ACTUARIAL SOCIETY OF SOUTH AFRICA

APN 207: ACCOUNTING FOR RETIREMENT BENEFITS

Classification

APN 207 is an Advisory Practice Note (APN) and compliance with it is advisory. It applies to all members of the Actuarial Society of South Africa. APN 207 replaces PGN 207. Where legislation or other documentation refers to PGN 207 it should be interpreted as APN 207.

Abstract

This advisory practice note discusses what the actuary should take into account and include in his reports when advising South African *entities* on how they should account, in the books of the *entity*, for retirement benefits in defined benefit retirement arrangements.

Purpose

The purpose of this advisory practice note is to ensure that reports comply with the requisite accounting standards. This note does not extend to post-employment health care benefits which are covered by APN 301. This note also does not extend to short-term employee benefits, post-employment life insurance or other long-term employee benefits (such as long term paid absences, long-service benefits and long-term disability benefits) or termination benefits.

This APN has been prepared to assist actuaries in performing their duties to *entities* in a manner that will maintain the high levels of professional competence and integrity required by ASSA and the reputation of our profession.

This APN is not intended to restrict the actuary's freedom of judgment in choosing valuation methodologies or actuarial assumptions. However, actuaries should be mindful of the relevant legislation and accounting statements below and the need (where appropriate) for consistency within their own work, and with the generally accepted actuarial practice within the industry.

Legislation or Authority

Actuarial Society of South Africa Retirement Matters Committee

South African Institute of Chartered Accountants (SAICA): SAICA Financial Reporting Guide 3

International Financial Reporting Standards (IFRS): IAS19 Employee Benefits, IFRIC 14

Other relevant accounting statements, e.g. GRAP 25 and FAS132 (USA), FRS17 (UK).

Application

Any actuary giving advice or preparing reports in connection with IAS19 (referred to as the *Statement* in this APN) in respect of retirement benefits.

Author

Actuarial Society of South Africa Retirement Matters Committee, ASSA, September 2017

Status

Version 1.0 Effective from March 2004
Version 2.0 Effective from September 2017

Definitions

Defined terms appear in italics when used in this APN.

Reference	Definition
Entity	Encompass all types of employer – i.e. private company, public body, subsidiary, holding company, etc
Statement	IAS19 Employee Benefits (June 2011) effective for financial years commencing no later than 1 January 2013 and prior versions of IAS19. This Statement covers accounting for a wide range of employee benefits.
Pension Funds Act	The Pension Funds Act 24 of 1956
Year	Shorthand for the "financial period" of the *entity* for which the report is being prepared

1. Scope

This APN concentrates on accounting for South African retirement funds for *entity* accounting purposes. It could be interpreted appropriately for other arrangements or benefits.

This APN deals with reporting on defined benefit employer sponsored plans, including multi-employer plans. Defined benefit plans include hybrid funds with defined benefit underpins; and defined contribution funds where members must, or have the option to convert their defined contribution benefit a retirement to an in-fund defined benefit pension. Reporting on other defined contribution employer sponsored plans does not require any actuarial techniques, and as such is not dealt with under this APN.

This APN is not intended to replace or summarise the relevant accounting statement, and should be read in conjunction with the relevant accounting statement.

1.1 Full actuarial valuations are not needed at every balance sheet date of the *entity*. In terms of the *Statement*, an approximate or updated valuation may be used to reflect current conditions, as long as the nature of the approximation is not such as to render the resulting deviations from the true position "material" as defined by the accounting profession (see Section 2 below).

1.2 Where projections are required between balance sheet dates, such projections should be prepared on a basis where the valuation of assets and liabilities are determined in a consistent manner so that the resulting position would not deviate materially from the true position had a full actuarial valuation been performed as at the projection date.

1.3 *Entity* accounts are generally prepared on a going concern basis. Accordingly calculations under the *Statement* should be prepared on the assumption of an ongoing scheme *unless the* circumstances indicate otherwise or unless there are specific instructions from the *entity* to the contrary.

