Statement of Intent (SOI) for a Proposed International Standard of Actuarial Practice (ISAP) on IAS 19 Employee Benefits

Submitted by: The IAS 19 Task Force of the Interim Actuarial Standards Subcommittee (IASSC)

1. Background

For employers preparing financial statements under IFRS ('*Reporting Entities*'), IAS 19 prescribes employers' accounting and disclosure requirements for their employee benefits (that is, most forms of consideration[1] given by a *Reporting Entity* in exchange for service rendered by employees).

On 16 June 2011, the IASB published an amended IAS 19. This standard is applicable for annual accounting periods beginning on or after 1 January 2013, with early adoption permitted.

A key principle of IAS19 is that it generally requires the cost of providing employee benefits to be recognised in the period in which the employee performs services, rather than when the benefit is paid. It should be noted that:

a) **Short-term benefits and defined contribution plans**
For short-term benefits or defined contribution post-employment plans[2], the undiscounted amount of the benefits or contributions expected to be paid is recognised in the accounting period the employee renders service.

b) **Defined benefit plans and other long-term employee benefits**
Defined benefit post-employment benefits and other long-term employee benefits are attributed to employees' service. The employer recognises a balance sheet liability/asset

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[1] IAS19 covers four categories of employee benefits (notably excluding equity share-based compensation):

- Short term benefits expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related services, such as wages, salaries and social security contributions, paid annual leave and paid sick leave, profit-sharing and bonuses and non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees
- Post-employment benefits, such as defined contribution retirement plans, pensions, lump sum payments on retirement, post-employment life insurance and post-employment medical care
- Other long-term employee benefits, such as long-service leave or sabbatical leave, jubilee or other long-service benefits and long-term disability benefits
- Terminations benefits payable as a result of the reporting entity's decision to terminate the employee or the employee's decision to accept an offer of benefits in exchange for termination of employment.

[2] The accounting treatment for a post-employment benefit plan will be determined according to whether the plan is a defined contribution or a defined benefit plan. IAS 19 defines these terms as follows:

- Under a defined contribution plan, the entity pays fixed contributions into a fund but has no legal or constructive obligation to make further payments if the fund does not have sufficient assets to pay all of the employees' entitlements to post-employment benefits.
- A defined benefit plan is a post-employment benefit plan other than a defined contribution plan. These would include both formal plans and those informal practices that create a constructive obligation to the entity's employees.

equal to the present value of these benefits, attributed to service through to the end of the accounting period (the "defined benefit obligation"), minus the fair value of plan assets at the balance sheet date. This net liability/asset is called the net defined benefit liability/asset. The net asset recognised on the employer's balance sheet is limited to the "asset ceiling," defined as the present value of economic benefits available to the employer as refunds from the plan and/or as reductions in future contributions.

Employers must recognise service cost and net interest (on the net defined benefit liability/asset) in the income statement. Service cost includes the cost of benefits attributed to service during the accounting period, changes in the defined benefit obligation due to plan amendments or curtailments occurring in the accounting period, and gains or losses from settlements occurring in the accounting period. Net interest is calculated by applying the discount rate (used to measure the defined benefit obligation) to the net defined benefit liability/asset, adjusted for contributions and benefit payments during the accounting period.

All other changes in the net defined benefit obligation/asset, including the difference between actual investment return and the expected return determined using the discount rate, changes in the defined benefit obligation from discount rate or other assumption changes, and experience gains and losses, are recognised immediately in Other Comprehensive Income (OCI).

c) Termination benefits

Termination benefits are triggered by the termination of employment, and are recognised when the *Reporting Entity* can no longer withdraw the offer of those benefits or, if earlier, when the *Reporting Entity* recognises associated restructuring costs. Termination benefits may take various forms, such as lump sum payments, pension benefit enhancements, or salary continuation for a specified period.

The *Reporting Entity* is ultimately responsible for the values reported in its IFRS financial statements, including the choice of assumptions within the guidelines set by IAS19. IAS19 does not require *Reporting Entities* to take advice from an actuary, and *Reporting Entities* typically do not need such advice with respect to short-term benefits, defined contribution post-employment benefits, and salary continuation. But for defined benefit post-employment benefits, other long-term employee benefits, and termination benefits paid in forms other than salary continuation, *Reporting Entities* normally seek advice from an actuary on the choice of assumptions, and actuaries typically play a central role in the calculation of reported amounts and the drafting of various disclosures for the accounting period. The actuary may also discuss these items with the auditor before the *Reporting Entity* finalises its financial statements.

