

## Accumulating Compensated Absences Actuarial Valuation considerations - 2021

It is now one year since the Government of India ordered a nationwide lockdown as a preventive measure against the COVID-19 pandemic. As companies embark on actuarial valuations of their employee benefits schemes for year-end 2021, here are a few considerations to be kept in mind specifically for this year.

### Impact of COVID-19 on Leave accumulation

Companies quickly shifted last March to “Work From Home” wherever possible. A K. A. Pandit study six months into the year observed that leave utilization had reduced significantly during the last year. <sup>1</sup> Due to the reduction in utilization of leaves, the increase in accumulated balances might lead to a steep increase in the leave obligation.

Anecdotal evidence from a few companies in our study suggested that certain companies have been managing costs by adjusting accumulated leave balances to offset costs.

For instance, employers had changed leave policies to:

Reduce the maximum number of leaves that can be encashed.

Reduce the maximum number of leaves that can be accumulated.

Reduce the number of leaves that can be carried forward.

Reduce in the leave credit for the year.

Disallow encashment and thereby ensure compulsory availment of certain leaves.

However, entities which were severely impacted due to COVID-19, especially where work from home was not possible or which could not smoothly implement it, the absence of work was being adjusted towards paid or un-paid leaves.

Many entities refrained from making any major changes in leave policies and thereby continue with the same benefits. Also, there were entities where leave policies were being adjusted only for the short term.

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1- [https://www.ka-pandit.com/assets/newsletter/Impact\\_of\\_COVID-19\\_on\\_Accumulated\\_Leave\\_Balances\\_Salary\\_and\\_Other\\_Components.pdf](https://www.ka-pandit.com/assets/newsletter/Impact_of_COVID-19_on_Accumulated_Leave_Balances_Salary_and_Other_Components.pdf)

### **KAP's view:**

Companies will need the actuarial valuation to reflect the impact due to any long-term change in leave policy. Furthermore, they need to ensure the assumption for leave utilization is reflective of expected experience going forward.

## **Impact of The New Labour Codes on Leave Benefit**

The Government of India amalgamated the existing 44 labour laws into four Labour codes - **Code on Wages<sup>2</sup>, Code on Social Security, Occupational Safety, Health and Working Conditions Code and Industrial Relations Code**. A company where leave encashment is provided on Basic salary may observe increase in costs if they decide to alter the compensation structure and significantly update the Basic Salary component. Furthermore, the “wages” definition under The Shops and Establishment Act in the respective States link with that defined under laws that were subsumed under the new Labour Codes (e.g., The Payment of Wages Act, 1936).

## **The Shops and Establishment Act**

The Central Government had given a uniform Shops and Establishment structure and some of the states have promulgated the same. We have summarised potential considerations when looking at the measurement of the leave obligation and provisions for leave encashment / availment / credit. The following table is an example, using Maharashtra Shops and Establishment (Regulation of Employment and Conditions) Act, 2017, as an example.<sup>3</sup>

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2- The Code On Wages, 2019 - <http://egazette.nic.in/WriteReadData/2019/210356.pdf>

3- (Mah. Act No. LXI of 2017) notified on September 17, 2017 Leave Encashment (Part 18 chapter 4) –

<https://bombayhighcourt.nic.in/libweb/acts/Stateact/2017acts/2017.61.pdf>

## Allows accumulation of unutilised leave

- **May increase employer liability.**
- **KAP View:** If leave encashment already in place in the *company's* leave policy for unutilised leaves, it may not impact liability.

## Accumulation upto 45 days

- **May increase availment/ encashment liability if existing entity's policy has lower maximum accumulation limit.**
- **KAP View:** Accumulation is allowed only if the leave applications are refused or as per *company's* policy.

## Right to encash leave in excess of 45 days

- **Short term encashment may occur- additional expense for employer.**
- **KAP View:** Employee is entitled for encashment if leave application is refused over and above 45 days. E.g., Employee's current balance 50 days, 5 days are refused, then employee can ask for encashment of 5 days.

## Encashment of 45 days

- **It is additional burden to the company, if encashment is currently not allowed in the company's policy. Also, if leave application is refused before exit (e.g., leave adjustment against notice period is not allowed) then encashment may occur.**
- **KAP View:** Before he/she has been allowed the leave, or if, having applied for and having been refused the leave, he/she quits his/her employment on account of retirement, resignation, death or permanent disability, the employer shall pay him/her full wages for the period of leave due to him/her.

## Encashment on full wages

- **Wages: The Code On Wages, 2019 Section 2(y)**
- **KAP View:** If the wages under S&E Acts link directly to the Code on Wages then there could be a significant increase in leave obligations and costs.

\*The impact of various such Shops and Establishment Acts when a company has pan-India offices needs to be treated carefully.

## Background

### Actuarial valuation of Accumulating Compensated Absences?

Actuarial valuation for Accumulating Compensated Absences is done for accounting purposes, as there are mandatory requirements. Entities have significant liabilities for employee benefits and thereby valuations are done to reflect the financial position of an entity's employee benefit plan. Actuarial valuation is complex because actuarial assumptions are required to measure the obligation. Moreover, the obligations are measured on a discounted basis because they may be settled many years after the employees render the related service.

Thereby, we recommend that entities should consider opting for Actuarial Valuations of Accumulating Compensated Absences.

We shall also be checking the trend as the pandemic has continued and we endeavor to keep our analysis up to date.

If you have any queries about this article or would like to discuss about any employee benefits related matter, such as actuarial valuations and related advice for Pension Scheme, Gratuity and Leave schemes, please get in touch with us at:

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