2. Materiality

2.1 Materiality is an accounting term reflecting the importance of a monetary amount to the *entity*'s financial results. The relevant amount may differ in the balance sheet and in the income statement. The actuary should seek from the *entity* 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 time-scale, the degree of accuracy required in the valuation. The actuary may carry out a detailed valuation of the obligation prior to reporting period, with the results of that valuation updated for any material transactions and other material changes in circumstances (including changes in market prices and interest rates) up to the end of the reporting period.

2.3 In some cases, estimates, averages and computational short cuts may provide a reliable approximation of the detailed computations illustrated in the *Statement*.

2.4 Under IAS 8 a material error requires a balance sheet restatement, whereas an immaterial error needs to be recognized through the income statement.

3. Relationships, Context and Information

3.1 An *entity's* accounts are the responsibility of the directors (or equivalent) and may be public documents. The actuary should be guided by the *entity* as to the significance of the *Statement* results to the *entity's* accounts and measures of financial performance.

3.2 The actuary should be aware that the *entity's* auditor may have specific requirements and should liaise directly with the auditor if requested to do so by the *entity*.

3.3 The actuary should ensure that the *entity* knows that the arrangements set out in 3.4 need to be in place to meet the time constraints of the *entity's* financial reporting regime.

3.4 Subject to clause 4.3, for each reporting exercise the actuary should make arrangements with the *entity* to ensure access to all relevant information including, but not limited to:

3.4.1 the previous *year's* disclosures under the *Statement*;
3.4.2 fund membership records;
3.4.3 details of benefit structures or commitments, including fund documents, policies and Rules;
3.4.4 details of any benefit improvements, curtailments (including retrenchments) or other fund amendments;
3.4.5 fund accounts (most recent audited or, if applicable, current drafts) or details of fund assets, income and expenditure from management accounts and investment policy statements;
3.4.6 details (including effective date for accounting) of bulk transfers, or other settlements;
3.4.7 pension increase policy, methodology and past practice and history of increases;
3.4.8 if applicable, details of the pensioner account if held separately from the main fund assets and details of the accounting transactions via this account;
3.4.9 details of practice for surplus utilisation and future allocation (if available), or any apportionments made in terms of the *Pension Funds Act,* including treatment of surplus within the pensioner account (if applicable)*;*
3.4.10 details of any relevant constructive obligations and discretionary benefits; and/or
3.4.11 details of any other material events, actions or changes.

(This list is not meant to be exhaustive)
unless any item is not applicable in the circumstances.

The actuary should ensure the *entity* is aware of the type of events, actions or changes that could have a material impact on the

actuary's calculations and the actuary's ability to meet the required time constraints.

3.5 While the *entity* is responsible for the data used in the valuations, the actuary should perform the necessary checks to ensure the data is reasonable relative to prior data available, if any. Any reservations regarding the data must be highlighted in his/her report.

4 Valuation

4.1 General

4.1.1 The effort involved in measuring employee benefit obligations should be proportional to the level of accuracy established for the assignment, taking into account materiality. The actuary is not required to recommend a particular type of assumption or a more refined approach when, in the actuary's professional judgment, its use is not expected to produce materially different results. For example, using a simplified approach to set the discount rate may not produce results that are materially different from a more refined approach.

4.1.2 Accounting by an *entity* for defined benefit plans involves the following steps:

(a) Using actuarial techniques to make a reliable estimate of the amount of benefit that employees have earned in return for their service in the current and prior periods. This requires an *entity* to determine how much benefit is attributable to the current and prior periods and to make estimates (actuarial assumptions) about demographic variables (such as employee turnover and mortality) and financial variables (such as future increases in salaries and pensions) that will influence the cost of the benefit. In determining the obligation and service cost, account should be taken of instances where the benefit is at least equivalent to the minimum benefit required in terms of the *Pension Funds Act*.

