

# Walk Through of Actuarial Report and IAS 19 Disclosure

By Rahim Feroz

**SHMACONSULTING**

# Flow of the Presentation

1. Assumptions used in the valuation
2. Primary disclosures
3. Additional disclosures
4. Report structure
5. Practical issues in implementing IAS 19

# EOSB valuation

As we know that EOSB is offered as per the KSA Labor Law.

The accounting of EOSB expense and Liability is as per the International Accounting Standard (IAS) 19.

The method mandated by IAS 19 is Projected Unit Credit (PUC) Method.

The basic difference is the approach followed before IAS 19 and the approach suggested by IAS 19 is

- Termination basis approach vs going concern basis

# Implementation of IAS 19 in KSA

IFRS was implemented from December 31, 2017 and 2018 for listed and unlisted companies respectively .

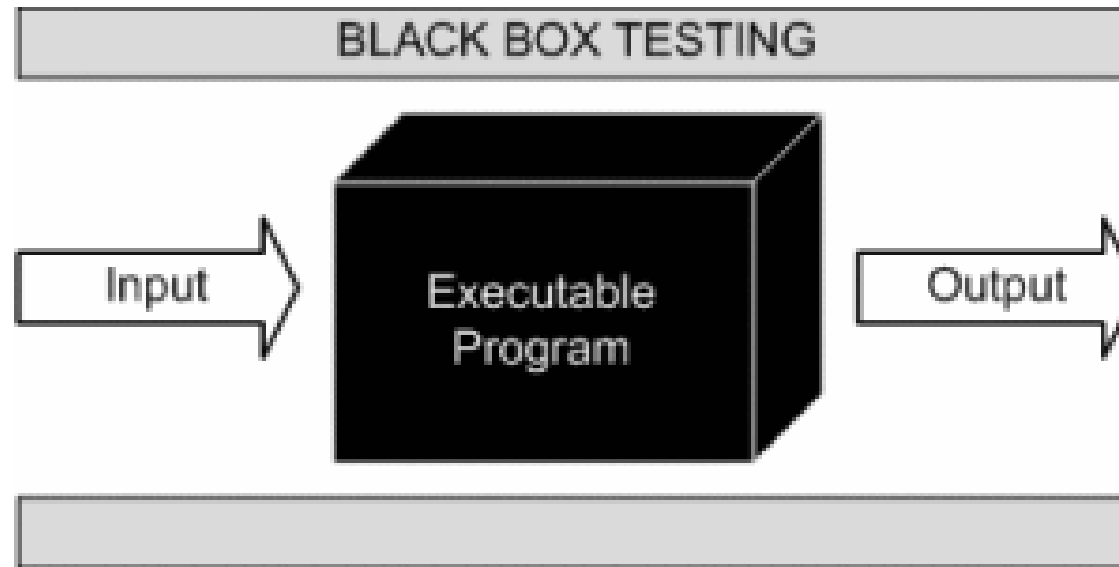
As that was the first time that companies were performing the valuations except for banks and insurance companies.

Due to the new area, companies are still getting use to with the data format, disclosure format and the assumptions.

The biggest concern was the deviation in the expense calculated by companies internal system and the expense (and OCI) calculated as per IAS 19.

# The valuation Process

Still the whole valuation process is a black box for most companies.

