Disclosure requirements for defined benefit plans in case of group administration plans and Accounting for provident fund contribution in case of provident fund trust run by the holding company

The following is the opinion given by the Expert Advisory Committee of the Institute in response to a query sent by a member. This is being published for the information of readers.

A. Facts of the Case

1. A company (hereinafter referred to as 'the company') is a wholly owned subsidiary of a listed public sector undertaking (hereinafter referred to as 'the holding company'). The company was incorporated in the year 2002 under the Companies Act, 1956. The main objective of the company is to acquire, establish and operate electrical systems etc. for distribution and supply of electrical energy, to undertake works on behalf of others and to act as engineers/consultants amongst others.

2. The querist has stated that all the personnel of the company are employees on the rolls of the holding company and are under deputation to the company on secondment basis. Every month actual share of employees related expenses of the company, like salary, provident fund (PF) contribution, etc. are being debited to the company by the holding company, for payments and accounting purpose. Other employee benefits like retirement benefits are allocated at the year end and accordingly accounted for in the accounts of the company, payable to the holding company. The holding company has constituted separate trusts for administering and managing employee benefits towards gratuity and provident fund.

3. The querist has further stated that the holding company gets the actuarial valuation done, at the year end, for all of its employees together, including those deputed to its subsidiary companies. In other words, no separate valuation report is obtained for the employees of subsidiary companies. Therefore, identifying employee liability and corresponding plan assets attributable to the personnel on deputation to its subsidiaries is not possible. However, the amount being proportionate share of expenses (for the year under consideration) is determined by the actuary and allocated to the subsidiary companies for accounting purpose. Therefore, the company and the auditor of the company rely upon the allocated figure for recognising expenses in the profit and loss account of the company. As a corollary, all the other information required to be disclosed as per paragraphs 119 and 120 of Accounting Standard (AS) 15, 'Employee Benefits' (revised 2005), since not available, is not disclosed in the Notes on Accounts. The expenses on account of long term defined benefits included for actuarial valuation are gratuity, leave encashment, post retirement medical benefits, transfer/travelling allowance on retirement/death, long service awards to employees, farewell gift on retirement and economic rehabilitation scheme.

4. In the case of provident fund, however, the accounting is done on the basis of actual contribution, although the holding company in its financial statements admits it as a defined benefit. The company is of the view that actuarial valuation is not required for provident fund liability. Further, the holding company (sponsor employer) is not making disclosures in its financials as required by paragraphs 119 and 120 of AS 15 in

the case of provident fund, unlike in the case of other defined benefits.

Disclosures made by the company:

- Accounting policy

  "The liabilities towards employee benefits are ascertained by the holding company i.e. …… Limited on actuarial valuation. The company provides for such employee benefits as apportioned by the holding company."

- Notes on Accounts

  "All the employees of the company are on secondment from the holding company, i.e…. Ltd."

  "Employees' remuneration and benefits include ₹ …. (Previous year ₹ ….) in respect of gratuity, leave encashment, post retirement medical benefits, transfer traveling allowance on retirement/death, long service awards to employees, farewell gift on retirement and economic rehabilitation scheme as apportioned by the holding company i.e. .... Limited on actuarial valuation, being defined benefits, at the year end. Therefore, disclosures in compliance of AS 15 are not being made as the same are being done by the holding company."

Company's view on the above accounting policy

5. The company's management is of the view that, as all the employees of the company are on secondment from the holding company and the defined plans are that of the holding company, by following paragraph 35 of AS 15, the other group enterprises are allowed to recognise, in their separate financial statements, a cost equal to their contribution payable for the period which the company is doing. Hence, no separate disclosure of details is required in the separate financials of the company. Accordingly, the disclosure requirements spelt out in paragraphs 119 and 120 of AS 15 are not applicable to other group enterprises.

6. In the case of PF, the contribution is made to the PF trust at statutorily specified rate. The company has accounted for the expenses on actual contribution basis. Actuarial valuation is required only for the purpose of statutory interest rate guarantee as per AS 15 which is being undertaken by the holding company. Further actuarial valuation, in order to determine sufficiency of assets for meeting obligation etc. is not required, as that is the industrial practice all across the country.

Auditor's view point

7. The auditor of the company is of the view that, in accordance with AS 15, various enterprises under common control are permitted to share risks on defined benefit plans and accordingly can follow a system of recognising expenses in the accounts of group enterprises, a cost equal to their contribution to the sponsoring employer (which is the holding company in this case). However, unlike in paragraph 30 of AS 15 (that deals with similar situations in case of multi employer plans, where the employee costs can be treated as defined contribution, even if they are defined benefit), paragraph 35 of AS 15 does not specify whether similar accounting treatment of deeming the defined benefits as defined contribution is possible or not. Where employee benefits are defined contributions, disclosures under paragraphs 119 and 120 of AS 15 are not necessary. So long as items dealt with under paragraph 35 of AS 15 are defined benefits, disclosures as per paragraphs 119 and 120 of AS 15 are also necessary. Therefore, the position of the company, that disclosures are not required as the holding company is disclosing the same, is not in compliance with AS 15.

