



CARIBBEAN ACTUARIAL ASSOCIATION



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2011 Conference: *“Tailoring Actuarial Practice to Caribbean Reality”*

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IAS 19 Changes

Simon Sutcliffe – Bacon Woodrow & de Souza Limited

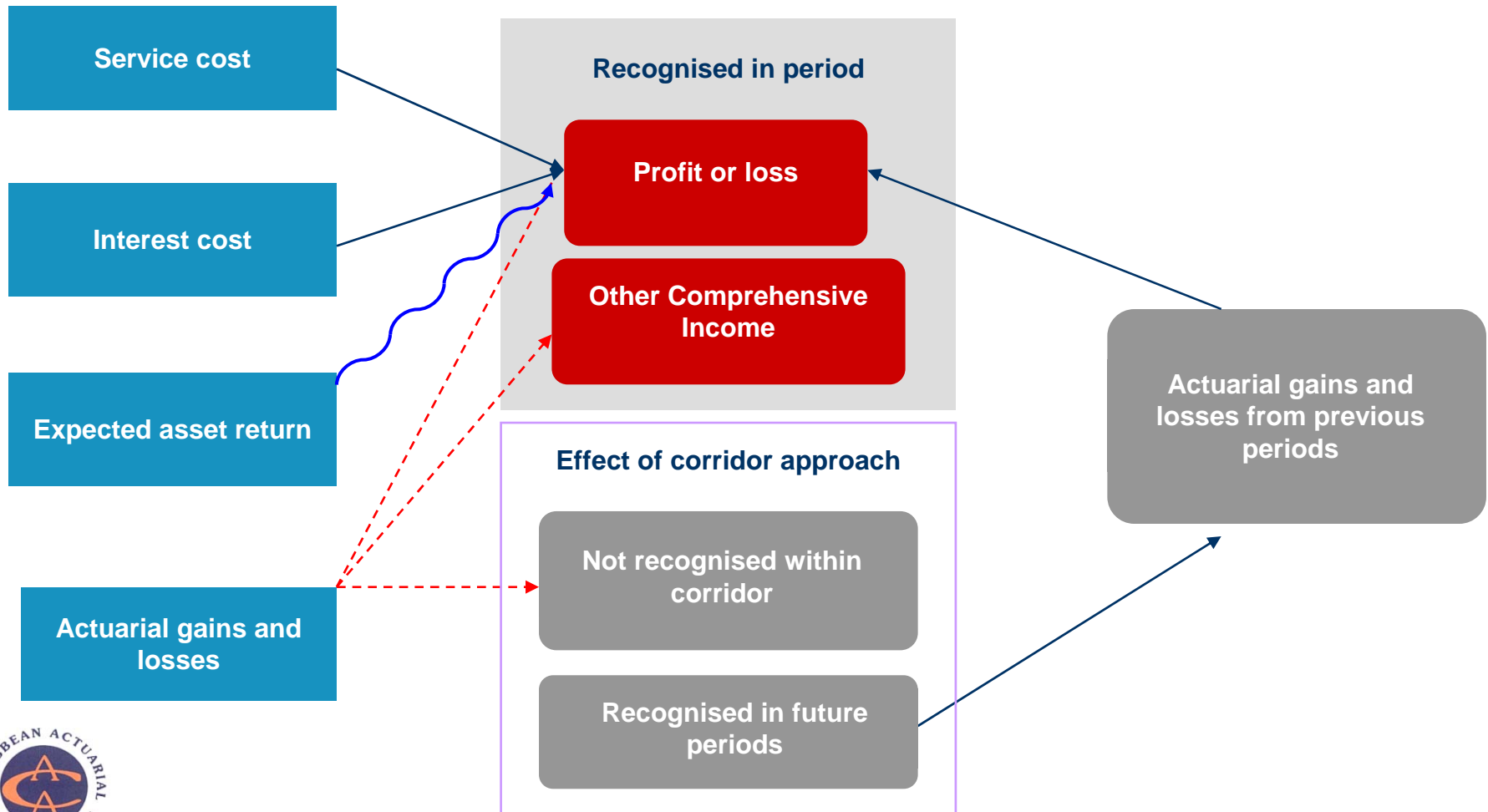
Peter Gittens – Ernst & Young

2 December 2011

Outline

- Why IASB changed IAS 19
- Key changes
- Business impact
- Effective Date and Transition
- Accounting impact
- Audit issues
- Future