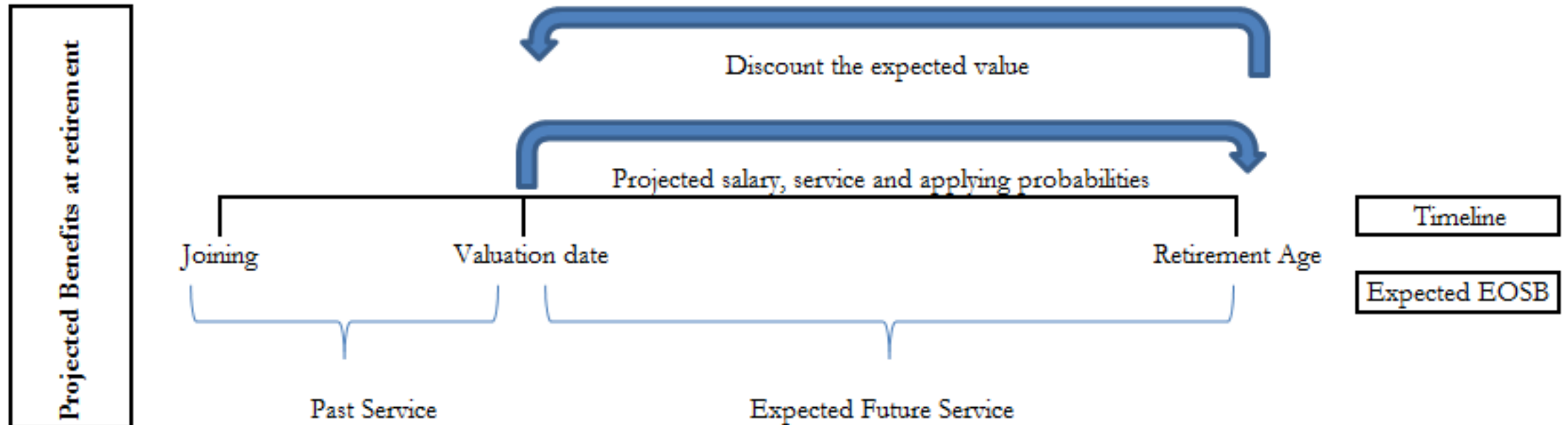


However, when you peek inside the box, you will find that it's a structured and process driven mechanism.

The assumptions are the critical factor in the overall appropriateness of the valuation process. We use the term "GARBAGE IN, GARBAGE OUT".

# Graphical Representation of PUC Method

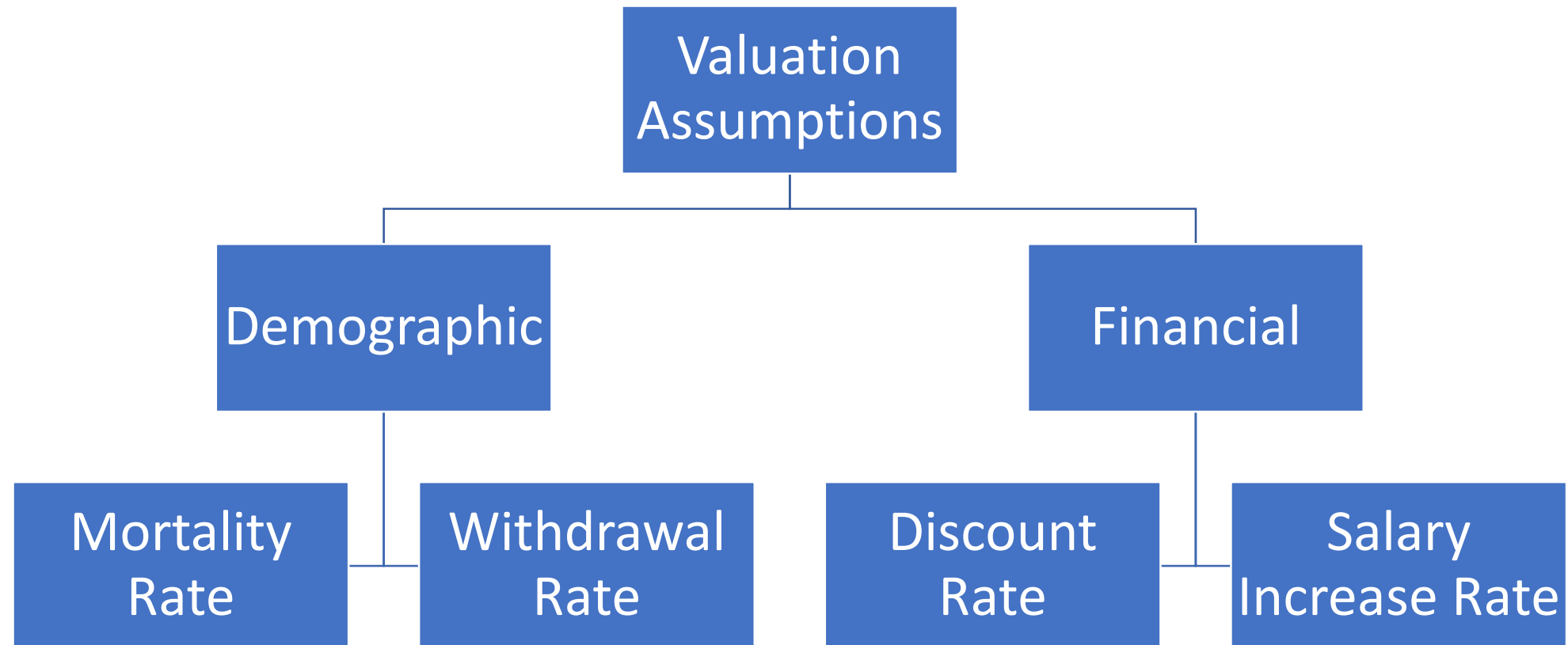
- Lets consider a simplistic example to understand the valuation process.
- Actuarial liability is the present value of **expected future payouts**.



