Is it a Plan Asset or a Separate Investment?

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PQR Company Ltd is a manufacturing company of toy kits for small babies. The products are a result of higher labour effort. The workforce of the company comprised of about two hundred and sixty employees. PQR Company does not trade any debt or equity instruments in the public market. Hence, the company was identified as a small and medium sized entity. They were having a policy of gratuity payment for the employees as follows.

Gratuity Liability= {(Basic salary)*Total No. of completed service years}*1.2

Discussion of the Issue

PQR Company was using the formula method for the gratuity calculation and both the booking of liability and payment of liability was based on the above formulae.

Management of the company had decided to invest in fixed deposit accounts for the purpose of settlement of the payment of liability as well as to earn an extra benefit (Interest) for the employees. Therefore they have maintained separate fixed deposits for every single employee since the number of employees were considerably a high amount and those fixed deposits were maintained under the company's name and given reference number with EPF No. for each employee. At the end of each financial year as part of profit appropriations, an additional transfer of funds have been made to these individual deposits to make current the eventual gratuity liability for the service rendered to date, reflecting the annually enhanced service period and basic salary as well as the fund has been economically updated annually by the interest earned on the deposit. Company calculated the liability for gratuity for the employees who have spent more than one year within the company. But they were enhancing the deposit amount at the end of the each year based on the employees who have completed more than four years in the company. Hence, it created a difference between the gratuity liability and the asset account or the fixed deposit account maintained for the purpose of settling that liability.

As per the company practice they had calculated the gratuity liability and since the deposit had maintained for the purpose of the settlement of the liability, the value of the fixed deposit account had reduced from the gratuity liability and they have shown it as a net liability.

Therefore we have evaluated the facts to assess whether the company practice is in line with the relevant standard guidance.

As per paragraph 32 on page 279 in LKAS 1 "presentation of financial statements" "an entity shall not offset assets and liabilities or income and expenses unless required or permitted by a standard."

As per the client's practice the Company offset an asset and a liability. Therefore as per LKAS 1 to offset assets and liabilities or income and expenses it should be permitted by a standard.

According to **SLFRS for SMEs part (a) in Paragraph 28.14 on page 212** it was mentioned that,

"In applying the general recognition principle in paragraph 28.3 to defined benefit plans, an entity shall recognize:

a) a liability for its obligations under defined benefit plans net of plan assets-its defined benefit liability."

Accordingly that asset is satisfied to be a plan asset, company shall recognize the liability for its obligation as defined benefit liability under defined benefit plans net of plan asset.
Hence it should be evaluated the facts further to assess whether those designated fixed deposits satisfied with the relevant criteria to be a plan asset in accordance with **LKAS 19** as **SLFRS for SMEs silence over this.**

As per page 546 of LKAS 19 'Employee Benefits' it was mentioned that 'plan asset' comprise:

a) Assets held by a long term employee benefit fund; and
b) Qualifying insurance policies

Assets held by a long term employee benefit fund are assets (other than non-transferable financial instruments issued by the reporting entity) that:

(a) are held by an entity a (fund) that is legally separate from the reporting entity and exist solely to pay or fund employee benefits;

Accordingly an asset held by an entity to pay its employee benefit, should be legally separated from the reporting entity and solely exist to pay /fund employee liability and then only it can be identified as a plan asset. In PQR Company Ltd the designated fixed deposits were maintained in an account which was under the company name. Hence, designated fixed deposits were not legally separated from the entity and as a result they did not fall within the satisfiable criteria to be a plan asset.

Implication of the Issue

But the company practice of showing the gratuity liability as a net figure thinking that the plan asset will misguide the users of financial statements. Though there is no any net impact to the statement of financial position this practice will affect upon the fair presentation of figures in financial statements

Conclusion and Recommendation

Therefore it is recommended that the Gratuity liability of PQR company Ltd and investments in fixed deposits should be presented separately in the financial statements and for good practice , a disclosure note has to be provided in financial statements to imply the existence of such designated fixed deposits for the purpose of settlement of gratuity.