# Pakistan Society of Actuaries

## PSoA GN 3

## Guidance Note on Selection of Assumptions and Reporting on Accounting of Post-Employment Benefits Schemes

**Final**

**26 August 2014**

# 1 BACKGROUND AND SCOPE

1.1 This Guidance Note offers advice to actuaries who are engaged to perform actuarial valuation by a post-employment benefits scheme sponsor on the reporting of such schemes (and the selection of assumptions for such schemes) in Pakistan under International Financial Reporting Standards ('IFRS').

1.2 This Guidance Note has been prepared by the members and non-members of the Pakistan Society of Actuaries ("PSoA") and was approved by the Council of the PSoA in its meeting held on 11 August 2014.

1.3 International Accounting Standard 19 ('IAS 19') *Employee Benefits* prescribes the accounting and disclosure by employers for employee benefits.

1.4 IAS 19 requires that actuarial assumptions be unbiased and mutually compatible. Actuarial assumptions are an entity's best estimates of the variables that will determine the ultimate cost of providing post-employment benefits. Actuarial assumptions comprise of demographic assumptions and financial assumptions.

1.5 Two actuaries, each familiar with the circumstances of a case, may select different assumptions for that case. That is acceptable if the range of their selections is appropriately constrained by this Guidance Note. Sometimes, however, it is desirable that actuaries produce results within a relatively narrow range which the profession and the public perceive to be reasonable and consistent. It is then appropriate for the profession to supersede the actuary's selection by a prescription in the guidance note that is within the range of assumptions otherwise considered acceptable.

1.6 Each individual assumption should satisfy this Guidance Note.

1.7 This Guidance Note is applicable for valuations with a reporting date (**not** valuation date) after August 31, 2014.

## 2 Assumption Guidance

2.1 **Discount Rate Assumption:** This assumption is determined with reference to market yields at the end of the reporting period on government bonds with terms equal to the estimated term of the post-employment benefit obligations. PSoA has set up a Discount Rate Committee which will issue Discount Rate Guidance at the end of each quarter. Guidance for the Committee in this regard is set out in PSoA's Guidance Note 4 on the selection of Discount Rate for Accounting of Post-Employment Benefits Scheme.

2.2 **Salary Increase Assumption:** This assumption estimates the future salary increases taking into account inflation, seniority, promotion and other relevant factors, such as supply and demand in the employment market.

The PSoA recommends the following basis as the benchmark for this assumption:

| Term | Basis | Maximum Differential |
|---|---|---|
| Short Run (upto 3 years from valuation date) | Management viewpoint + Past compensation practices | Selected discount rate +/- 500 bps in the short term |
| Long Run | Driven by differential with discount rate/long term economic view of actuary | Selected discount rate +/- 200 bps in the long run |

In addition, the actuary should disclose the following in relation to this assumption:

1) The historical salary increase information for at least one year;
2) The use of management's viewpoint on the salary increase assumption (if used in the short run); and
3) The date at which the salary increase assumption is applicable.

2.3 **Mortality Assumption:** An entity shall determine its mortality assumptions by reference to its best estimate of the mortality of plan members both during and after employment.

The PSoA recommends the following basis as the benchmark for this assumption:

Post-retirement mortality will be as follows:

- For male member/male spouse: **SLIC with 1 year setback**
- For female member/female spouse: **SLIC with 4 year setback**

Pre-retirement mortality will be as follows:

- For male member: **SLIC with 1 year setback**
- For female member: **SLIC with 4 year setback**

Where spousal date of birth information is not available

- Female spouse will be assumed to be 5 years younger than male member
- Male spouse will be assumed to be 5 years older than female member

2.4 **Pension Increases Assumption:** Due to varying practices, no specific guidance is provided with respect to this assumption.

Actuaries will use their discretion in setting this assumption based on

- Past practices;
- Future expectations; and
- Management's viewpoint.

Importantly, the actuary should disclose the basis (i.e. the three items above) of this assumption.

2.5 **Withdrawal Rates Assumption:** Withdrawal rates, both at early durations of service and near retirement date, have a significant impact on the liability of post-employment benefit schemes and is the most difficult to estimate. The past may not be a guide to the future. Even if the past experience can be statistically analyzed and produce some meaningful rates, the future experience of withdrawals will depend on general economic conditions as also the particular conditions affecting the given employer's business. Furthermore, withdrawal rates differ significantly from scheme to scheme and within a scheme from year to year.

