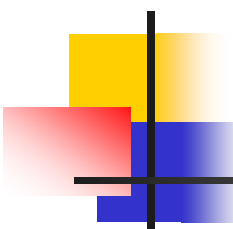


Leave Valuation

By Group 3

The valuation of the compensatory absences has to be done according to principles of valuation under AS 15 (R), PCS and GN 26. Which mainly falls in to two categories as below:

- Accumulating compensatory absences; and
- Non-accumulating compensatory absences



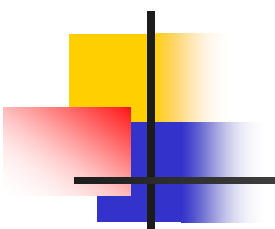
Non-accumulating compensatory **absences do not carry forward** and they lapse if the current period's entitlement is not used in full and **do not entitle employees to a cash payment** for unused entitlement on leaving the enterprise. An enterprise **recognizes no liability or expense** until the time of the absence, because employee service does not increase the amount of benefit.

Accumulating compensatory absences may be vesting when the 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. Some companies could have rules which make a leave remain in an accumulating status for a defined period and thereafter lapse so that from such point of time it would become non-accumulating.



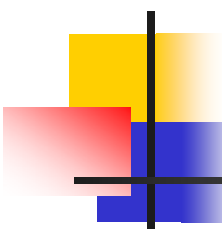
The list of main compensatory absences seen in India is given below.

- Casual Leave (CL);
- Annual Leave / Privilege Leave/ Earned leave;
- Sick Leave;
- Maternity / Paternity Leave;
- Other leave;



Any leave has to be classified in to a short-term employee benefit or a long-term employee benefit for the purpose of valuation as the principles depends very much on this classification.

- Short-term employee benefit includes Compensatory Absences which **accrue** to employees and are **expected to be availed or encashed within twelve months** after the end of the period in which the employees render the related service e.g. Casual Leave, Maternity / Paternity Leave.
- Long-term employee benefit includes Compensatory absences which can be availed or encashed and also expected to availed or encashed for any further period e.g. Annual Leave / Privilege Leave/ Earned leave, Sick Leave.



Long-term Compensatory absence has to be further classified in to the following categories:

- Compensatory absence that can only be availed during the service but cannot be encashed at any point of time;
- Compensatory absence that can be availed while in service and any unutilized leave that can be encashed on separation;
- Compensatory absence that can be availed or encashed while in service and any unutilized leave that can be encashed on separation.

Long-term Compensatory absence:

- Sick Leave falls in to first category where it can only be availed during the service but may not be encasheable at any point of time. Where encashment is permitted the treatment for valuation will be similar to long term compensatory absence.
- Annual leave / Privilege leave/ Earned leave may fall either in to second or third category depending on the rules of the enterprise.



Measurement:

Short-term Compensatory Absences require measurement on an **actual basis** and not on actuarial basis. Measurement should take into account the following points:-

- Leave at credit needs to be availed within twelve months
- Cost to Company (CTC) and
- Probability that a portion of leave may lapse without giving rise to any Liability.

Long-term Compensatory Absences require measurement on **Actuarial basis**. Measurement should take into account the following points:-

Availment of Leave on Cost to Company Salary:-

- Measurement of availment of leave should be based on Cost to Company Salary (CTC). Employer's contribution to Provident Fund should be a component of CTC Salary.

