GN13: Actuarial Statements Required in Connection with the Statements of Financial Accounting Standards No. 87, No. 88 and No. 132 (FAS 87, 88 and 132) in the USA

Classification
Recommended Practice

Legislation or Authority
Financial Accounting Standards Board (USA). *Employers' accounting for pensions.* Statement of Financial Accounting Standards No.87. 1985. (FAS 87 as amended)

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. 1985. (FAS 88)

Financial Accounting Standards Board. *Employers' disclosures about pensions and other post-retirement benefits. Statement of Financial Accounting Standards No. 132. 1998.*

Joan Lordi Amble and Jules M Cassel. *A guide to implementation of Statement 87 on Employers Accounting for Pensions: questions and answers.* 1986 (Financial Accounting Standards Board special report).

Joan Lordi Amble and Jules M Cassel. *A guide to implementation of Statement 88 on Employers Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits: questions and answers.* 1988. (Financial Accounting Standards Board special report).

Actuarial Standards Board (USA). *Actuarial compliance guideline No.1: an actuary's guide to compliance with Statement of Financial Accounting Standards No.87* (FAS 87*).* 1989.

Actuarial Standards Board (USA). *Actuarial compliance guideline No.2: for Statement of Financial Accounting Standards No.88* (FAS 87*). 1989.*

Application
Any actuary required to furnish information under FAS 87, FAS 88 and FAS 132 in respect of an occupational pension scheme in the United Kingdom.

FAS 106 (Employers' accounting for post-retirement benefits other than pensions) is outwith the scope of this Guidance Note.

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Status
Technical Amendment

Version	*Effective from*
1.0	01.04.88
1.1	01.09.90
2.0	01.05.91
3.0	01.07.93
3.1	01.10.99

1 General Principles

1.1 This Guidance Note gives actuaries guidance on certain aspects of FAS 87 (paragraphs 2 to 10) and FAS 88 (paragraphs 11 to 15). In addition, Section 2 sets out the methodology in relation to specific calculations required for UK pension schemes in connection with FAS 87.

1.2 The Financial Accounting Standards Board in the United States of America adopted FAS 87 *Employers' accounting for pensions* in December 1985. This places certain requirements upon employers as to the information regarding pension costs which they should present in their accounts in the United States. Actuaries will normally be required to furnish certain of this information and this Guidance Note is intended to clarify their responsibilities having particular regard to occupational pension schemes in the United Kingdom.

1.3 Paragraphs 2 to 10 of these guidelines must be read in conjunction with FAS 87. A helpful set of explanatory questions and answers entitled *A guide to implementation of Statement 87 on employers' accounting for pensions* by Joan Lordi Amble and Jules M Cassel has also been published by the Financial Accounting Standards Board.

1.4 The Actuarial Standards Board in the USA has also issued a compliance guideline for members which further elucidates the Standard, entitled *Actuarial compliance guideline No. 1:an actuary's guide to compliance with Statement of Financial Accounting Standards No. 87.*

1.5 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.

1.6 The results obtained for FAS 87 should not be confused with those required for any other purposes. Thus, it should be made clear to the client at all times that figures produced for FAS 87 may not be regarded as valid for funding purposes or for statutory certificates required in the United Kingdom, for example for contracting-out purposes, the Minimum Funding Requirement (MFR), or to comply with the requirements of the Pension Scheme Surpluses (Valuation) Regulations 1987 (SI 1987 No. 412). Attention is drawn to the fact that the requirements of the UK accounting standard, SSAP 24 and the international accounting standard IAS19 are in general different from those of FAS 87.

1.7 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, the staff of the FASB have confirmed that 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 paragraphs 5(d) and (f) of FAS 132 the equivalent discount and salary assumptions should be shown for that purpose in nominal terms.

1.8 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 UK 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 FAS 132 (paragraphs 54 and 55).

1.9 The following wording is suggested to actuaries to consider as a basis for their statements:

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

1.10 Attention is drawn to the fact that FAS 87 has been prepared having regard to the types of scheme and benefit available in the United States and to American terminology. For certain aspects of UK pension schemes therefore it is necessary to interpret the intention and attention is drawn to the particular elucidation set out in Section 2 which is the result of discussion between the Faculty and the Institute and the staff of the Standards Board.

1.11 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 described in FAS 88.

1.12 A 'settlement' is defined as a transaction which:

1.12.1 relieves the employer or the scheme of responsibility for a pension obligation;

1.12.2 eliminates significant risks related to the obligation and the assets used to effect the settlement; and

1.12.3 is irrevocable.