Actuaries have to examine any relevant information available to them and use their best possible judgement.

2.6 **Morbidity Assumption:** There is no guidance available on this right now. Actuaries have to examine any relevant information available to them and use their best possible judgement.

2.7 **Post-Retirement Medical Schemes**: Assumptions about medical costs shall take account of estimated future changes in the cost of medical services, resulting from both inflation and specific changes in medical costs.

2.7.1 **Average Medical Cost Assumption:** Client's data recording and collection practices vary widely. Individual scheme experience should be used establish this assumption. Importantly, the actuary should disclose the basis of this assumption.

2.7.2 **Medical Inflation/Cost Increase Assumption:** The PSoA recommends the following basis as the benchmark for this assumption:

| **Period** | **Basis** | **Maximum Differential** |
|---|---|---|
| Pre-retirement Inflation | Management viewpoint + Past compensation practices | Selected discount rate - 200 bps |
| Post-retirement Inflation | Driven by differential with discount rate/long term economic view of actuary | Equal to selected discount rate (to account for age-based increases in utilization) |

## 3 Leave Accumulation Schemes

This section refers to those schemes which allow for accumulation of leave balances beyond the end of the year.

3.1 **Accrued Balances:** Leave accumulation schemes should be valued based on accrued leave balances.

3.2 **Subjective Area:** Notwithstanding the above, the area of "Other Long-Term Employee Benefits" under IAS 19 is a very subjective area. There is not one single correct methodology to value complex leave arrangements that employers have and therefore the actuary has discretion on methodology used. As long as the actuary's methodology (which will need to be disclosed) is reasonable, differences can be tolerated.

## 4 Assumptions: Communications and Disclosures

The report should provide enough detail on assumptions used so that another actuary can determine the reasonableness of the results. This includes:

4.1 **Assumptions Used:** The actuary should describe each significant assumption used in the measurement. Sufficient detail should be shown to permit another qualified actuary to assess the level and pattern of each assumption.

4.2 **Rationale for Assumption:** The actuary should disclose the information and analysis used in selecting each assumption that has a significant effect on the measurement. The disclosure may be brief but should be pertinent to the scheme's circumstances.

4.4 **Changes in Assumptions**: The actuary should disclose any changes in the economic and demographic assumptions from those previously used for the same type of measurement.

4.5 **Deviation from Guidance Note:** The actuary should report and justify any deviation from this Guidance Note.

4.6 **Confidential Information:** Nothing in this Guidance Note is intended to require the actuary to disclose confidential information.

## 5 Reporting: Communications and Disclosures

In addition to the assumption disclosure in Section 3, for large schemes (i.e. scheme's membership > 10,000 members) the actuary's report should be more detailed. The Actuarial Standards of Practice published by the Society of Actuaries are the best guide on reporting standards.

The report:

5.1 Should include the valuation date and report date;

5.2 Describe the membership data;

5.3 Describe the market value of assets and a summary of the assets by major category;

5.4 Describe the plan's benefit provisions;

5.5 Describe the valuation of any substantive commitment;

5.6 Describe the actuarial cost method i.e. Projected Unit Credit Method; and

5.7 Describe the assumptions as per Section 2 of this Guidance Note.

5.8 Should state whether the report has been prepared in accordance with this Guidance Note.

## 6 Audit Review Protocol

There are three parties involved in this process: The original actuary, the auditor appointed actuary and the auditor

When an auditor appointed actuary is to review another actuary's work, the actuaries involved have a responsibility to follow the protocol below:

**6.1 Information Requests:** As is the case in the terms of engagement between the auditor and auditor appointed actuary**,** the auditor appointed actuary should direct all information or data requests to the auditor.

**6.2 Cooperation between Actuaries:** Generally, the original actuary has a duty to cooperate with the auditor appointed actuary.

**6.3 Keep Auditor in Loop:** The auditor appointed actuary will seek permission from the auditor to directly discuss any differences that arise in the review with the original actuary.

**6.4 Addressing any Differences**: Following any discussions, any unresolved differences between the results of the auditor appointed actuary and the results of the original actuary, will subsequently be reported to the auditor by the auditor appointed actuary.

**6.5 Compliance with this Guidance Note:** The auditor appointed actuary's report should state whether the original actuary's report is in compliance with this Guidance Note.