Encashment of Leave on Qualifying Salary

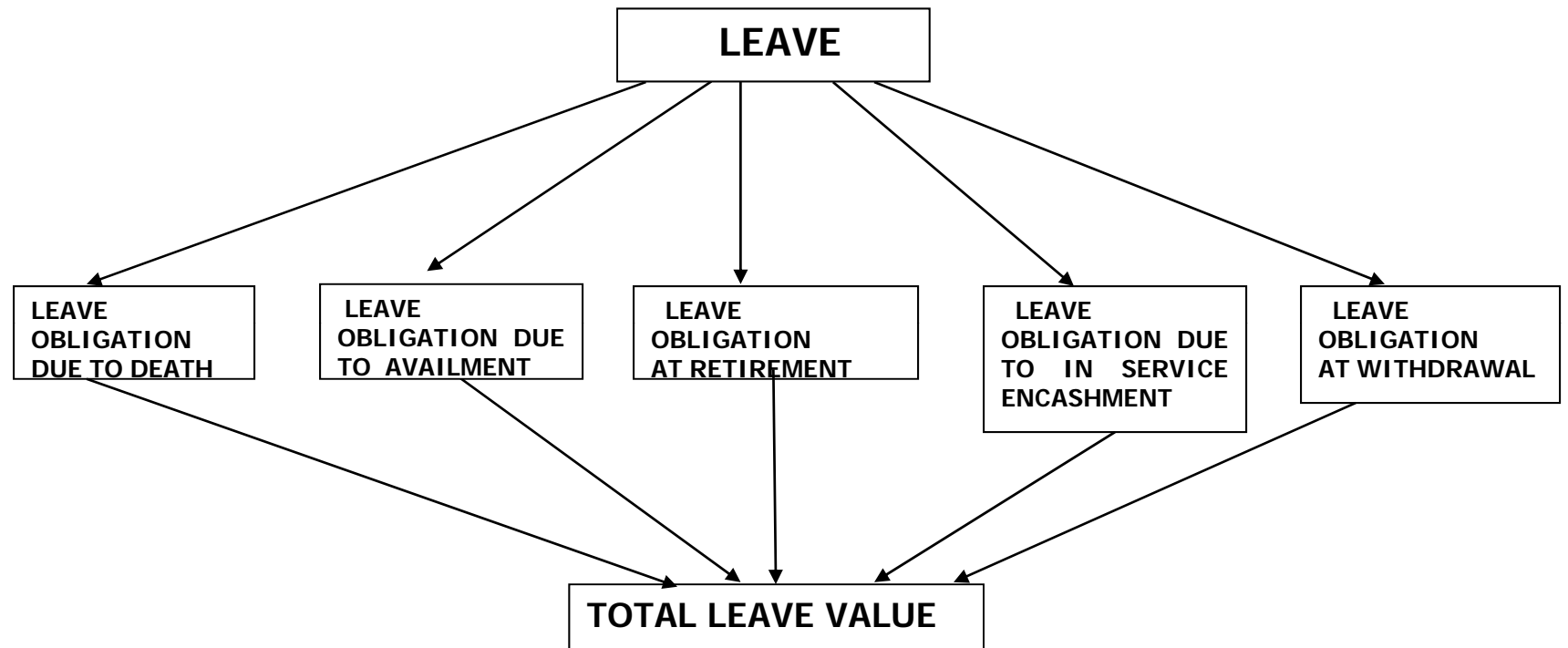
- Qualifying Salary for Encashment of Leaves may be a different from Cost to Company Salary or Same Salary depending upon the rules of the enterprise.



Assumptions of Valuation

- For valuing sick leave the probability that an employee will avail sick leave and the proportion which could be availed during each year of projection period should be taken in to account. In arriving at the incidence rates the experience of the enterprise is to be considered and allowance should be made for leave that will lapse on separation without giving rise to any liability.
- For valuing Annual leave / Privilege leave the probability that an employee availing the leave during each year of projection period should be taken in to account. In arriving at these rates the experience of the enterprise is to be considered and allowance should be made for employees' encashing the leave at the time of separation and/or while in service.

Actuarial valuation of obligation under Leave Encashment plan.





Requirement of leave valuation

Scheme rules

- Retirement age
- Maximum of accumulated leaves allowed
- Leave granted in a year. Whether credited to employee a/c at the BOY or proportionately during the course of year.
- Benefit payable on Death/withdrawal/Retirement/Ill health Retirement
- Salary to be reckoned on leave availment /leave encashment
- Vesting Period if applicable

Individual Employee Data

- Leave outstanding at the beginning of the year
- Leave credited in a year
- Leave availed/encashed during the year
- Leave lapsed at the end of year
- Leave outstanding at the end of year
- Salary CTC/Salary to be reckoned for Encashment
- Date of birth, Date of joining and Gender

Availment/Encashment rates

At individual employee:

Leave outstanding (BOY)

(-)

Leave outstanding (EOY)

If negative then availment is equal to 0.

Availment/Encashment rate=

**Sum of above for all employees * 100 / Total leave
outstanding BOY**

Practical issues:

Complete data is not made available by the companies.



Leave Lapsation rates

At individual employee:

Lapsation rate=

**Sum of leave lapsed for all employees during the year
* 100 / Total leave outstanding BOY**

Practical issues:

Complete data is not made available by the companies.

Current service Cost

Different Approaches:

- Value of leave (Accrued during the year less leave availed/encashed/lapsed out of that)
- Sum of (PBO at the end of the year / No. of Years of service at Individual level*) * *In case of service less than one year this is taken as 1*
- Total PBO at the end of the year less PBO at the beginning of the year
- Rolling forward last year's normal cost with previous year discount rate

Which is the correct Approach?

What value should be disclosed in the disclosure?



Other Issues

- Leave credited for the year at the beginning:
 - Pro-rata basis
 - Actual
- Proportionate leave availment/encashment/lapsation rates for quarterly valuation
- Leave availment/encashment/lapsation Assumptions by age grouping
- Liability on takeover – Disclosure of acquisition/settlement cost



Suggestions

- IAI should institute a research paper on Leave availment/encashment/lapse rates for the Industry
- Current Service Cost : There should be prescribed methodology through an APS
- Past Service Cost: Disclosure norms, specially in case of First Time Valuation



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