8. Further, the auditor of the company is of the view that provident fund contribution in the case of the company is also a defined benefit plan as the management is responsible for ensuring the statutory benefits to employees by managing the funds through the company run trusts. Therefore, carrying out actuarial valuation and making provisions based on such actuarial valuation is necessary to comply with AS 15. The company has instead accounted for the same on the basis of actual contribution only. This is not in compliance with AS 15.

B. Query

9. In the above background, the querist has sought the opinion of the Expert Advisory Committee on the following issues:
   (i) Whether the position of the company that it is not liable to make complete disclosures in its separate financial statements, in view of the fact that the same have been done by the holding company, is correct.
   (ii) Whether the company's policy of accounting for the provident fund based on actual contribution instead of actuarial valuation basis (and not

making disclosures even in its parent's financials, as a defined benefit, as required in paragraphs 119 and 120 of AS 15) is correct.

C. Points considered by the Committee

10. The Committee notes that the basic issues raised by the querist are related to the disclosure requirements for defined benefit plans as per paragraphs 119 and 120 of AS 15 in the financial statements of the subsidiary company when the same are being made in the financial statements of the holding company; and accounting for the provident fund based on actual contribution instead of actuarial valuation basis and its disclosures in the financial statements of the company. Therefore, the Committee has examined only these issues and has not examined any other issue that may arise from the Facts of the Case, such as, recognition and measurement of employees related expenses other than contribution to PF, accounting in the financial statements of the holding company, statutory obligations relating to employee benefits arising under various laws and statutes, etc.

11. At the outset, the Committee notes from the Facts of the Case that *all the employees* of the subsidiary company have been sent by the holding company on secondment basis. In order to determine the nature of relationship between such employees with the subsidiary company, the Committee notes Issue No. 1 of 'ASB Guidance on Implementing AS 15, Employee Benefits (revised 2005)', issued by the Accounting Standards Board of the ICAI, which provide as follows:

> ***"1. What are the kinds of employees covered in the revised AS 15 and whether a formal employer-employee relationship is necessary or not, for benefits to be covered under the Standard?***
> The Standard does not define the term "employee". Paragraph 6 of the Standard states that 'an employee may provide services to an enterprise on a full-time, part-time, permanent, casual or temporary basis and the term would also include the whole-time directors and other management personnel. The Standard is applicable to all forms of employer-employee relationships. There is no requirement for a formal employer-employee relationship. Several factors need to be considered to determine the nature of relationship ..."

In view of above, the Committee is of the view that though the holding company is the legal employer of the employee but in substance the employees are rendering service to the subsidiary company, hence, the latter should be considered as the employer of such employees.

12. As regards the disclosure requirements for defined benefit plans, the Committee notes the following paragraphs of AS 15, notified under the Companies (Accounting Standards) Rules, 2006:

> "33. Multi-employer plans are distinct from group administration plans. A group administration plan is merely an aggregation of single employer plans combined to allow participating employers to pool their assets for investment purposes and reduce investment management and administration costs, but the claims of different employers are segregated for the sole benefit of their own employees. Group administration plans pose no particular accounting problems because information is readily available to treat them in the same way as any other single employer plan and because such plans do not expose the participating enterprises to actuarial risks associated with the current and former employees of other enterprises. The definitions in this Standard require an enterprise to classify a group administration plan as a defined contribution plan or a defined benefit plan in accordance with the terms of the plan (including any obligation that goes beyond the formal terms).
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> 34. Defined benefit plans that share risks between various enterprises under common control, for example, a parent and its subsidiaries, are not multi-employer plans.
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> 35. In respect of such a plan, if there is a contractual agreement or stated policy for charging the net defined benefit cost for the plan as a whole to individual group enterprises, the enterprise recognises, in its separate financial statements, the net defined benefit cost so charged. If there is no such agreement or policy, the net defined benefit cost is recognised in the separate financial statements of the group enterprise that is legally the sponsoring employer for the plan. The other group enterprises

recognise, in their separate financial statements, a cost equal to their contribution payable for the period."