- For projection purposes, we have to make certain assumptions.

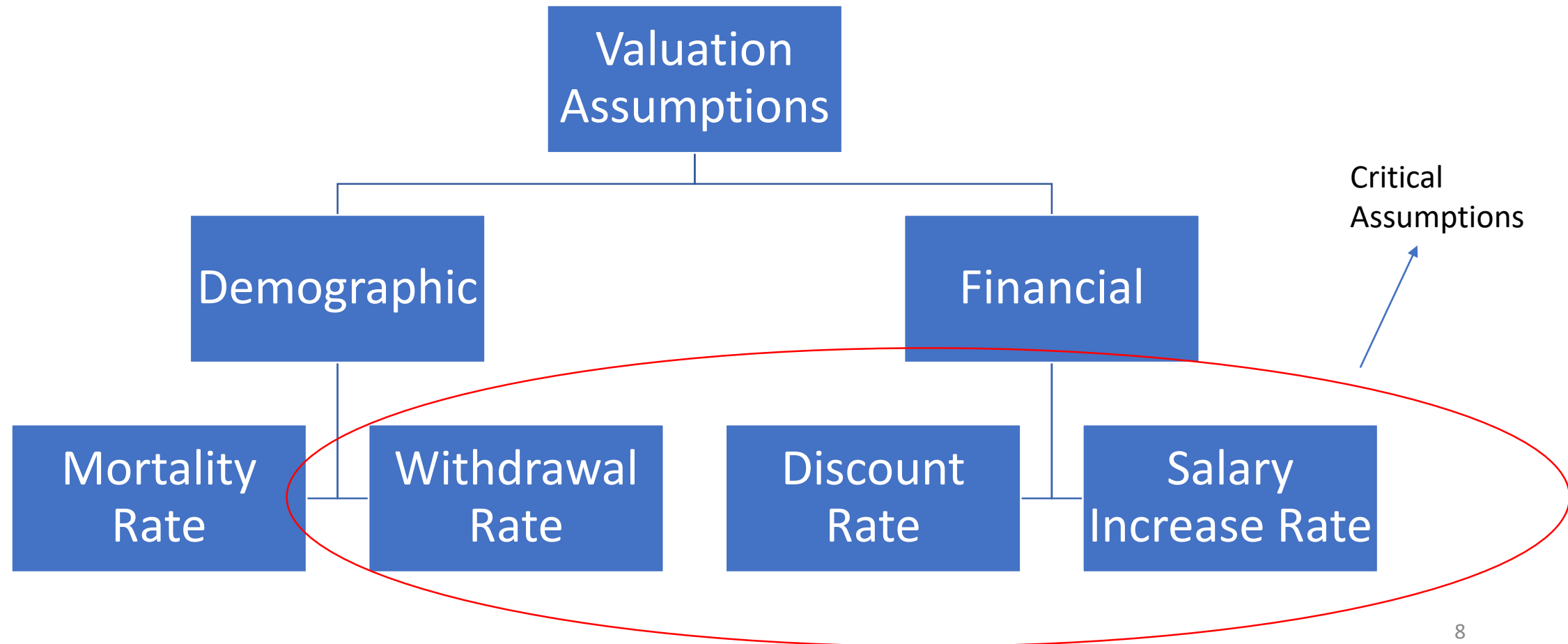
# Assumptions Used in the Valuation

The assumptions are divided into two main parts:



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# Basis of the Assumptions Used in the Valuation

## Withdrawal Rate

- Depends on the past Trend
- Should be futuristic
- Could be a blend of past and future
- Could be based on nationalities, cadre
- Could be age based, service based or some blend of both
- Could be different for short and long term period

## Discount Rate

- Based on the withdrawal rate, we calculate the **duration of the liability**
- Discount rate should be based on the market condition as at the valuation date
- Shouldn't be based on the company specific risk factors

## Salary Increase Rate

- Based on past trend
- Should also consider future dynamics
- Should ignore one off events
- Could be nationality based, cadre based or one factor for all employees
- Could be different for short and long term period

Assumptions should be consistent, mutually compatible, reasonable point estimates.

# Assumptions responsibility

- The onus of the assumption is on the management.
- The current practice is that the management is transferring the responsibility on the Auditors, which the auditors have on their expert actuaries.
- The assumptions have to be backed with the past trend or budget figures in case the assumptions are deviating with the past trend.
- There are certain disclosures that you can analyze to see whether the assumptions are reasonable or not.

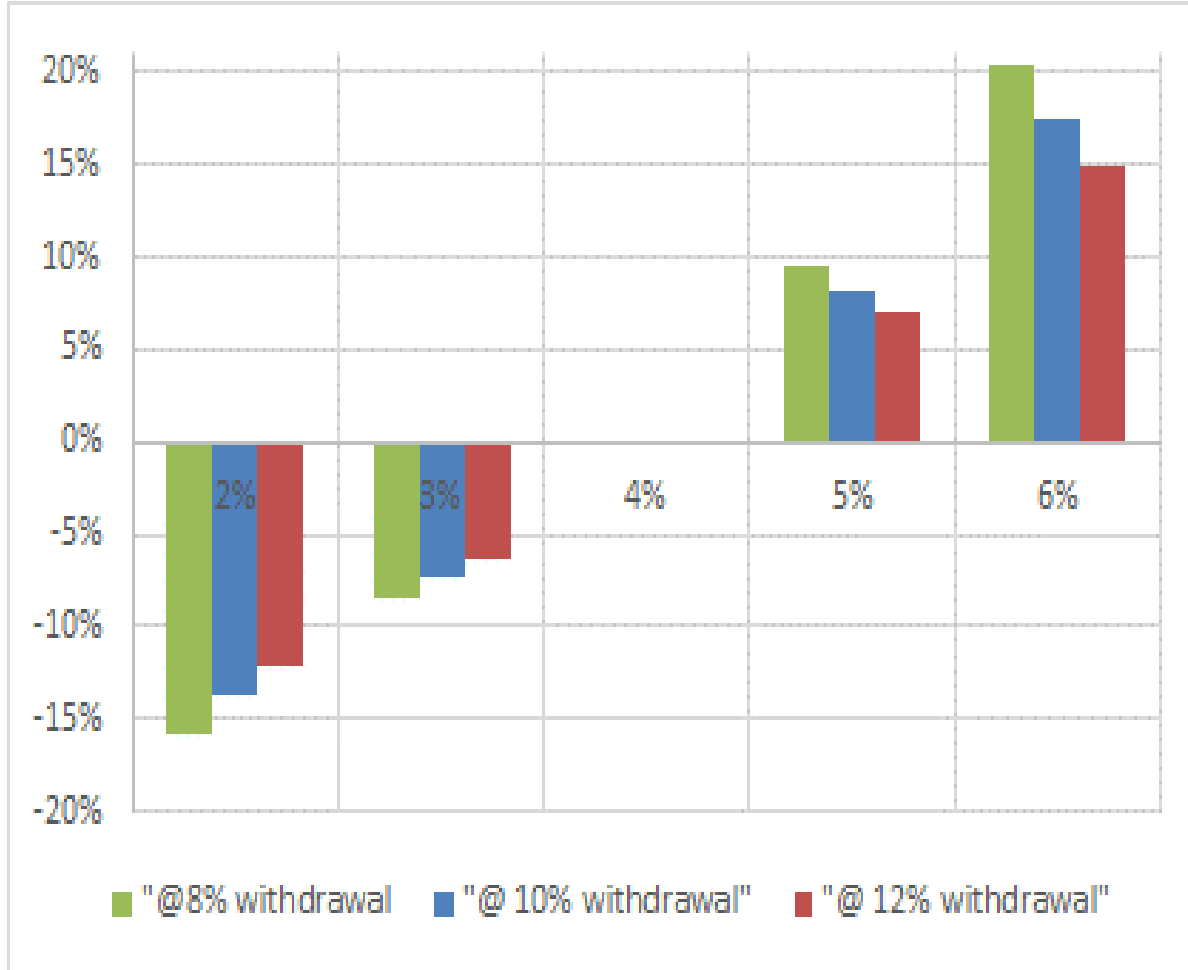
# Duration

- We use duration to determine the appropriate discount rate
- Duration is the average future service of the employees.
- Could also represent the rate of change in liability for 1% change in discount rate.
- Duration = 
$$\frac{\text{Liability at 1\% lower DR} - \text{Liability at 1\% higher DR}}{0.02 * \text{Liability at base discount rate}}$$
- The above figures can be taken from the sensitivity analysis table.

# Example – Impact of change in assumptions

- We will try to understand the impact of change in salary increase rate and the withdrawal rate on actuarial liabilities.
- Base assumptions
  - Discount rate: 4% p.a.
  - Salary increase rate: 4% p.a.
  - Withdrawal rate: 10% p.a. This includes resignation, termination and any other mode of cessation of service.
- Keeping the discount rate constant, we will change the salary increase rate by +/-1% and will change the withdrawal rate by +/-2%.
  - Salary increase rate of 2%, 3%, 5% and 6% p.a.
