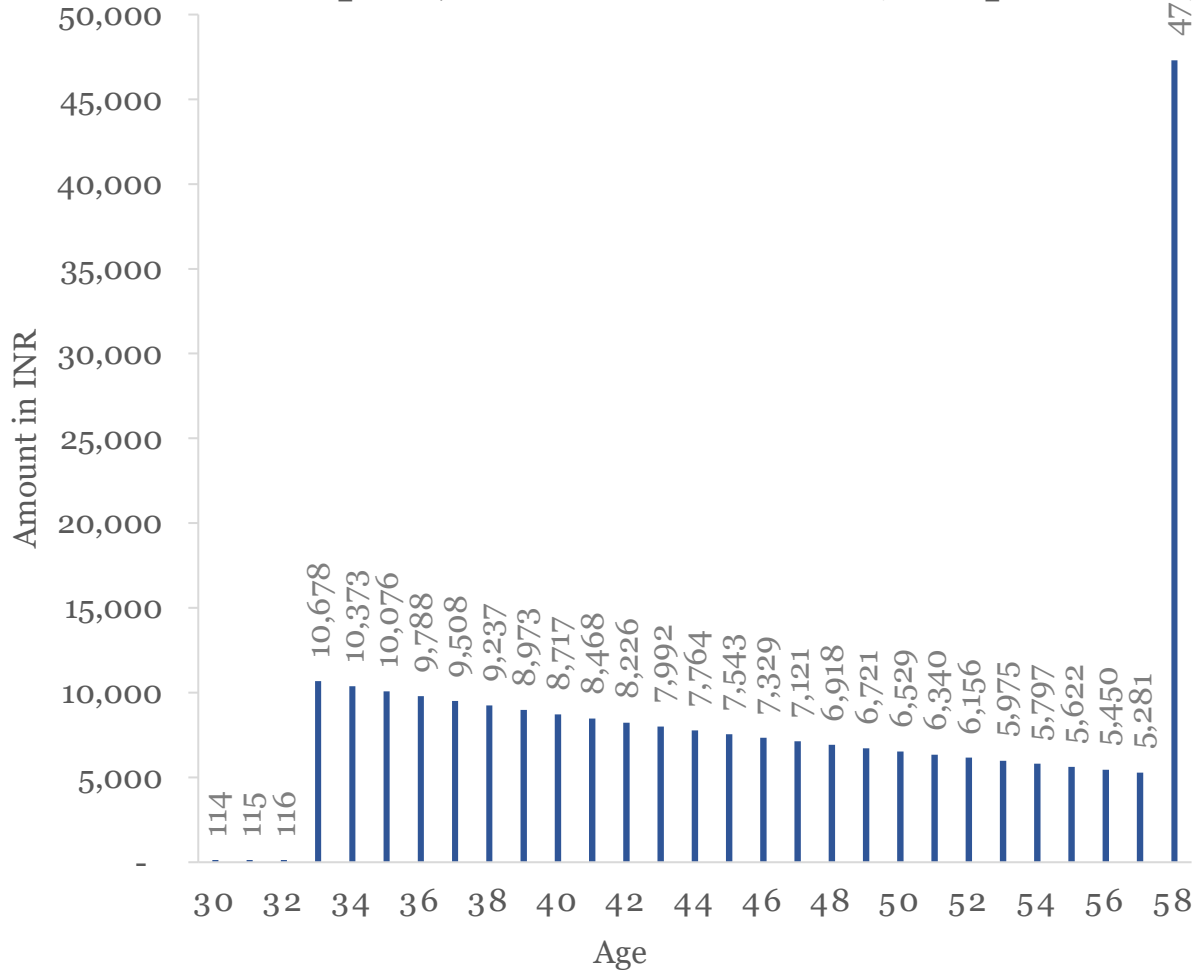
Expected Payout



Impact of Change in Attrition Assumption (10% p.a. to 5% p.a.)

