ACTUARIAL SOCIETY OF INDIA

Guidance Note 13: INVESTIGATIONS OF RETIREMENT BENEFIT SCHEMES: THE ACTUARIAL REPORTS REQUIRED UNDER FAS 87, FAS 88 AND FAS 132.

Classification:

Practice Standard

Legislation or Authority:

1. There is no legislation in India which has impact on this GN

2. Financial Accounting Standards Board (USA). *Employers' accounting for pensions.* Statement of Financial Accounting Standards No.87 (as amended). (FAS 87)

   Financial Accounting Standards Board (USA). *Employers' accounting for settlements and curtailments of defined benefit pension plans and for termination benefits* .Statement of Financial Accounting Standards No.88 (as amended). (FAS 88)

   Financial Accounting Standards Board (USA). *Employers' disclosures about pensions and other postretirement benefits – an amendment of FASB Statements No. 87, 88, and 106.* Statement of Financial Accounting Standards No. 132 (revised 2003). (FAS 132).

   Financial Accounting Standards Board (USA). FASB Staff Implementation Guides, September 2001. 'A Guide to Implementation of Statement 87 on Employers' Accounting for Pensions' and 'A Guide to Implementation of Statement 88 on Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits'.

   Actuarial Standards Board (USA). *Actuarial compliance guideline No.1: an actuary's guide to compliance with Statement of Financial Accounting Standards No.87.*

   Actuarial Standards Board (USA). *Actuarial compliance guideline No.2: for Statement of Financial Accounting Standards No.88.*

3. ASI GN 11: Actuarial Investigations of Retirement Benefit Schemes

4. IAA International Actuarial Standards of Practice: Currently there is no applicable IAA standard of Practice

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Compliance:

Members are reminded that they must always comply with the Professional Conduct Standards (PCS) and that Guidance Notes impose additional requirements under specific circumstances.

Application

This Guidance Note, applies for any actuarial valuation of retirement schemes of Defined Benefit kind carried for an accounting entity by an actuary as required under the provisions of FAS 87, FAS 88 and FAS 132 of the Financial Accounting Standards Board of USA.

The provisions of this guidance note are applicable to all Fellow members who carry out such actuarial valuation irrespective of the fact whether they do so as an employee of an insurer or an employee of the accounting entity for which the valuation is being done or as a consultant.

Status

This Guidance Note shall constitute a Guidance Note on professional matters within the meaning of Rule29 (ℓ) of the Rules of the Society and has been authorized to be issued by the Executive Committee in its meeting held on 14 02 2005.

Version:

1.00	Applicable for all actuarial reports carried out on and after 01 04 2005

1. Objective

This Guidance Note gives actuaries guidance on certain aspects of FAS 87 and FAS 88 as amended by FAS132 and should be read in conjunction with these documents. Section 2 sets out the methodology in relation to specific calculations required for Retirement Benefit Schemes of accounting entities in India in connection with FAS 87.

2. Valuation Methodology

2.1 For arriving at the actuarial values of liability for the purpose of Financial Accounting Standard No. 87, actuary will adopt the methodology as applicable under the Projected Unit Credit Method as described in Para 3.6.1 of GN 11, for the calculation of PBO.

2.2 In calculating the ABO and PBO it is necessary to include an allowance for the accrued portion of certain prospective benefits which are dependent on the member remaining in service for their payment but which are not directly attributable to accrued service – such as lump sums payable on death in service at a fixed multiple of salary and future notional years of service counting for ill health or death-in-service pensions. Thus, as indicated in FAS 87 paragraph 42(b), allowance should be made for the accrued portion of all these non-vesting-type benefits, even if they are insured by the plan concerned.

2.3 To calculate the ABO, projections should be made which exclude allowance for prospective salary increases which the member may receive during service if they are dependent upon the member continuing in service (*).

2.4 The Financial Accounting Standards Board adopted FAS 88 *Employers'* Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits in December 1985. FAS 88 deals with the specific items named in its title and, where these circumstances arise, the pension information needed for the employer's financial statements is significantly different from that prescribed in FAS 87 which pertains to the routine events of an ongoing plan. The terms 'settlement' and 'curtailment' need to be interpreted according to the definitions given in FAS 88.

