Actuarial Valuation of End of Service Benefit: Why you should ask for Employee Wise liability?

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Why you should ask for employee-wise liability?

Actuarial valuation of End of Service Benefit (EOSB) liability involves the determination of the liability for each and every employee of the organisation. The liability for each employee is calculated as the present value of the accrued benefits using the Projected Unit Credit (PUC) Method, as prescribed in IAS 19 Employee Benefits. The results of all employees within the organisation are then aggregated to prepare the actuarial valuation report for the organisation. The employee-wise information of liability is thus readily available.

In this article, we discuss the reasons why we recommend asking for employee-wise liability figures and how the employee wise liability helps companies in checking the appropriateness of actuarial valuation of EOS benefit liabilities.

In our previous article, we discussed how attrition rates can influence the value of liability and thus how a better analysis of attrition rates can help in managing cost and optimizing liabilities. You can access that article by [clicking here].

Background

We often come across clients (and auditors) who want to understand how to validate the appropriateness of actuarial valuations. However, surprisingly, we do not come across many who specifically ask for employee wise liability figures.

Looking at employee wise liability or storing this data for future reference can have huge utility. Here are the **reasons why we recommend asking for employee-wise liability figures:**

1. Better analysis and comfort on accuracy of valuation

Overall liability of the organisation can be much better analyzed by studying the employee-wise liability. Some simple checks that can be done are:

- ***Spot checks,*** which can help in identifying outliers, random movements and inconsistencies in the valuation.

For example, one can ***individually look at the liability calculated in respect of senior employees***. Often top 10% of the employees constitute a significant proportion of the overall liability. Analyzing the liability calculated in respect of such employees can provide a great comfort on the appropriateness of overall valuation.

Also, studying the change in liability year on year for different employee groups can help in identifying any emerging trends. For large organisations, one can segregate data basis different salary bands and then perform the above analysis.

- ***Age and year of service wise analysis:*** A simple two dimensional table showing split of liability by employee age and year of service can help in knowing where the company's liability is concentrated and how the liability varies for different ages.

Example: Table showing liability as a % of total liability by age and years of service.

Age Band / Years of service	0 to 2 years	2 to 5 years	5 to 10 years	10 to 15 years	More than 15 years	Total
18 to 30 years	4%	7%	6%	1%	0%	18%
31 to 40 years	4%	8%	23%	10%	1%	46%
41 to 50 years	4%	5%	14%	1%	0%	24%
51 to 55 years	0%	1%	1%	2%	0%	4%
56 to 60 years	0%	0%	2%	3%	2%	7%
61 & above	0%	0%	0%	1%	0%	1%
Grand Total	**12%**	**21%**	**46%**	**18%**	**3%**	**100%**

- ***Ratio of actuarial liability to discontinued liability*** for different employee groups can also be seen at employee level to spot any outliers and identify any inconsistencies in the valuations. Discontinued / wind up liability is the amount that would be payable to employees if all the obligations were to be settled immediately. This is typically calculated ignoring the vesting criteria.

  Studying this ratio year on year or between different employee groups can reveal different trends and the efficiency of valuation.

2. Use in case of Transfer of Employees from one entity to other within the same group or in case of Mergers and Acquisitions

Employee wise liability plays an important role in case of a merger or acquisition or when employees are transferred from one entity to the other within the same group.

Every time an employee is transferred from one entity to the other, there is a need to transfer liability and corresponding asset to the acquiring company. Assessing the amount of liability to be transferred becomes easy in case you have access to the individual employee wise liability because the acquisition cost can simply be the sum of liability of those employees who have been transferred.

3. Key Management Personnel

Other financial reporting standards like IAS 24, and any other applicable standard may require an entity to disclose the information about employee benefits for key management personnel and requires disclosing the expense resulting from such benefits, if material.

Thus, an access to employee level details would be helpful in fulfilling the disclosure requirements for other relevant accounting standards.

4. It is a great Audit Evidence

From auditors' perspective, employee wise liability figures can also serve as great audit evidence indicating accuracy of the valuations done. This can also be handy in future, if past results need to be revisited for some reason.

I hope you found this article useful and I strongly recommend studying employee wise valuation results. I also thank you for reading this document and welcome any comments or recommendations or observations you may have on the subject. You can direct those to the email address mentioned below.

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