



Wage Definition under Labour Codes – Emerging Financial Reporting and Audit Considerations

Pursuant to the implementation of The Code on Wages, 2019, The Industrial Relations Code, 2020, The Code on Social Security, 2020 and The Occupational Safety, Health & Working Conditions Code, 2020, together referred to as 'the four Labour Codes', from 21 November 2025, a new unified definition of "wages" has been introduced. Historically, the meaning and basis of computation for "wages" varied across different legislation for social security benefits. For instance, gratuity computations under the Payment of Gratuity Act were largely linked to basic salary and certain limited components, whereas other legislations, such as PF and ESIC, operated on their respective definitions and computational frameworks.

Under section 2(y) of the Code on Wages, 2019, "wages" has now been defined inclusively to broadly cover all remuneration, except for a specified list of exclusions such as bonus, house rent allowance, overtime allowance, commission, and

certain other prescribed components. The revised framework further provides that such specified exclusions should not exceed 50% of total remuneration, failing which the excess is required to be added back into "wages". In addition, the proviso to the definition also contemplates inclusion of remuneration payable in kind to the extent such remuneration exceeds 15% of total wages.

The revised definition does not, by itself, mandate a revision to compensation structures; however, it governs the components required to be included in or excluded from "wages" for computation of social security benefits, including gratuity.

Historically, several organizations evolved compensation structures with a significant portion of remuneration structured through allowances and similar salary heads. If such compensation structures are evaluated through the lens of the revised wage definition and the specified exclusions thereunder,

many of them could broadly operate closer to a 70:30 (inclusion: exclusion) construct for statutory purposes.

Under the revised framework, where specified exclusions exceed 50% of total remuneration, the excess is required to be added back into “wages” for computation of social security benefits. Consequently, compensation structures operating closer to a 70:30 model could potentially increase employee benefit outflows significantly.

Accordingly, several organizations have evaluated or implemented restructuring and reclassification of salary components to align compensation structures closer to a 50:50 (inclusion: exclusion) construct, which may be viewed as both legally compliant and commercially optimal from an employee benefit cost perspective.

Emerging Financial Reporting and Provisioning Considerations

An important issue which may arise from a financial reporting and audit perspective is whether gratuity and other employee benefit provisions as at the reporting date should continue to be evaluated based on the compensation structure prevailing as at the balance sheet date, or whether the expected transition toward revised compensation structures should also influence actuarial assumptions and provisioning assessments.

This issue may become particularly relevant in situations where revised compensation structures are implemented prospectively from a future date (for example, 1 April 2026), whereas the compensation structure prevailing during the earlier period continued to operate under the historical 70:30 construct.

In such scenarios, organizations may need to carefully evaluate:

- the basis and appropriateness of actuarial assumptions adopted;
- the resulting impact on employee benefit liabilities and related provisions;
- management’s documented assessment supporting the accounting position adopted;
- consistency between payroll structures, HR policies, and statutory computations; and
- the adequacy and operating effectiveness of related internal financial controls.

Full-and-Final Settlement Exposure during the Intervening Period

An additional area requiring careful consideration relates to employee separations occurring during the intervening period between the date from which the Labour Codes became applicable and the date from which revised compensation structures are formally implemented.

In such situations, an exposure may continue to exist in relation to full-and-final settlements, including gratuity computations, since the compensation structure in force during the relevant period may still have reflected the earlier 70:30 construct.

Accordingly, one possible view is that employee benefit computations relating to such an intervening period may need to be based on the compensation structure then prevailing and the corresponding wage component forming part thereof.

In practice, organizations may adopt different approaches based on legal advice, risk assessment, and evolving regulatory clarity. Certain organizations may choose to immediately settle the differential gratuity amount arising between computations based on the erstwhile Payment of Gratuity Act framework and computations based on the revised wage definition under the Labour Codes using the compensation structure then prevailing as part of full-and-final settlements, while others may prefer to create appropriate provisions in the financial statements and await greater implementation clarity before effecting actual payment.