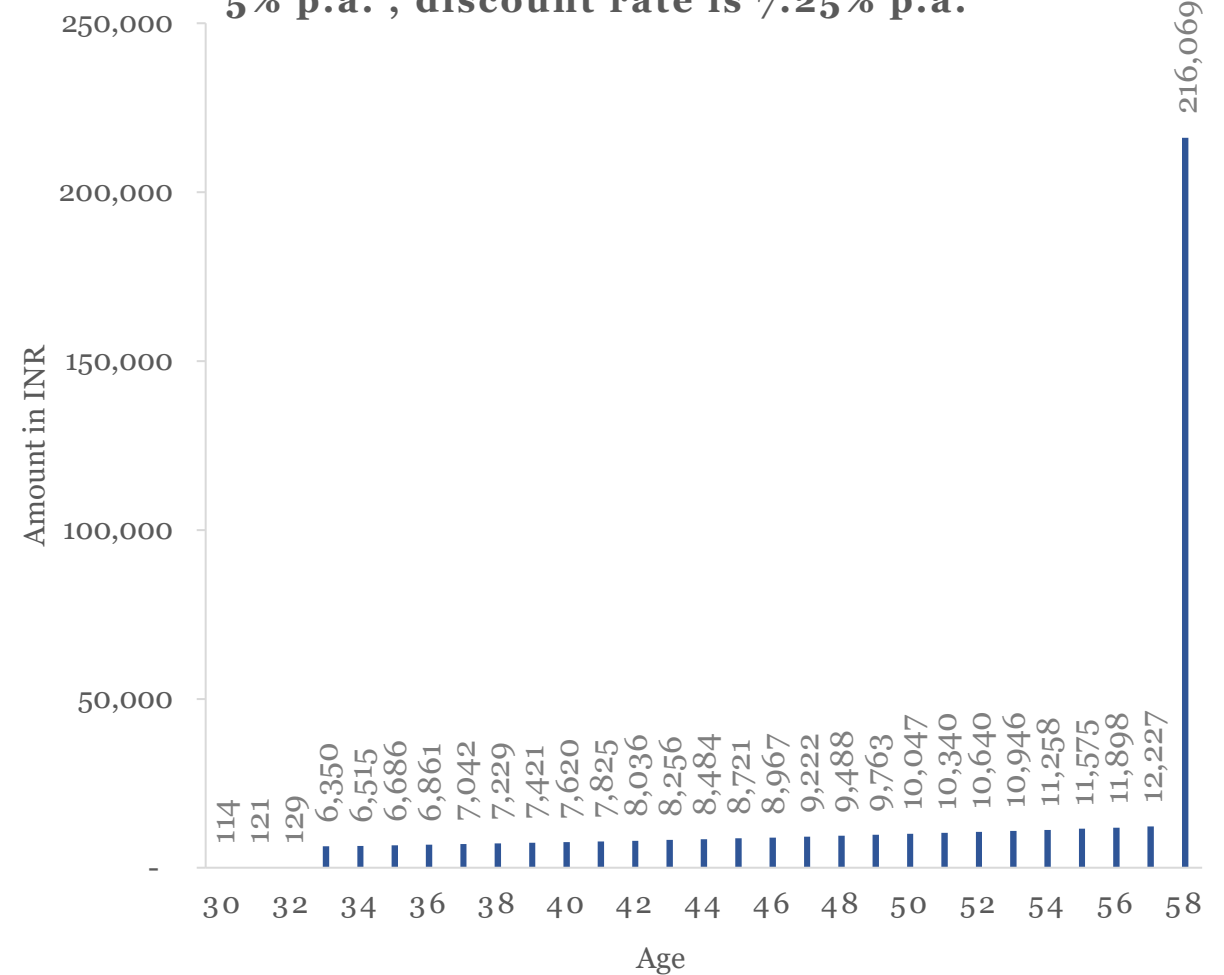
Defined Benefit Obligation INR 94,629

Expected Payout when Attrition Rate is 10% p.a. , discount rate is 6.90% p.a.



