

# GN36 (ROD): ACCOUNTING FOR RETIREMENT BENEFITS UNDER FINANCIAL REPORTING STANDARD 17

## Classification

Recommended practice

## Legislation or Authority

Accounting Standards Board. Retirement Benefits. Financial Reporting Standard 17. 2000. (FRS 17).

Accounting Standards Board. Urgent Issues Task Force. Draft UITF Abstract: death-in-service and incapacity benefits. Urgent Issues Task Force Information Sheet 54. 26 February 2002. (UITF Information Sheet 54).

## Application

Any Fellow or Associate member of the Society of Actuaries in Ireland giving advice in connection with FRS 17.

Version	Effective from
1.0	01.09.2002

## 1 Introduction

- 1.1 FRS 17 covers accounting for a wide range of employee benefits including, but not limited to:
- pension schemes, both defined benefit and defined contribution,
  - retirement benefits other than benefits from pension schemes,
  - funded and unfunded arrangements,
  - approved and unapproved arrangements,
  - Irish and overseas arrangements,
  - multi-employer arrangements,
  - benefits secured under trust or other scheme constitution,
  - constructive as well as legal obligations.

*This list is not meant to be exhaustive.*

This Guidance Note concentrates on accounting for a funded Irish defined benefit pension scheme. It should be interpreted appropriately for other arrangements or benefits.

- 1.2 Additional aspects specifically relating to post-retirement medical plans are covered in Institute & Faculty GN21.
- 1.3 Smaller entities, as defined in Section 8 of the Companies (Amendment) Act 1986 as amended by the European Communities (Accounts) Regulations 1993 (S.I. No 396 of 1993), may choose to follow the Financial Reporting Standard for Smaller Entities (FRSSE) rather than the accounting standards (including FRS17) that apply to other entities. The FRSSE requirements for retirement benefits differ in some respects from those of FRS17. If the actuary is unsure which standard to use, he or she should consult the client.
- 1.4 For ease of reading, “year” is used as shorthand for the “financial period”. As in FRS17, references to an “employer” encompass all types of employer – private company, public body, subsidiary, holding company etc. References to trustees in FRS17 should be taken to mean the body governing the operation of the retirement benefit arrangement and references to “trust deed” should be taken to mean the documentation governing the operation of the retirement benefit arrangement.
- 1.5 Full actuarial valuations are not needed at every balance sheet date. An approximate or updated valuation may be used to reflect current conditions (see FRS17 paragraph 35).

Throughout this Guidance Note, the terms 'update' and 'updated' are used as they are in FRS17.

- 1.6 Employer accounts are generally prepared on a going concern basis. Accordingly calculations under FRS 17 should be prepared on the assumption of an ongoing scheme unless the circumstances indicate otherwise or unless there are specific instructions from the employer to the contrary.

## **2 Materiality**

- 2.1 Materiality is a technical accounting term reflecting the importance of a monetary amount to the employer's financial results. The relevant amount may differ for the balance sheet, the profit and loss account and the Statement of Total Recognised Gains and Losses (STRGL). The actuary should seek from the employer an indication of the materiality levels applicable for each accounting report (interim or full year results).
- 2.2 The actuary should advise on the steps required to achieve, within the reporting timescale, the degree of accuracy required in the valuation. However it is recognised that in some circumstances the degree of accuracy which can be achieved by the update compared with the results of a full valuation will be outside the normal materiality levels.

## **3 Relationships, Context and Information**

- 3.1 Employer's accounts are the responsibility of the directors (or equivalent) and may be public documents. The actuary should endeavour to establish the significance of the FRS17 results to the employer's accounts and measures of financial performance.
- 3.2 The actuary should be aware that the auditor may have specific requirements and should liaise directly with the auditor if requested to do so by the client.
- 3.3 The actuary should ensure that the employer knows that the arrangements set out in 3.4 need to be in place to meet the time constraints of the employer's financial reporting regime. The actuary should, if necessary, initiate discussions with the employer and auditor on other relevant aspects of the reporting exercise including assumptions, any split of work between different actuaries and the timescales for reporting.
- 3.4 For each reporting exercise the actuary should make arrangements with the employer to ensure access to all relevant information. This could include but is not limited to:
- the previous year's disclosures under FRS17,
  - scheme membership records,
  - details of benefit structures or commitments, including scheme documents,
  - details of any benefit improvements, benefit curtailments (including redundancies) or other scheme amendments,
  - scheme accounts (audited and, if applicable, draft) or details of scheme assets and income and expenditure,
  - details (including effective date for accounting) of bulk transfers, or other settlements,
  - details of practice for surplus utilisation,
  - details of any relevant constructive obligations (as defined in FRS 12) and discretionary benefits
  - details of any other material events, actions or changes,