From the above-reproduced paragraphs of AS 15, the Committee is of the view that the multi-employer and group administration plans are completely different from each other. In case of group administration plan, it is merely an aggregation of individual employer plans and therefore, the Standard itself states that the accounting related information is readily available with the participating enterprises as any other single employer. Further, the Committee notes from the Facts of the Case that in the extant case, the holding company gets the actuarial valuation done, at the year-end, for all of its employees, including those deputed to its subsidiary companies. The amount being proportionate share of expenses (for the year under consideration) is determined by the actuary and allocated to the subsidiary companies for accounting purpose. It is assumed that amount allocated is derived considering current service cost plus increase or decrease in total defined benefit obligation arising on account of other reasons like the actuarial gains and losses on entire obligation (irrespective of whether the obligation relates to period during which employee was with service with subsidiary or not). This indicates that there is a contractual agreement or stated policy based on which the proportionate share of expenses is being allocated to the subsidiary company. Further, since there is a common scheme for the employees of the holding company and the subsidiary company, keeping in view the Facts of the Case, it appears to the Committee that in substance, the holding company is running a group administration plan. The Committee is further of the view that the existence of such contractual agreement or stated policy through which the current service costs and obligations of defined benefit plans for employees of subsidiary company are being allocated to it clearly provides a basis for allocating the assets and obligation of the plan too. The Committee is also of the view that in case there is no such contractual agreement or stated policy to bear entire obligation relating to that employee, as per paragraph 35 of AS 15, the net defined benefit cost should be recognised in the financial statements of the enterprise which is legally the sponsor employer (holding company in the extant case) for the plan and the other group enterprises (subsidiary company in the extant case) should recognise a cost equal to their contribution payable for the period.

13. With regard to accounting for contribution being made to provident fund trust, administered by the holding company, the Committee notes paragraphs 25 to 27 of AS 15 and Issue No. 9 of 'ASB Guidance on Implementing AS 15, Employee Benefits (revised 2005)', issued by the Accounting Standards Board of the ICAI, which provide as follows:

AS 15

"25. Post-employment benefit plans are classified as either defined contribution plans or defined benefit plans, depending on the economic substance of the plan as derived from its principal terms and conditions. Under defined contribution plans:

(a) the enterprise's obligation is limited to the amount that it agrees to contribute to the fund. Thus, the amount of the post-employment benefits received by the employee is determined by the amount of contributions paid by an enterprise (and also by the employee) to a post-employment benefit plan or to an insurance company, together with investment returns arising from the contributions; and

(b) in consequence, actuarial risk (that benefits will be less than expected) and investment risk (that assets invested will be insufficient to meet expected benefits) fall on the employee.

26. Examples of cases where an enterprise's obligation is not limited to the amount that it agrees to contribute to the fund are when the enterprise has an obligation through:

(a) a plan benefit formula that is not linked solely to the amount of contributions; or

(b) a guarantee, either indirectly through a plan or directly, of a specified return on contributions; or

(c) informal practices that give rise to an obligation, for example, an obligation may arise where an enterprise has a history of increasing benefits for former employees to keep pace with inflation even where there is no legal obligation to do so.

27. Under defined benefit plans:
    (a) the enterprise's obligation is to provide the agreed benefits to current and former employees; and
    (b) actuarial risk (that benefits will cost more than expected) and investment risk fall, in substance, on the enterprise. If actuarial or investment experience are worse than expected, the enterprise's obligation may be increased."

ASB Guidance on Implementing AS 15, Employee Benefits (revised 2005)

> ***"9. Whether a provident fund which guarantees a specified rate of return is a defined benefit plan or a defined contribution plan.***
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> 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. 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 26(b) of AS 15."

From the above, the Committee is of the view that in the extant case, the actuarial risk (that benefits will cost more than expected) and investment risk of provident fund, in substance, falls on the employer, and as such, the provident fund plan would be a defined benefit plan. Accounting for such a benefit by the subsidiary should be as suggested in paragraph 12 above.

D. Opinion

14. On the basis of the above, the Committee is of the following opinion on the issues raised in paragraph 10 above:
    (i) The contention of the company that it is not liable to make complete disclosures in its separate financial statements, in view of the fact that the same have been done by the holding company, is not correct. Refer to paragraph 12 above.
    (ii) The provident fund plan in the extant case should be accounted for as a defined benefit plan as discussed in paragraph 13 above. For appropriateness of company's accounting policy, refer paragraphs 12 and 13 above.

1	The Opinion is only that of the Expert Advisory Committee and does not necessarily represent the Opinion of the Council of the Institute.
2	The Opinion is based on the facts supplied and in the specific circumstances of the querist. The Committee finalised the Opinion on 06.02.2012. The Opinion must, therefore, be read in the light of any amendments and/or other developments subsequent to the issuance of Opinion by the Committee.
3	The Compendium of Opinions containing the Opinions of Expert Advisory Committee has been published in thirty volumes. A CD of Compendium of Opinions containing thirty volumes has also been released by the Committee. These are available for sale at the Institute's office at New Delhi and its regional council offices at Mumbai, Chennai, Kolkata and Kanpur.
4	Recent opinions of the Committee are available on the website of the Institute under the head 'Resources'.
5	Opinions can be obtained from EAC as per its Advisory Service Rules which are available on the website of the ICAI, under the head 'Resources'. For further information, write to eac@icai.org.