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CHARTERED ACCOUNTANTS

Impact of New Labour Codes on Financial Reporting

The introduction of the new labour codes represents a significant legislative development, consolidating multiple existing statutes and redefining key aspects of employee compensation and benefits. This has direct implications for financial reporting, provisioning, and disclosure under both Ind AS and AS frameworks.

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1 Accounting Recognition and Timing

The Institute of Chartered Accountants of India (ICAI) has clarified that entities must assess whether the labour codes are "substantively enacted" for the purposes of Ind AS 12 and related standards. Until notification and effective dates are clear, companies should continue applying existing laws but remain vigilant for developments that may necessitate prompt recognition in financial statements.

2 Change in Law vs. Change in Estimate

The implementation of the labour codes constitutes a legal change. However, adjustments to actuarial assumptions—such as modifications to salary structures or benefit formulas—are generally treated as changes in accounting estimates, to be accounted for prospectively in accordance with Ind AS 8.

3 Defined Benefit Obligations

Entities must reassess actuarial valuations for gratuity, leave encashment, and other defined benefit plans if the new wage definitions or benefit formulas increase obligations. The impact should be recognized in profit or loss or other comprehensive income (OCI) as required by Ind AS 19/AS 15, once the new terms are effective or binding.

4 Curtailments, Enhancements, and Classification

Any curtailment or replacement of benefits must be recognized when the entity is demonstrably committed and the impact can be reliably measured. Enhancements increase the defined benefit liability. Changes in vesting periods or settlement timing may require reclassification between short-term and long-term benefits, affecting measurement and disclosure.

5 Wage Definition and Compensation Structure

The revised statutory definition of "wages" necessitates a realignment of salary structures and recalibration of bases for provident fund, gratuity, and bonus calculations. Entities should model the impact of including or excluding various pay components and document management's rationale for key judgements.

6 Transitional Adjustments and Disclosures

Most changes arising from the new codes will be treated as plan amendments or curtailments, with immediate recognition in profit or loss or OCI. Enhanced disclosures are required, including the nature of legislative changes, key assumptions, sensitivity analyses, and qualitative risk assessments, especially when the codes are notified but not yet effective.

7 Provisions, Contingent Liabilities, and Interim Reporting

Where the codes create a present obligation that can be reliably estimated, a provision is required under Ind AS 37/AS 29. If uncertainty remains, a contingent liability should be disclosed. Material changes must be reflected in interim financial results with appropriate explanatory notes.

8 Taxation and Industry-Specific Considerations

Entities must update deferred tax calculations for new temporary differences and assess the enactment status for tax accounting. Sectors with significant contract labour or gig workers should evaluate whether more personnel fall within the scope of statutory benefits.

9 Governance, Expert Involvement, and Audit

Boards and audit committees should ensure robust governance over estimates and assumptions, supported by actuarial and legal expertise where necessary. Statutory auditors are expected to rigorously evaluate management's processes, challenge assumptions, and review disclosures for adequac

10 Communication and Best Practices

Clear communication with stakeholders—including through MD&A and narrative reporting—is essential to explain the impact on cost structures and long-term obligations. Best practices include conducting impact assessments, updating systems and controls, engaging experts early, and maintaining comprehensive documentation.

Conclusion

The enactment of the new labour codes necessitates a rigorous reassessment of accounting policies and financial statement disclosures. Entities must carefully evaluate the timing of recognition for obligations arising from revised wage definitions and benefit formulas, ensuring compliance with Ind AS and AS standards. Immediate recognition of plan amendments, curtailments, and enhancements in profit or loss or OCI is essential, alongside transparent disclosure of key assumptions, sensitivity analyses, and qualitative risk factors. Companies should document management's judgments and provide detailed explanatory notes in both annual and interim financial statements, reflecting the impact of legislative changes and any uncertainties regarding effective dates. Robust governance and expert involvement will be critical to maintaining the integrity of financial reporting and fostering stakeholder trust during this period of regulatory transition.

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