

ICAI: FAQ on accounting treatment of increase in liability due to enhancement of the gratuity ceiling

This FAQ on accounting treatment of increase in liability on account of enhancement of the gratuity ceiling from Rs. 10 lakhs to Rs. 20 Lakhs due to Payment of Gratuity (Amendment) Act 2018 (vide notification no. S.O. 1420 (E) dated March 29, 2018) has been issued by the Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (ICAI). The purpose of this FAQ is to clarify the accounting treatment of increase in liability due to enhancement of the gratuity ceiling.

Question: ABC Ltd. is covered by the Payment of Gratuity Act, 1972 which is required to pay gratuity to its employees. Due to the recent amendment in the aforesaid Act there is substantial increase in the liability of the company. Whether there is any exemption or relief available to the company under Accounting Standards with regard to the accounting treatment of such increase in the liability.

Response: The Gratuity benefit is an employee benefit and accordingly any increase in company's liability due to enhancement of the gratuity ceiling from Rs. 10 Lakhs to Rs. 20 Lakhs would be accounted for as per the principles of AS 15, Employee Benefits or Ind AS 19, Employee Benefits, as the case may be.

In this regard, it may be noted that effect of above type of amendments need to be dealt with reference to accounting treatment of past service costs. The 'past service cost' is defined as below in AS 15 and Ind AS 19:

As per AS 15, "Past service cost is the change in the present value of the defined benefit obligation for employee service in prior periods, resulting in the current period from the introduction of, or changes to, post-employment benefits or other long-term employee benefits. Past service cost may be either positive (where benefits are introduced or improved) or negative (where existing benefits are reduced)".

As per Ind AS 19 "past service cost, which is the change in the present value of the defined benefit obligation for employee service in prior periods, resulting from a plan amendment (the introduction or withdrawal of, or changes to, a defined benefit plan) or a curtailment (a significant reduction by the entity in the number of employees covered by a plan)".

As per the above, the increase in liability arising due to enhancement of gratuity ceiling from 10 to 20 Lakhs is a past service cost.

It may also be noted that the aforementioned accounting standards do not provide any exemption/one time relief with regard to the accounting treatment of increase in liability arising on account of past service cost. Accordingly, ABC Ltd. is required to account for any increase in the liability on account of increase in gratuity ceiling as expense as per the requirements of the relevant applicable Standard.