Current IAS 19



Deficiencies

- True financial picture not shown
 - Defers recognition of gains/losses
- Inconsistency in employers' financial statements.
 - Subjective expected return
 - Options for recognising gains/losses
- Risks relating to defined benefit plans not highlighted
- Some areas of practice need clarifying

IAS 19 Changes

- Relate to
 - Recognition
 - Presentation
 - Disclosure

- Methodology for measurement is largely unchanged (some exceptions)

Key Changes

■ Recognition

- Do away with 10% corridor/amortisation
- Gains/losses hit balance sheet immediately
- Unvested past service costs recognised immediately
- Do away with expected return

■ Presentation

- Service cost and net interest cost (P&L)
- Re-measurements (OCI)

■ Disclosures

- Sensitivity of key items to changes in assumptions
- Risk management information

Recognition

- Gains and losses recognised immediately in OCI
 - Improved comparability as all options removed
 - Actual surplus/deficit on balance sheet
 - Greater volatility of net asset on balance sheet
 - Gains/losses do not impact P&L – not recycled
- Entire past service cost expensed immediately in P&L (service cost)
 - Accelerated recognition of unvested changes

Recognition

- Expected returns removed
- Interest on assets calculated at discount rate (in net interest in P&L)
- Actual return less interest on asset is remeasurement in OCI
- Impact
 - $EROA > \text{discount rate}$ – increase in costs
 - $EROA < \text{discount rate}$ – reduction in costs

Example

- Assumptions at start of year

Value of assets	300	Expected return = 8%pa
DBO	320	Discount rate = 5%pa
Net liability	20	

Current IAS 19

Interest cost = 16
(320 x 5%)

Expected return = 24
(300 x 8%)

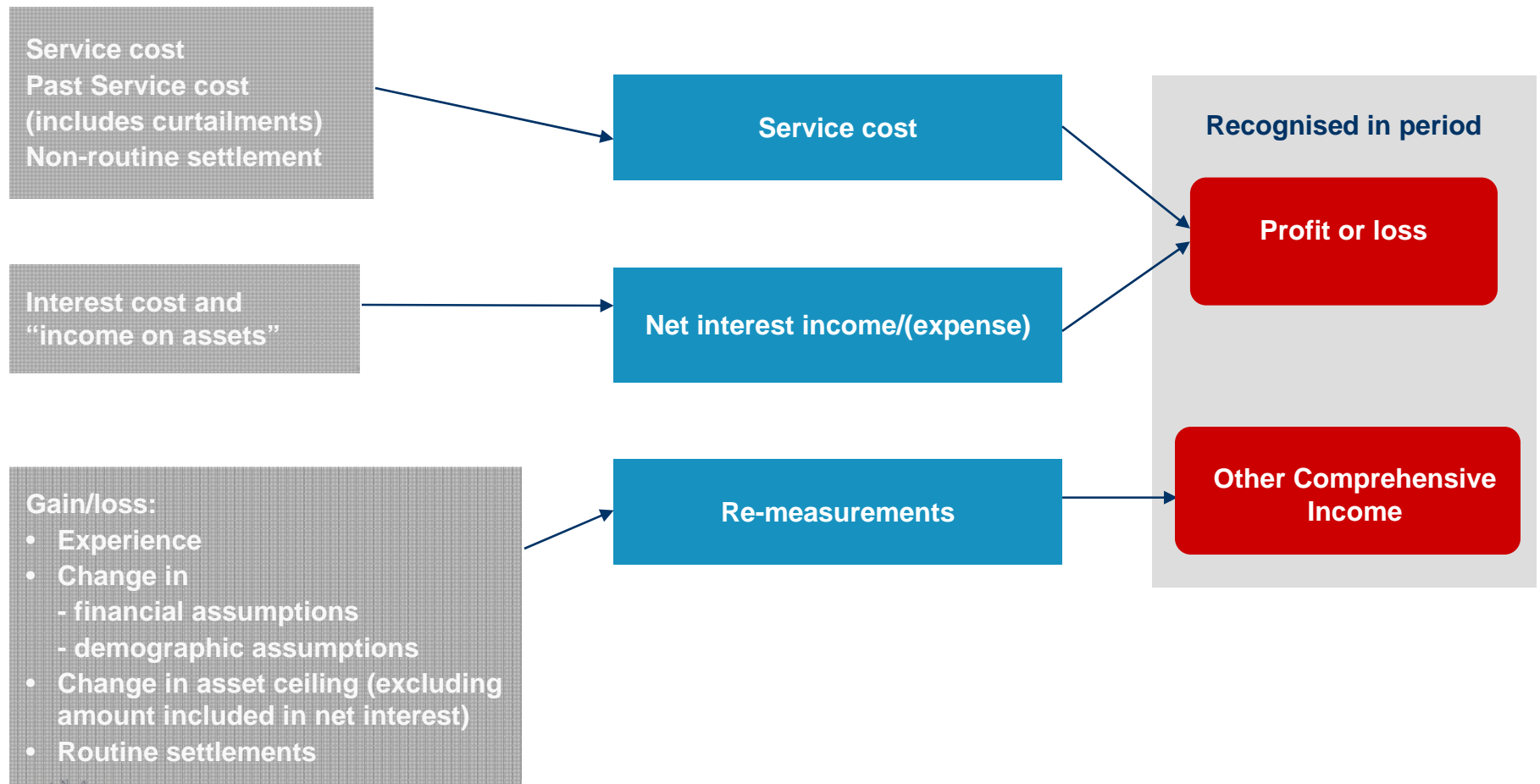
Net = (8)