*This list is not meant to be exhaustive.*

unless any item is inapplicable in the circumstances. The actuary should ensure the employer is aware of the sort of events, actions or changes which could have a material impact on the actuary's calculations.

## **4 Valuation**

### **4.1 General**

- 4.1.1 Under FRS17, the amount of any surplus that will be passed to members must be treated as increasing the scheme liabilities (see FRS17 paragraph 21). The actuary should take instructions from the employer as to whether, and to what extent, employees have a valid expectation that surplus will be used in this way, unless it is clear from the scheme rules or the actuary is already aware of the position.
- 4.1.2 Where there is a surplus, the employer should recognise an asset in its balance sheet only to the extent that the surplus can be recovered either through reduced contributions in the future or through refunds from the scheme (see FRS17 paragraph 37). If necessary, the actuary should calculate the amount that can be recovered by reducing the employer's contributions (see FRS17 paragraphs 41, 44, 68-70) after consulting the employer regarding the level of future active scheme membership to be assumed. The actuary should obtain from the employer details of any agreed refund to the employer (see FRS17 paragraph 42).
- 4.1.3 The current service cost (as defined in FRS 17 paragraph 2) should be based on the employees' and/or employer's contributions for the complete year, or details of pensionable earnings for the year, or an estimate of either of these based on the latest available information. It should be recalculated for any material events during the year.
- 4.1.4 The actuary should discuss with the employer the work required in connection with interim or part year reporting.
- 4.1.5 Where applicable, the actuary will need to consider the treatment of death-in-service and incapacity benefits. FRS17 sets out how the charge for such benefits must be calculated (see paragraphs 73 and 74). The actuary should also refer to the Urgent Issues Task Force Information Sheet 54, February 2002.
- 4.1.6 Insurance policies held in the name of the trustees and the related liabilities should be included in the FRS17 calculations and disclosures. To the extent that the policies are measured at the same value as the liabilities (see FRS17 paragraph 18) the net effect on the profit and loss account charge should be zero. However it is recognised that in some circumstances this information may not be available and this should be confirmed in the Actuary's report.

### **4.2 Assumptions**

- 4.2.1 The assumptions used for the valuation of liabilities are ultimately the responsibility of the employer's directors (or equivalent) who should have regard to advice given by an actuary (see FRS17 paragraph 23). The assumptions underlying the valuation should be mutually compatible and reflect a best estimate of the likely future experience.
- 4.2.2 FRS 17 states that if there is no liquid market in suitable bonds to determine the discount rate, then a reasonable proxy should be used (see paragraphs 32, 33 and 34). It is recognised that for many Irish pension schemes, the duration of the liabilities may differ from the duration of available AA bonds. Further, the liquidity of the corporate bond market will vary by jurisdiction and type and can be expected to vary from time to time. Where a reasonable proxy is required, it should be determined by reference to one or more of:
- an extrapolation or interpolation of the yields on available AA-rated corporate bonds,
  - the yield on interest rate swaps, and
  - the yield on other fixed interest or index-linked bonds with an appropriate adjustment for credit risk.