1.13 A 'curtailment' is an event which significantly reduces the expected years of future service of current employees or eliminates, for a significant number of employees, the accrual of defined benefits for future service. Paragraphs 3-7, FAS 88 give full details and examples.

1.14 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. 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*: questions and answers 1988 by Joan Lordi Amble and Jules M Cassel.

1.15 The Actuarial Standards Board in the USA has also issued a compliance guideline for members which further elucidates the Standard, entitled *Actuarial compliance guideline No.2: for Statement of Financial Accounting Standards No. 88 (FAS 87) 1989.*

1.16 The Financial Accounting Standards Board adopted FAS 132 *Employer's disclosures about pensions and other post retirement benefits* on 19 February 1998. FAS 132 revised employers' disclosures about pensions and other post retirement benefit plans. It did not change the measurement or recognition of those plans. It standardised disclosure requirements for pensions and other post retirement benefits to the extent practicable, required additional information on changes in the benefit obligations and fair values of plan assets that facilitate financial analysis and eliminated certain disclosures that are no longer as useful as they were when Statements No. 87 and 88 (and 106) were issued.

1.17 The Statement suggested combined formats for presentation of pensions and other post retirement benefits, as covered by FAS 106.

1.18 The specific disclosure amendments in FAS 132 are contained in paragraphs 12-14. The Statement also permits reduced disclosures for non-public entities. A non-public entity is any entity other than one:

1.18.1 whose debt or equity securities trade in a public market either on a stock exchange (domestic or foreign) or in the over-the-counter market, including securities quoted only locally or regionally,

1.18.2 that makes a filing with a regulatory agency in preparation of the sale of any class of debt or equity securities in a public market, or

1.18.3 that is controlled by an entity covered by 1.18.1 or 1.18.2.

1.19 The Statement was effective for fiscal years beginning after 15 December 1997. Earlier application was however encouraged. Restatement of disclosures for earlier periods provided for comparative purposes was required unless the information was not readily available, in which case the notes in the financial statements were to include all available information and a description of the information not available.

2 Methodology for the Calculation of the ABO, PBO and VBO

2.1 The following paragraphs describe the methodology for the calculation of the different benefits obligations under FAS 87. What is described is either in accordance with a strict interpretation of the wording of FAS 87 or what has been agreed with the staff of the Financial Accounting Standards Board. However, experience has shown that there may be more than one acceptable set of figures under FAS 87 (see paragraph 2.7 below) and the auditors to the client may agree to different methodologies to those discussed below.

2.2 FAS 87 defines three benefit obligations: the accumulated benefit obligation (ABO), the projected benefit obligation (PBO) and the vested benefit obligation (VBO). These three expressions which are defined in FAS 87 should be interpreted in a consistent manner. For most schemes the ABO and VBO will be the same, whilst for other schemes the ABO and the PBO might be the same. Because of UK preservation requirements the bulk of the benefits payable from UK pension funds are fully vested in American parlance. FAS 132 (paragraph 52) removed the requirement to disclose the VBO, so the term is redundant and not used hereafter.

2.3 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 reassured by the plan concerned.

2.4 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. 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. In calculating the PBO, allowance should also be made for prospective salary increases where appropriate.

2.5 The staff of the FASB have confirmed that, if the value of the accrued benefits (determined as described in Guidance Note GN9 paragraph 3.8, and using a closed fund approach) exceeds the value of the accumulated benefit calculated by projecting benefits in the manner described in paragraph 2.4 above, the value of the accrued benefits may be used. For this purpose, the actuary should use the assumptions as defined in FAS 87 to determine the value of the accrued benefits as described in GN9 paragraph 3.8 (using a closed fund approach). The actuary need not carry out an individual member by member comparison but the actuary may use an aggregate approach provided he or she is satisfied that in doing this it is not materially affecting the results so obtained.

2.6 It is possible that for many UK final salary schemes the accrued benefit liability calculated as described in paragraph 2.5 above will be greater than the ABO (allowing for projected benefits as described in paragraph 2.4 above) and this fact will be so self-evident that the actuary will only have to value the accrued benefits. In these circumstances his or her disclosures under FAS 87 will equate the ABO to the value of this accrued liability, although it is not necessary to disclose the ABO provided the plan assets exceed that amount.

2.7 As mentioned in paragraph 2.1, above, there are other interpretations for calculating certain items under FAS 87 and 88 for UK pension schemes. For example, FASB's Emerging Issues Task Force has expressed an opinion that, as an alternative to the approach described in paragraph 2.5 above, it would in their view be acceptable to calculate the ABO strictly in accordance with the terms of FAS 87 even though this may produce results which show the ABO as less than the value of the accrued benefits calculated as described in paragraph 2.5 above.