New IAS 19

Net interest = 1
(20 x 5%)

Extra expense = 9

Presentation



Disclosures

- Principle based
- Characteristics and risks of DB plans
 - Final salary, cash balance etc
 - Provide:
 - Obligation for active members, deferreds, pensioners
 - Obligation for vested and non-vested benefits
 - Conditional benefits included in DBO
 - Separate results for plans with different risks
 - Regulatory environment, eg minimum funding
 - Specific risks, eg asset over-exposure

Disclosures

- Explain amounts in statements
 - Reconciliations of DBO, asset and net position
 - Asset allocation
 - Significant actuarial assumptions (including mortality?)
- Potential impact on amount, timing and uncertainty of future cash flows
 - Sensitivity analysis and method used
 - Risk management strategies, eg annuity policies
 - Employer's future contributions
 - Duration of liabilities
- Level of detail?

Clarifications

- Taxes
 - Investment-related - in return on Plan assets (OCI)
- Expenses
 - Investment in return on Plan assets (OCI)
 - Administration – as incurred via in service cost (not DBO)
- Shared risk plans
 - Variable employee contributions/benefits according to plan's financial position
- Classification of benefits as long-term or short-term
 - Based on timing of settlement
 - Short-term if within 12 months of period end



Consequences of Changes

- On profits
 - Reduced for many employers
 - More stable P&L pension expense in future
- Balance sheet
 - Increased volatility
- Disclosures
 - More explanation of risks needed
 - Greater attention on approaches to mitigate risks

Possible Impact on DB Plans

- Asset allocation no longer affects profits
 - Discourage equity investment (in favour of bonds)?
 - Unlikely, given limited investment options
- Balance sheet volatility
 - Artificial?
 - Difficult to manage
 - Close DB plans (pension, medical etc)?
 - Increased compliance costs - annual valuations?
- Importance of appropriate discount rate
 - Challenge in many Caricom countries

Effective Date and Transition

- Periods starting on or after 1 January 2013
- Early adoption is permitted
- In first year
 - In accordance with IAS 8 (limited exceptions)
 - Restate prior year's disclosures on new rules
 - Unrecognised items brought on balance sheet by adjusting prior year's opening retained earnings
 - Not required to
 - restate carrying amount of assets outside scope of IAS 19 (eg employee benefit costs capitalised during construction of property)
 - provide comparable sensitivity disclosures

Preparation

- Clients should now be looking at potential impact
 - Materiality
 - Opening adjustments - unrecognised gains/losses and unrecognised past service cost at 31 Dec 2011 for 1 Jan 2013 transition
- Interim reporting requirements

Accounting Impact

- Significant impact on accounting, however little impact on processes, data and information systems
- Possible exceptions:
 - Entities affected by new requirements for distinguishing short-term and long-term employee benefits
 - Requirements for additional disclosures (e.g., quantitative sensitivity of the DBO, separate impact of demographic and financial assumptions)

US Standard

- ASC-715 (FAS 87, 88, 106, 132, 158)
- Similar to new IAS 19
 - Balance sheet liability now same
- Despite “convergence project”, still differences:
 - Gains and losses recycled from OCI to P&L (using corridor approach)
 - Allow for expected return on assets
 - Past service costs can be amortised
 - No surplus limit (IFRIC 14)
 - Different disclosures

IAS 19 – more changes?

- IASB to review agenda
- May include
 - Limited scope review
 - Fundamental review
- Focus could be on
 - Measurement (discount rate, ABO vs PBO)
 - DB vs DC vs contribution based promises

Questions