In situations where payments are deferred pending further clarity, organizations may also consider maintaining transparent communication with affected employees through suitable letters or formal communication documenting the position being adopted.

Audit Perspective

From an audit perspective, the revised wage definition potentially extends beyond payroll structuring and introduces additional complexity in the areas of employee benefit obligations, actuarial estimates, management judgments and financial reporting assumptions.

Audit attention may be required in situations where compensation structures have been revised prospectively while the underlying employee benefit obligations relate to periods during which historical compensation structures continued to prevail. In such cases, the appropriateness of the assumptions adopted by management while determining gratuity and related employee benefit liabilities, including assumptions used by

management experts such as actuaries for actuarial valuation purposes, may become a key area of evaluation.

Accordingly, areas which may warrant increased audit focus include:

- management's documented interpretation of the revised wage definition and the basis of the position adopted;
- appropriateness and consistency of actuarial assumptions, including assumptions used by management experts for employee benefit valuations;
- alignment between revised compensation structures, gratuity computations, and other employee benefit obligations;
- evaluation of exposures relating to employee separations during the intervening period between the applicability of the Labour Codes and the implementation of revised compensation structures;
- adequacy of related provisions, contingent liability assessments, and financial statement disclosures;
- consistency between payroll records, HR policies, actuarial workings, and statutory computations;
- impact of subsequent management actions and compensation restructuring decisions on provisioning assumptions adopted as at the reporting date; and
- adequacy and operating effectiveness of payroll, employee benefit, and related internal financial controls.

As implementation progresses across states and additional regulatory and judicial clarity emerges, these matters may increasingly

evolve into areas requiring significant management judgment and enhanced audit scrutiny from a financial reporting perspective.

Conclusion

While implementation practices across organizations continue to evolve and additional regulatory clarity may emerge over time, organizations may nevertheless need to proactively evaluate the impact of the revised wage definition on existing compensation structures, employee benefit obligations and related financial reporting positions.

In particular, organizations may need to ensure that the assessment of the revised wage definition and its impact is not evaluated in isolation by a single function. Given the interconnected implications across compensation structuring, employee benefit provisioning, actuarial valuations, payroll processing, and legal interpretation, a coordinated assessment involving HR, payroll, finance, actuarial, and legal teams may become essential.

Such cross-functional evaluation may be particularly important while assessing:

- alignment of existing compensation structures with the revised wage definition;
- impact on gratuity and other employee benefit liabilities;
- implications for actuarial valuations and provisioning assumptions;
- exposures relating to employee separations during the transition period; and
- adequacy of related documentation, controls, and employee communication.

Given the potential interplay between compensation restructuring, employee benefit provisioning, and financial reporting judgments, organizations may need to ensure that the basis of the position adopted, related actuarial assumptions, provisioning approach, and employee communication framework are appropriately evaluated and documented from both compliance and audit readiness perspectives.

Sudit K. Parekh & Co. LLP

Chartered Accountants

MUMBAI


PUNE

HYDERABAD

GURUGRAM

BENGALURU

GET OUR INSIGHTS IN YOUR MAILBOX

 Subscribe to our newsletter today for more insights, thought leadership publications, and success stories to help you better navigate complex business challenges.

communication@skparekh.com

Follow us on:



Disclaimer

This document has been prepared for informational purpose only and is intended to provide general guidance on the subject matter. It should neither be construed as an opinion or advice nor be relied upon as being complete, comprehensive, and accurate. We accept no liability or responsibility to any person for any loss or damage incurred by relying on such information. Readers are advised to seek appropriate professional advice before acting on any matter discussed in this document. All content contained in this document, including text, graphics, logos, and other materials, is the proprietary property of Sudit K. Parekh & Co. LLP and is protected under applicable intellectual property laws, including the Copyright Act, 1957. No part of this document may be reproduced, distributed, or transmitted in any form or by any means without prior written permission of Sudit K. Parekh & Co. LLP, except as permitted under applicable law.

©2026 Sudit K. Parekh & Co. LLP. All rights reserved.

www.suditkparekh.com

skpco.info@skparekh.com