Defined Benefit Obligation INR 111,124

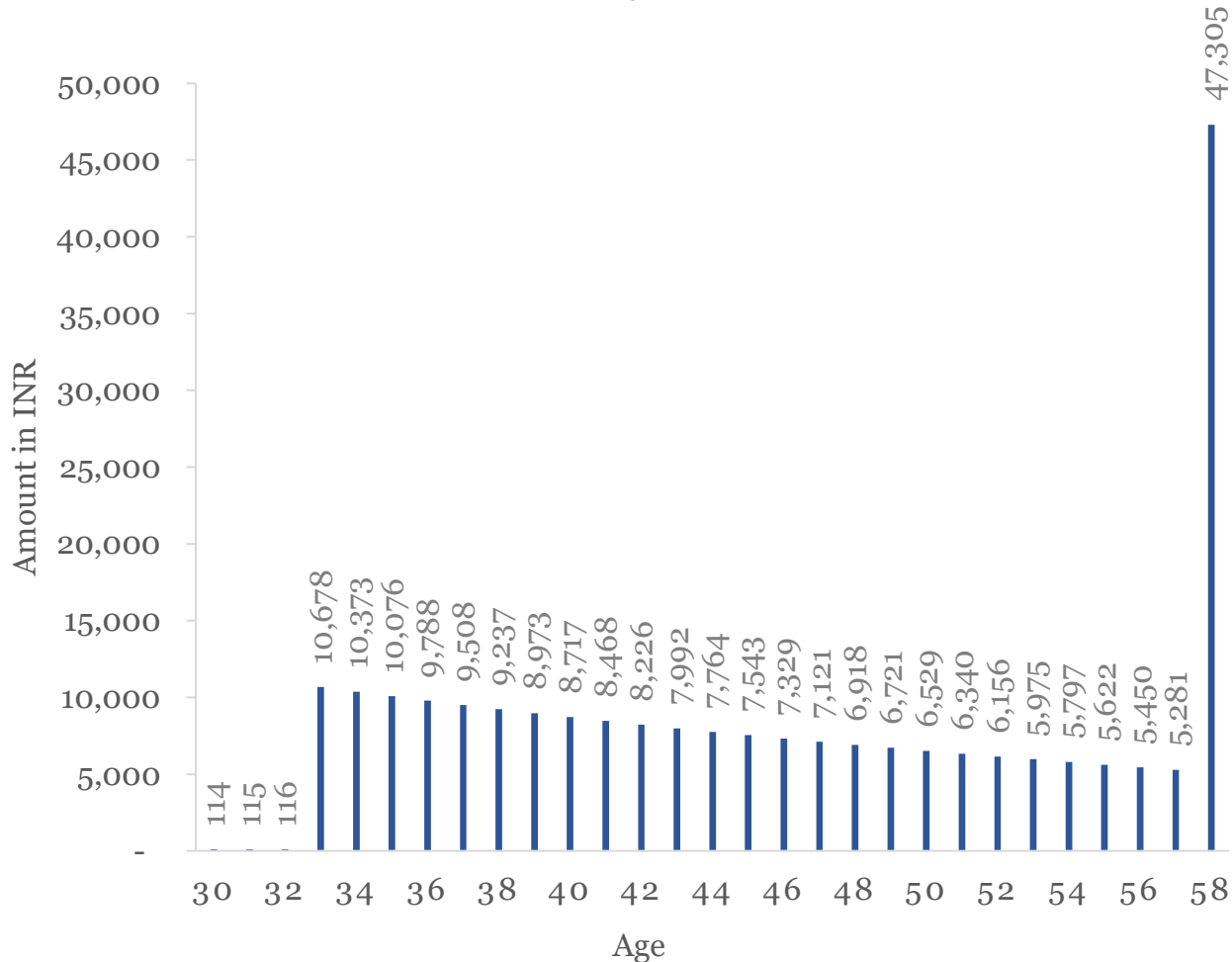
Expected Payout when Attrition Rate is 5% p.a. , discount rate is 7.25% p.a.



