

Query No. 33

Subject: *Accounting treatment of accumulated unencashable half-pay leave.*¹

A. Facts of the Case

1. A public sector undertaking under the Ministry of Railways is engaged in catering business (on board and off board). The company is making provision/liabilities towards gratuity and leave encashment on the basis of actuarial valuation at the year end and charging to the statement of profit and loss. The company's rules also provide for grant of compensated absence on account of half pay leave which can be carried over in case not utilised by the employees. Further, the company's rules categorically provide that accumulated half pay leaves can in no case be encashed either on retirement or on separation.

2. The querist has stated that as per the Department of Public Enterprises (DPE) guidelines, half pay leaves cannot be encashed under any circumstances. The company is making provision for encashment of earned leaves upto the maximum level of encashment permitted by the company's rules. According to the querist, as per paragraph 14 of the Accounting Standard (AS) 15 (revised), 'Employee Benefits', the liability for the expected cost of accumulated compensated absence is to be recognised only when there is expectation to pay any additional amount on account of accumulation. However, while conducting the supplementary audit, the Comptroller & Auditor General (CAG) had raised the issue of non-provision of accumulated half pay leaves stating that the company is accounting the expenditure on cash basis rather than on accrual basis.

B. Query

3. The querist has sought the opinion of the Expert Advisory Committee as to whether under the circumstances narrated above, the company is required to create provision for accumulated half pay leaves which are not encashable. If so, how the provision is to be operated on each balance sheet date, since the half pay leaves are not to be encashed?

C. Points considered by the Committee

4. The Committee, while answering the query, has considered only the issues raised in paragraph 3 above and has not touched upon any other issue that may arise from the Facts of the Case, such as, accounting treatment for earned leave benefits and gratuity, classification of accumulating half pay leaves as 'short-term' or 'other long-term' employee benefits and their measurement, etc. Further, the Committee presumes from the

¹ Opinion finalised by the Committee on 11.4.2014.

Facts of the Case that the half pay leaves in the extant case can be carried forward and availed upto the retirement/superannuation of the employees.

5. At the outset, the Committee wishes to point out that from an accounting angle, the nature of unencashable leave is similar to that of the encashable leave insofar as the former provides a right to an employee to receive salaries and wages for the period for which he avails leave as during that period he does not render any services to the employer. The Committee is of the view that accumulating half pay leave creates an obligation on the enterprise because any unused entitlement increases the employee's entitlement to avail leave in future periods. Thus, a provision should be recognised for all these benefits and recorded as part of the cost of service rendered during the period in which the service was rendered which resulted the entitlement. In this regard, without examining the classification of accumulating half-pay leaves into 'short-term' and 'other long-term' employee benefits, the Committee further notes the following paragraphs of Accounting Standard (AS) 15, 'Employee Benefits', notified under the Companies (Accounting Standards) Rules, 2006 as below:

“8. Short-term employee benefits include items such as:

...

- (b) 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;

...”

“Short-term Compensated Absences

11. An enterprise should recognise the expected cost of short-term employee benefits in the form of compensated absences under paragraph 10 as follows:

- (a) in the case of accumulating compensated absences, when the employees render service that increases their entitlement to future compensated absences; and*

- (b) in the case of non-accumulating compensated absences, when the absences occur.”*

“13. Accumulating compensated absences are those that are carried forward and can be used in future periods if the current period's entitlement is not used in full. Accumulating compensated absences may be either vesting (in other words, 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). An obligation arises as employees render service that increases their entitlement to future compensated absences. The obligation exists, and is recognised, even if the compensated absences are non-vesting, although the possibility that employees may leave before they use an accumulated non-vesting entitlement affects the measurement of that obligation.”

“Other Long-term Employee Benefits

127. Other long-term employee benefits include, for example:

- (a) long-term compensated absences such as long-service or sabbatical leave;

...”

From the above, the Committee notes that as per the above-reproduced paragraph 13 of AS 15, obligation exists in respect of short-term accumulating compensated absences irrespective of whether these are vesting or non-vesting and is required to be recognised. Similarly, paragraph 129 of AS 15 requires to provide for a liability in respect of other long-term compensated absences. Accordingly, the Committee is of the view that irrespective of whether accumulating half-pay leaves in the extant case can be classified as ‘short-term employee benefits’ or as ‘other long-term employee benefits’, a liability on account of compensated absences should be recognised as per the requirements of AS 15, which should be reviewed at each reporting date to recognise the effects of changes in estimates in this regard.

D. Opinion

6. On the basis of the above, the Committee is of the opinion that irrespective of whether accumulating half-pay leaves in the extant case can be classified as ‘short-term employee benefits’ or as ‘other long-term employee benefits’, a liability on account of compensated absences should be recognised as per the requirements of AS 15, which should be reviewed at each reporting date to recognise the effects of changes in estimates in this regard, as discussed in paragraph 5 above.