(b) Discounting that benefit using the Projected Unit Credit Method in order to determine the present value of the defined benefit obligation and the current service cost.

(c) Determining the fair value of any plan assets.

(d) Determining the total amount of actuarial gains and losses that should be recognised.

(e) Where a plan has been introduced or changed, determining the resulting past service cost.

(f) Where a plan has been curtailed or settled,

determining the resulting gain or loss. (The actuary should seek direction from the *entity* and their appointed auditors where there is uncertainty whether curtailments and settlement occurs at the same time and what the accounting treatment should be.)

Where an *entity* has more than one defined benefit plan, the *entity* applies these procedures for each material plan separately.

4.1.3 When the actuary takes plan assets into account, the actuary should be guided by the following:

(a) Asset Values Supplied by Others – The actuary may rely on asset values prepared by a third party (such as an investment manager).

(b) Qualifying Insurance Policies – When plan assets include qualifying insurance policies, the actuary should appropriately reflect those policies in the calculation of the obligation. For example, the actuary should appropriately differentiate between the reporting entity's employee benefit obligations and those that an insurer has assumed.

(c) Asset-related Benefit Liabilities – The actuary should apply professional judgment to appropriately value employee benefits when the benefit level is affected by the value of plan assets (for example, when benefit levels are linked to the return on plan assets or depend on whether there is a surplus).

(d) Asset Ceiling – When there is a surplus (that is, the fair value of plan assets exceeds the present value of the defined benefit obligation for the plan), the actuary should consider whether the asset ceiling applies. The asset ceiling applies when the surplus exceeds the present value of economic benefits available to the reporting entity in the form of refunds from the plan or reductions in future contributions to the plan. If the asset ceiling applies – or the actuary is uncertain whether it applies – the actuary should seek guidance from the reporting entity whether to apply International Financial Reporting Interpretations Committee Interpretation number 14 (IFRIC 14).

4.1.4 Under the *Statement*, the amount of any surplus that has been allocated to members or former members must be treated as increasing the fund liabilities. Any amount held in the Member Surplus Account should be added to the fund liabilities.

4.1.5 Some funds ring-fence pensioner assets and liabilities in a pensioner account. When such an account is defined in the rules of the fund, any surplus in the pensioner account may be deemed to increase the pensioner liabilities to the level of the available assets in the pensioner account. Any deficit in the pensioner account should not be limited to the available assets, but should be treated as a deficit.

4.1.6 The actuary should take care in the treatment of unallocated surpluses and only recognise surplus as an employer asset when it falls in line with paragraph 64 of IAS19 and SAICA Financial Reporting Guide 3. In addition, surplus in one category of membership may not be used to offset a deficit in another category of membership unless

(a) it is provided for in the rules of the fund, or
(b) the trustees of the fund have resolved to the same, or
(c) the surplus will be allocated to the employer surplus account in terms of the rules or by resolution of the trustees.

4.1.7 Where there is a surplus, the *entity* should recognise an asset in its balance sheet only to the extent that the surplus can be utilised either through reduced contributions in the future or through refunds from the scheme. The extent that the surplus can be utilised either through reduced contributions in the future or through refunds from the fund is dependent on the rules of the fund which may be:

(a) silent on the treatment of statutory surpluses,
(b) specify that all statutory surpluses be allocated to members of the fund or to the employer, or
(c) allocated in a specified proportion between the employer and members of the fund.

SAICA Financial Reporting Guide 3 provides detail as to the level of accounting surplus available as a refund under each of these scenarios and takes consideration of the level of the Employer Surplus Account.

4.1.8 The current service cost is the present value of the increase in the defined benefit obligation resulting from an employee service in the current period.

4.1.9 The actuary should discuss with the *entity* the work required in connection with interim or part *year* reporting.

4.1.10 Where applicable, the actuary will need to consider the treatment of death in-service and incapacity benefits – if the actuary is dealing exclusively with retirement funds, then free-standing insurance arrangements would typically be excluded.