(*)However, revaluation required under the plan (statutory or otherwise) related to external indices, such as national average earnings or prices, which are not dependent on the service of a member should be allowed whilst in service or after leaving e.g. D A relief, each company has different practice in relation to D A. However the result produced should give higher value than those calculated without allowing for D A increase.

3. Actuarial Assumptions

3.1 FAS 87 describes the method which the actuary is required to use to determine the various figures to be incorporated in the employer's accounts, and it also sets out the basis upon which the various assumptions to be used in his calculations are to be determined. It should be noted that the responsibility for setting these assumptions rests with the employer not the actuary, although this does not preclude the actuary from advising his or her client on the interpretation of FAS 87 and on the various assumptions, nor from commenting on any assumptions which the client may specify which he or she believes do not conform with the requirements of FAS 87.

3.2 Paragraph 44 of FAS 87 describes how assumed discount rates are to be determined. The normal interpretation is that the rates shall be the nominal rates according to the criteria adopted. However, as per FAS 87 where a scheme provides increases automatically linked to the retail prices index, where the typical asset cover would be index-linked bonds and the annuity contracts for settlement would be index-linked contracts, it will be in order for the discount rate for calculating the service cost and the projected benefit obligation to be the real rate after allowing for price inflation. The equivalent nominal rates should be used for calculating the interest cost and the asset return. When this approach is adopted the fact that the discount rate is a real rate should be clearly stated. For disclosure to be made in financial statements pursuant to paragraph 5(j) of FAS 132 the equivalent discount and salary assumptions should be shown for that purpose in nominal terms(**).

3.3 FAS 87 paragraph 10 explains that suitable approximations may be made in applying the standard, 'provided the results are reasonably expected not to be materially different from the results of a detailed application'. Materiality is the responsibility of the employer and the auditor who will have regard to the aggregate accounts as well as the Indian component. Any questions of materiality should therefore be discussed with the client and the actuary should in all cases disclose the nature of any approximations made. This point is particularly relevant in connection with the frequency of valuations. When valuation data are not available annually, the actuary may make suitable approximations provided the client is fully informed and the client is satisfied that the effect of these approximations is not material. Materiality is further considered in Appendix A to FAS 132 (paragraph A51).

3.4 It is the employer and the auditor who together determine whether an event is material to the extent that the provisions of FAS 88 must be implemented. (***)

***Most Pension schemes in India hves to buy the annuity from approved insurer, and for the purpose of calculation of the pensioners liability such current rates have to be taken into account as there are immediate outflow from the fund, these rates may not be consistent with valuation assumptions and changes over a period of time. For calculation of liabilities of active member other rates consistent with valuation rates could be used.*

(***)A similar set of explanatory questions and answers has been published by the Financial Accounting Standards Board entitled 'A Guide to Implementation of Statement 88 on Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits' FASB Staff Implementation Guides.

4. Actuarial Gains and Losses

4.1 FAS 87 provide an option to recognise actuarial gains and losses either: by following a 'Corridor Approach', which results in deferred recognition of the actuarial gains and losses, or immediately in the statement of profit and loss. It is left to the sponsor of the scheme to decide on this. Once the treatment of Actuarial Gains and Losses is determined, this can not be changed for subsequent accounting years.

4.2 The results obtained for FAS 87 should not be taken for those required for any other purposes. Thus, it should be made clear to the client that figures produced for FAS 87 should not be regarded as valid for funding purposes or for statutory certificates required in India. Attention is drawn to the fact that the requirements of the Indian accounting standard, AS - 15, and the international accounting standard IAS19 are in general different from those of FAS 87.

5. Conforming with GN-13 of UK Actuarial Profession

The following text should be made part of the report wherein the accounting entity has to comply with UK Standards falling within the scope of GN 13: Actuarial Statements required in connection with the US Statements of Financial Accounting Standards No 87, No 88 and No 132:

"The calculations reported herein have been made on a basis consistent with my understanding of the Statement of Financial Accounting Standards No. 87 for the purpose of fulfilling the obligation of the employer under FAS87 and with the guidance issued by the Faculty and Institute of Actuaries on this subject (GN13). Figures required for other purposes need to be calculated in accordance with the specific requirements for such purposes and it must not be assumed that figures produced for the purposes of FAS 87 have any relevance beyond the scope of the US Accounting Standards requirements".