Impact of Change in Vesting Criteria (5 years to 3 years)

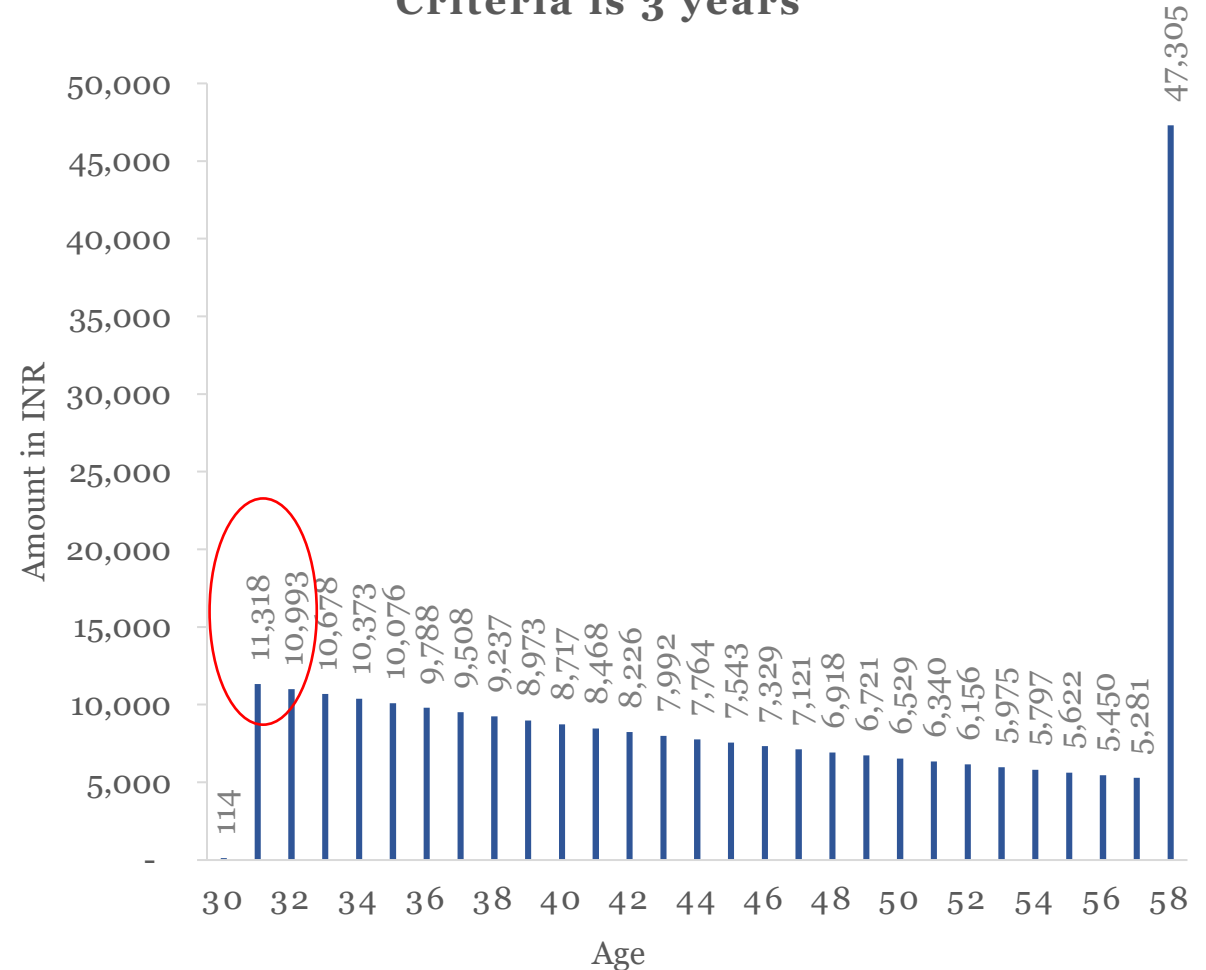
Defined Benefit Obligation INR 94,629

Expected Payout when Vesting Criteria is 5 years



Defined Benefit Obligation INR 114,627

Expected Payout when the Vesting Criteria is 3 years



The image features a white background with decorative curved lines in the top-left and bottom-right corners. These lines are composed of multiple overlapping layers in shades of light green and light blue, creating a soft, layered effect.

Practical aspects of Actuarial Valuation

Practical aspects in Audit of Actuarial Valuation



Common Errors Found by FRRB (AS15, Ind AS19)

Non-provisioning of Gratuity (Matching Principle)

No disclosure or inadequate disclosures post employment plans

Defined Benefit Plan wrongly treated as Defined Contribution Plan

Non-Disclosure of expense for Defined Contribution Plan

Inadequate disclosure pertaining to Use of PUCM Method

Issues Found by Quality Review Board (QRB) [SA 620]

Not evaluating whether :

- the actuary has the necessary competence, capabilities and objectivity for the auditor's purposes and
- the relevance and reasonableness of the assumptions and methods used by him (Para 9, 12).

(Ref: QRB Report on Audit Quality Review - 2021-22 - (02-11-2022) ICAI Website)

Possible Solution to this:

Auditor can check/ ask for the qualification/ CoP of member providing actuarial valuation report. As per the Institute of Actuaries of India, Fellow Actuary having valid Certificate of Practice can practice in this field as proprietor or partnership firm, company is not allowed to practice as per Actuaries Act.