- 4.2.3 Paragraph 26 of FRS 17 sets out one method by which the expected future rate of inflation can be measured. However it should be recognised that there is not at present a liquid market in index linked bonds in this country. While such a market does exist in the Eurozone, actuaries will need to consider whether the implied level of price inflation is appropriate to Irish circumstances.
- 4.2.4 Under FRS17, pension increase assumptions must reflect established practice of granting discretionary increases if there is a constructive obligation to that effect (see FRS17 paragraphs 20 and 28).
- 4.2.5 The statistical assumptions must have regard to the difference between anticipated experience and the consequences of events initiated by the employer (see FRS 17 paragraphs 27-29 and 64-66).
- 4.2.6 The assumption relating to the expected return on assets is discussed in paragraphs 54-55 of FRS 17. In interpreting these paragraphs each year, the actuary should consider what has caused any change in market conditions and whether this justifies a change in the assumed rate of return. As such, an element of subjectivity is involved. The actuary should therefore provide advice on the basis of a reasonable estimate, which should ignore the impact of any potential restriction on recognised surplus under paragraph 67(c) in FRS 17.
- 4.2.7 Scheme expenses are mentioned in the FRS17 definition of the expected return on assets. The actuary should discuss with the employer the approach to be adopted to the treatment of scheme expenses.
- 4.3 **Valuation Updates (general)**
- 4.3.1 The employer's reporting timetable will typically require FRS17 valuation figures within a tight timescale. The results of a full or triennial valuation at the end of the employer financial year will not normally be available when the FRS17 figures are required, and a valuation update is therefore required; this update would normally be based on the most recent full valuation. However, where a subsequent actuarial assessment has been carried out, the actuary should start from this assessment if he or she believes this will provide a more accurate update.
- 4.3.2 The actuary cannot be definitive about the degree of accuracy of an updated valuation, especially an update over several years, as the accuracy of the updated valuation can only be assessed against the results of a full valuation. The actuary should therefore advise the employer on the key aspects of the valuation which could mean that the approximate FRS17 figures differ materially from those produced by a full actuarial valuation.
- 4.3.3 FRS17 (paragraphs 14-18) requires the use of the fair value of assets at the year-end, including net current assets. The actuary may need instructions from the employer on the asset values to be used in the valuation. Alternatively the actuary may make arrangements to obtain this information from an appropriate alternative source.
- 4.4 **Valuation Updates (process)**
- 4.4.1 Because the data availability, timescale, date of previous valuation, materiality levels, scheme experience and benefit structure will vary in each case, no particular valuation update process or approach can be specified or recommended. The actuary should however consider how to measure the assets and liabilities consistently, given that asset information will allow for actual payments to and from the scheme.
- 4.4.2 The actuary may use data on the membership at a date prior to the financial year-end provided he or she expects this not to have a material effect on the results.
- 4.4.3 Unless there have been major changes to the scheme, only the financial assumptions and the fair value of assets need to be updated at the balance sheet date (see FRS17 Appendix IV,

23(b)). In such circumstances experience gains and losses arising on scheme liabilities will be zero (see FRS17 paragraph 85(b)). Major changes that should be taken into account include:

- salary growth or pension increases, which are materially different from those expected,
- settlements, curtailments and other material scheme changes,
- other material events which the actuary has been advised of under 3.4 above.

## **5 Reporting**

5.1 The actuary should prepare a letter or report covering the relevant items in 5.2 –5.9 below.

5.2 The actuary should provide a clear statement of his or her remit, including but not limited to:

- the retirement benefits covered,
- the entity for which accounting figures are being prepared,
- whether he or she is advising on assumptions, calculating liabilities and costs for the schemes covered, or both
- the share of surplus/deficit allocated to employees (and any change in this assumption from the previous year).

*This list is not meant to be exhaustive.*

5.3 The actuary should specify the full valuation or subsequent actuarial assessment on which the update is based.

5.4 The actuary should provide details of the information and instructions used for the update.

5.5 The actuary should set out the assumptions used and, where relevant, the actuary's advice relating to those assumptions (see 4.2), including, if applicable, the basis of calculation of the amount of surplus recoverable.

5.6 The actuary should set out the material aspects of the update and the results of the calculations, including the numbers required to allow the employer to comply with the disclosure requirements of FRS17.

5.7 Where appropriate, the actuary should highlight the approximate nature of the update process, and should advise the employer on the key aspects of the valuation which could mean that the approximate FRS17 figures differ materially from those produced by a full actuarial valuation.

5.8 Where appropriate, the actuary should draw attention to the inherent volatility of the pension scheme figures shown in the balance sheet, the profit and loss account and the STRGL.

5.9 The actuary should state whether (and if so what) allowance for deferred tax has been made.