2. Purpose

Because actuaries in many jurisdictions with many different types of benefit plans will be providing actuarial services in connection with IAS 19, an ISAP is the most effective means to facilitate convergence in actuarial practice within and across jurisdictions (as per Council decision in Vienna in October 2010). Hence this ISAP is expected to:

- Provide guidance to actuaries providing actuarial services for IAS 19 purposes to facilitate convergence in actuarial practice within and across jurisdictions,
- Increase public confidence in actuaries' services for IAS 19 purposes,
- Increase *Reporting Entities'* confidence in actuaries' contributions to IFRS reporting of employee benefits,
- Promote the development of the Actuarial Profession, as *Reporting Entities'* greater confidence leads them to expand their use of actuaries for IFRS reporting of employee benefits and
- Demonstrate the IAA's commitment to support the work of the IASB in achieving comparable financial reporting internationally (as envisaged by the recently signed MoU between the IAA and the IASB).

3. Scope, roles and content

The proposed ISAP will provide guidance to actuaries providing actuarial services in connection with IAS 19, Employee Benefits, as revised in 2011.

The proposed ISAP is expected to address the following aspects of actuarial services in connection with IAS 19, to the extent not fully or appropriately covered in ISAP1:

- Role of the actuary in providing actuarial services for IAS 19 purposes
- Knowledge of and compliance with IAS 19, those aspects of other IFRS relevant to the engagement, and the *Reporting Entity's* accounting policies
- Knowledge and consideration of the *Reporting Entity's* specifications regarding materiality for the engagement
- Scope and categorization (for example, as defined benefit or defined contribution) of the contractual and constructive employee benefit obligations as defined in IAS 19
- General process to be followed and factors to be considered by the actuary when advising a reporting entity on the selection of actuarial assumptions to be used for IAS 19 purposes (particularly the discount rate and mortality assumptions)

- Identifying “significant” assumptions and their “reasonably possible” variations for the *Reporting Entity’s* financial statement disclosures
- Actuarial methods for calculating the economic benefit under the rules governing the asset ceiling
- Actuarial issues surrounding:
    - The attribution of benefits to service
    - The recognition of hybrid plans, which combine elements of pure defined benefit and pure defined contribution plans
    - Risk-sharing arrangements, including member contributions and member options
    - The calculation of cost components (such as net interest)
    - The settlement of defined benefit obligations
    - The determination of fair value of plan assets and qualifying insurance contracts
    - The recognition of termination benefits
- Approaches to separating investment management costs from other administration costs (the two types of cost are recognised differently)
- Approaches for determining the duration of an obligation
- Items to be included in the actuary’s communication of results
- Practice-specific exceptions to ISAP 1, for example:
    - Disclosure *of the actuary’s* opinion of the appropriateness of the assumptions may be provided either in the report or in a separate communication to the principal
    - IAS 19 prescribes the valuation method
    - Assumptions must be unbiased
    - “Sensitivities” follow a specific framework and not in accordance with the actuary’s opinion alone

The areas ultimately covered by the proposed ISAP will depend on feedback received from consultation. A key requirement for inclusion in this ISAP is whether the guidance is likely to influence actuaries’ behavior in a way that promotes appropriate processes and transparent reporting of what can be very significant and material liabilities in the context of the *Reporting Entity* as a whole. If any listed areas are determined to be educational rather than behavioral, they may be covered in an Appendix to the proposed ISAP. In addition, areas where practice under amended IAS 19 is still evolving might not be covered (or covered in full) initially, but added to the proposed ISAP by amendment at a later time.

Finally it should be noted that the proposed ISAP dealing with IAS19 would not stand alone; ISAP 1 would also apply and actuaries would be encouraged to refer to it.

4. ***Principle of Subsidiarity***

Producing this ISAP on IAS 19 does not conflict with the principle of subsidiarity because all ISAPs are model standards. Nonetheless, the IAA can fulfil a unique role for the profession at international level vis-à-vis the IASB. The standard will provide guidance to actuaries providing actuarial services in accordance with IAS 19 and thus usefully contribute to international convergence of actuarial practice as per the IAA Strategic Objective 3[3]. The IAA will give the IASB opportunity to comment on the draft ISAP, thus complying with the 2012 Memorandum of Understanding between the IAA and the IASB and with the expectations of the IASB.

[3] Establish, maintain and promote common standards of actuarial education and common principles of professional conduct. Promote the development and issuance of actuarial standards in the jurisdictions of all Full Member Associations, and the global convergence of actuarial standards.