Reasonableness of Assumption should be checked, for example company having Actual Attrition rate of 15% - 20% p.a. consistently but 2% p.a. Attrition assumption is used. This can be checked by performing assumption analysis at overall level and may require thorough analysis at regular intervals from Company/ Actuary.

Consequences of Non Compliance

Labour law penalties for non payment of benefits

Companies Act requirement to follow AS 15, Ind AS 19

Auditors to **qualify** Audit Report with quantification if non compliance of AS

Gratuity Funding via '**Approved Trust**' only to ensure Tax deduction

Actuarial Valuation Report required even if funding with LIC, **LIC report not AS15.**

Check for Qualification/ CoP, companies can't practice (similar to CA Act)

Social Security Code - Key Changes in “Gratuity”

Minimum Vesting criteria relaxed from 5 years to 3 years for Gratuity Eligibility

Applicable Salary

Working Journalist

Fixed Term Contract Employee

Definition updated from Basic + DA to ‘Wages’

No Minimum vesting criteria

Social Security code is yet to be implemented, as effective date not yet notified till 21 December 2022.

Effect and Treatment of Liability Transfer In/Out

For Example: - Mr. Ram who served 10 years in company X Ltd and transferred to Group Company, Y Ltd with continuation of service.

Transfer value (10 years $\times \frac{15}{26} \times$ Salary at time of transfer) or actuarially calculated

In books of Transferee (Y Limited)

At time of transfer:

X limited A/c Dr

To Provision for Gratuity A/c

At time of amount received from X limited:

Bank A/c Dr

To X Limited A/c

[If Transfer is made in to Fund, Debit will be to Gratuity Trust Fund A/c in spite of Bank Account]

In books of Transferor (X Limited)

At time of transfer:

Provision for Gratuity A/c Dr

To Y limited A/c

At time of amount paid to Y limited:

Y limited A/c Dr

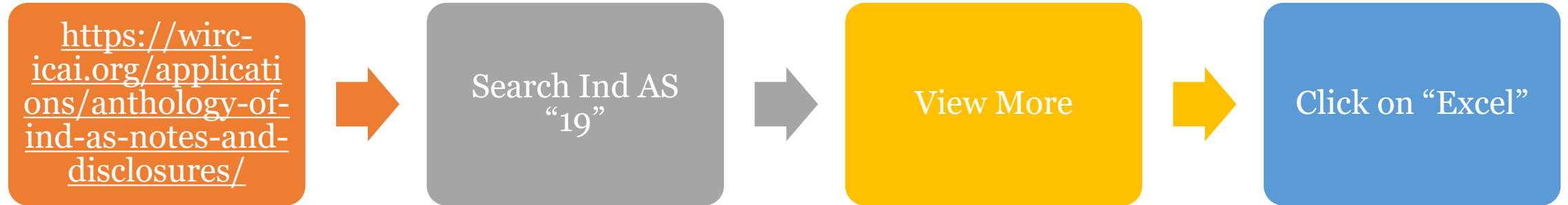
To Bank A/c

[If Transfer is made out of fund, Credit will be to Gratuity Trust Fund A/c in spite of Bank Account]



**Sample Actuarial Valuation Report,
Disclosure by Listed Companies**

Presentation of Ind AS 19 – Listed company



The image features a white background with decorative curved lines in the top-left and bottom-right corners. These lines are composed of multiple overlapping layers in shades of light blue and light green, creating a soft, layered effect.

Sample Audit Check Points

Sample Audit Check Points

- Whether Gratuity is paid in line with Gratuity Act or company pay without restriction.
- Employee Data - appropriate, complete and cut off. Include all with service less than 5 years
- Inclusion of Directors, trainee's data.
- Ensure leave availment is valued on Gross salary and encashment on eligible salary as per company policy.
- Appropriate divisor is used in calculation of Gratuity (generally 26) and Leave (as per company policy).
- Treatment for due but not paid liability.
- Treatment for liability and assets transfer In/ Out.
- Validating appropriateness of valuation assumptions.
- Check for average past service, discontinuance/ accrued benefit liability.
- Check results of actuarial gain/ loss for year and analyse for valid reasons.
- Compare charge on Profit & Loss and OCI for current year v/s previous year.
- Check results of balance sheet, Profit and Loss, OCI amount match in Actuary Report, accounting books and financials including notes to accounts.
- SA 620 Using the Work of an Auditor's Expert.

Opportunities for CAs

Gratuity Trust Set up, Audit

Funding from Insurance company

Demand Supply Gap of Actuaries

CA can also Practice as Actuary (Actuary is separate Qualification)

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Q&A and Open Forum Discussion

Contact us

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Appendix

AS Applicability for Companies – SMC and Non-SMC definition

Particulars	Non-SMC [#]	SMC
Securities Listed in India or Outside India	✓	✗
Bank, Financial Institution, Insurance company	✓	✗
Turnover in Previous Year	≥ 250 cr	< 250 cr
	Or	and
Borrowing at anytime in Previous Year	≥ 50 cr	< 50 cr
Holding/ Subsidiary of above	✓	✓

[#] Earlier for accounting period till 31 March, 2021, limit of turnover was 50 cr and for borrowing 10 cr, which is now increased to 250 cr and 50 cr respectively.

Definition of SMC and Non-SMC Company (turnover and borrowing are criteria) as Applicable:

- Accounting period till 31.03.2021: http://www.mca.gov.in/Ministry/notification/pdf/Notification_GSR_739.pdf
- Accounting period on or after 01.04.2021: <https://egazette.nic.in/WriteReadData/2021/227890.pdf> (Page 329)

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Kindly note that criteria for classification is different for Companies (issued by MCA) and Non-Company Entities (issued by ICAI)