4.1.11 Insurance policies in respect of long term benefit payments held in the name of the retirement fund and the related liabilities should be included in the *Statement* calculations and disclosures. The fair value of those insurance policies is deemed to be the present value of the related obligation if the amount and timing of benefit payments match and the net effect to the profit and loss account and balance sheet should be zero.

4.1.12 Administration costs should be recognized by the *entity* when the administration services are provided.

4.2 Assumptions

4.2.1 Although the assumptions used for the valuation of liabilities are ultimately the responsibility of *the entity's* directors (or equivalent), this does not preclude the actuary from advising his or her client on the application of IAS19 and on the various assumptions, nor from commenting on any assumptions or other matters which the client may specify which he or she believes do not conform with the requirements of IAS19.

4.2.2 When advising the reporting *entity* on the selection of assumptions, the actuary may consider assumptions selected for other purposes or demographic assumptions used at a prior valuation date, if in the actuary's professional judgment, those assumptions satisfy the account standard requirements.

4.2.3 The actuary generally should apply a consistent process from *year* to *year* to develop recommended assumptions for a particular reporting *entity*. When the actuary considers it appropriate to change the process used to develop a recommended assumption, the actuary should discuss the change with the reporting *entity*, and should seek guidance from the reporting *entity* regarding what, information about the change should be disclosed in the report.

4.2.4 The assumptions underlying the valuation should be unbiased and mutually compatible and reflect a best estimate of the variables that will determine the ultimate cost of providing post-employment benefits. Financial assumptions shall be based on market expectations, at the end of the reporting period, with specific reference to the duration of the obligations valued.

4.2.5 The *Statement* states that if there is no liquid market in suitable corporate bonds to determine the Discount Rate (as defined in the *Statement*), then the market yields on government bonds should be used. The currency and term of the corporate bonds or government bonds shall be consistent with the currency and estimated term of the post-employment benefit obligation. Actuaries should note that this assumption is the Discount Rate assumption, and should not be adjusted to reflect any expenses, including investment expenses.

4.2.6 Under the *Statement*, pension increase assumptions should reflect established practice of granting discretionary increases if there is a constructive obligation to that effect as well as take cognisance of the requirements of the *Pension Funds Act*. Specifically, in terms of the *Pension Funds Act*, allowance must be made for the trustees' pension increase policy and the minimum pension increase provisions.

4.2.7 It is not appropriate to use an input in calculating the undiscounted liability that is not based on reasonable expectations given that IAS 19 prescribes the discount rate that should be used to determine the present value. For example, it is not appropriate to 'adjust' other assumptions such as pension increases or expected returns to align with the IAS 19 discount rate in order to derive an IAS 19 valuation that is closer to the statutory valuation. The valuation basis for the IAS 19 valuation must meet the requirements of the accounting standard which may be different from the requirements of the statutory actuarial valuation. For example, if it is expected that pension increases will be 80% of CPI (i.e. if this is the expectation of the actual increases that the pensioners will receive before taking the present value into account), then that assumption should be used in the calculation of the undiscounted IAS 19 liability without any adjustment.

4.2.8 The statistical assumptions must have regard to the difference between anticipated experience and the consequences of events initiated by the *entity*.

4.2.9 The salary increase assumption should be set taking account of inflation, seniority, promotion, and other relevant factors, such as supply and demand in the employment market. In setting this assumption, discussions should be held with the *entity*, and any areas of subjectivity need to be highlighted and justified.

4.2.10 For demographic assumptions, consideration should be given to those used at the last statutory actuarial valuation, unless an experience investigation (if any) suggests a material departure such that it reflects a best estimate of the likely future experience.

4.2.11 The actuary may use a generational mortality table (that is, a matrix including separate mortality tables for each year of birth). The actuary may also use simplified mortality projection methods such as projecting the mortality rates for an appropriate period.