AS Applicability for Non Company Entities - Level I/II/III/IV

Particulars	Level I	Level II	Level III	Level IV
Securities Listed in India or Outside India	✓	✗	✗	✗
Bank, Financial Institution, Insurance	✓	✗	✗	✗
Turnover in Previous Year	≥ 250 cr	50 cr - 250 cr	10 cr - 50 cr	< 10 cr
Borrowing at anytime in Previous Year	≥ 50 cr	10 cr - 50 cr	2 cr - 10 cr	< 2 cr
Holding/ Subsidiary of above	✓	✓	✓	✓

Definition for Applicability of Level I/II/III/IV - Non Corporate Entities *for Accounting periods commencing on or after April 1, 2020*
as Issued by ICAI: <https://resource.cdn.icai.org/64269asb51535.pdf>

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Above classification is applicable for *Non Company Entities* e.g. Partnership firm, LLP etc. They need to follow Accounting Standards as issued by ICAI.

Tax Implication of Gratuity – Employer

The gratuity as and when paid by the employer to his employee, is deductible from his income under **section 37(1)** of Income Tax Act.

Contributions paid to approved Gratuity Fund is deductible from income under Section **36(1) (V)** of Income Tax Act. Approved Gratuity fund regulatory aspects given in part c of fourth schedule to Income Tax Act.

As per **Rule 103** of Income Tax rules 1962, ordinary annual contribution should not exceed **8.33% of salary** of employee.

Investment pattern to be followed as per Income Tax rules 1962.

Initial contribution may be permitted to be made in not more than five annual instalments commencing from the year in which the employee has been admitted to the benefits of the fund.

Income (whether interest or capital gains) out of the investments of the Trust is not taxable as per Section 10(25) (iv) of Income Tax Act.

As per Section 40A(7) No deduction shall be allowed for provision made for Gratuity. However provision for payment to approved gratuity fund is allowed on basis of actual payment as per Section 43B before due date of filling Tax Return.

Tax Implication of Gratuity - Employees

Section 10 (10) of Income Tax Act provides for exemption of Gratuity as follows:

- employee of the Central Government, State Government or local authority: wholly exempt.
- gratuity received under the Payment of Gratuity Act, 1972: Sections (2) and (3) of Section 4 of Gratuity Act.
 - 15 days' salary (7 days in the case of employees of seasonal establishments) based on the last salary drawn for every completed year of service or part thereof in excess of 6 months; or
 - INR 20,00,000; or
 - Gratuity actually received,
 - Whichever is the less.
- any other gratuity received by an employee:
 - Half month's salary for each completed year of service; or
 - INR 20,00,000 (as applicable to Central Government employees); or
 - Gratuity actually received.
 - Whichever is the least.

As per CBDT, letter F.No.194/6/73 - I.T. (A-I), dated 19.06.1993, the expression 'Termination of employment' used in Section 10 (10), covers the case of any employee whose service comes to an end on account of his resignation.

Tax Implication of Gratuity – Employees....

Relief under Section 89: For the computation of relief under Section 89, Rule 21A (3) of the IT Rules, 1962, prescribes the mode of computation of such relief.

In a case past service is **15 years or more** relief is worked out as under:

- i. Compute the average rate of tax on the total income, including the taxable gratuity in the year of receipt.
- ii. Find out the tax on taxable gratuity at the average rate of tax computed in (i) above.
- iii. Compute the average rate of tax by adding one-third of the taxable gratuity to the other income of each of the three preceding years.
- iv. Find out the average of the three-average rates computed in the manner specified in (iii) above and compute the tax on taxable gratuity at that rate.
- v. The difference between the tax on the taxable gratuity computed in (ii) and that in (iv), will be the relief admissible under Section 89.

In cases past service is **5 years or more but less than 15 years**, the relief is computed on the similar lines as above, with the only difference that instead of average of the average rates of the preceding three years, the average of the rates of the preceding two years is computed by adding one-half of the taxable gratuity to the other income of each of preceding two years.

No relief is admissible if taxable gratuity is in respect of services rendered for less than five years.