4.2.12 Where a multi-employer group exists, consideration should be given to consistency of assumptions amongst the various companies or funds.

4.3 Valuation updates

4.3.1 The *entity's* reporting timetable will typically require *the Statement* valuation figures within a tight timescale. The results of a full or triennial valuation of the pension scheme at the end of the *entity's* financial *year* will not normally be available when the *Statement* figures are required. The *Statement* does allow estimates, averages and computational shortcuts, provided that these are reasonable approximations.

4.3.2 Because the data availability, time-scale, date of previous valuation, materiality levels, scheme experience and benefit structure will vary in each case, no particular approximation 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.

4.3.3 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.

4.3.4 Unless there have been major changes to the scheme, only the financial assumptions and the resulting impact thereof to the liabilities valued and the fair value of assets need to be updated at the balance sheet date.

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 (including benefit payments in respect of schemes closed to new members),
- other material events which the actuary has been advised of under 3.4 above,
- Changes to the pension increase policy, or
- **Minimum benefits calculation methodology.**

5. Reporting

5.1 The actuary should prepare a letter or report which clearly directs itself to the *entity* covering the relevant items in 5.2 – 5.13 below. This list is not meant to be exhaustive and the actuary should take note of the information that the *entity* should disclose in their financial statements as set out in paragraph 135 to 152 in the *Statement*.

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

- the *entity* for which the accounting figures are being prepared,
- the purpose of the valuation and the dates as at which the current and immediately preceding valuation (if any) were performed,
- details of any special events that occurred since the previous valuation and an allowance, if any, for significant

developments that occurred after the valuation date although these developments should be allowed for in the next reporting period,

- a summary of the benefits valued. The actuary should highlight any ambiguity in terms of the benefit definitions or characteristics or risks that are unusual to the reporting *entity*'s liability,
- a summary of the data used in the valuation,
- information about the maturity profile of the obligation, including the weighted average duration,
- whether he or she is advising on assumptions, calculating liabilities and costs for the funds covered, or both
- the share of surplus/deficit allocated to employees, the *entity*, or any other stakeholder (and any change in this assumption from the previous *year*),
- a reconciliation of the valuation results with those of the previous valuation (if any), including an analysis of any gains and losses,
- the actuary's qualification and the capacity in which the actuary has signed the report.

5.3 The actuary should specify the full valuation or subsequent actuarial assessment on which any approximation 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, including, if applicable but not limited to, the treatment of reserve account balances, consideration of the trustees' pension increase policy, pensioner account and the basis of calculation of the amount of surplus available to the *entity*.

5.6 The actuary should set out the material aspects of any approximations and the results of the calculations, including the numbers required to allow the *entity* to comply with the disclosure requirements of the *Statement*.

5.7 Where appropriate, the actuary should highlight the nature of any approximations, and should advise the *entity* on the key aspects of the valuation which could mean that the approximate *Statement* figures differ materially from those produced by a full actuarial valuation.

5.8 Where appropriate, the actuary should disclose:

a) A sensitivity analysis for each significant actuarial assumption as of the end of the reporting period, showing how the defined benefit obligation would have been affected by changes in the relevant actuarial assumption;

b) The methods and assumptions used in preparing the sensitivity analysis and the limitations of those methods;
c) Changes from the previous period in the methods and assumptions used in preparing the sensitivity analyses, and the reasons for such changes.

5.9 The report should be clearly qualified to the extent that the actuary has any reservations regarding the data, assumptions or interpretation of the benefits being valued.

5.10 The report should state any significant departure(s) from this APN and the reasons for such departures.

5.11 The report should be signed by a Fellow of the Actuarial Society of South Africa.

5.12 If the actuary has signed more than one version of the report at the same valuation date, the revised report should state in broad terms the difference(s) between the revised report and any previous versions of the report at the same valuation date.

5.13 Consideration should be given to those entities that have parent companies in other countries. Separate disclosures may be necessary.