  - Withdrawal rate of 8% p.a. and 12% p.a.

# Example – Percentage change in liability @ DR 4%



Salary Increase Rate Impact



Withdrawal Rate Impact

# Disclosures

- The disclosures required by IAS 19 are
  - Significant actuarial assumptions
  - EOSB Movement and expense breakup
  - OCI breakup
  - Maturity Profile
  - Sensitivity Profile
  - Description of characteristics and the risks to the plan
  - Next year expected Expense

# Disclosure – EOSB movement

- We have considered a dummy data to demonstrate the disclosure

	As per Ledger	As per Actuarial Valuation	Difference	
Opening Net (Asset) / Liability	100,000,000	100,000,000	-	
(Prepaid cost) / Expense	22,000,000	25,000,000	3,000,000	Net increase in actuarial liability is 20 million
Other Comprehensive Income (OCI)	-	(5,000,000)	(5,000,000)	
Benefits paid during the year	(15,000,000)	(15,000,000)	-	
Closing Net (Asset) / Liability	107,000,000	105,000,000	(2,000,000)	

- There could be numerous reasons for the +ve impact on expense and –ve impact on OCI
  - Change in assumption
  - Salary increase lower than expected
  - Withdrawal higher than expected (general rule of Thumb is that the lower withdrawals has higher liability).

# Disclosures – OCI breakup

- OCI Breakup

Particulars	December 31, 2019
	PVDBO (in SAR)
Remeasurement (Gain)/Loss on Obligation	
- Financial Assumptions	
- Demographic Assumptions	
- Experience Adjustments	
Total Remeasurement on Obligation	



# Disclosures

- Components of Expense
  - Current Service Cost
    - Increase in actuarial liability due to the service rendered in the current period.
    - Based on beginning of year data and beginning of year assumptions.
  - Net Interest Cost
    - Multiply the beginning of year liability by the discount rate at the beginning of the year, taking account of any changes during the period as a result benefit payments.
    - Represent the effect of unwinding of the discounting.
  - Past Service Cost (if any)
- Other comprehensive Income
  - Difference between the expected liability and the actual liability
    - Could be due to the experience adjustment – actual adjustment
    - Could be due to the change in the valuation assumptions

# Disclosures – maturity profile

- Maturity Profile

Particulars	December 31, 2019
	Undiscounted Payments (Amount in SAR)
Year 1	10,831,201
Year 2	9,959,118
Year 3	11,586,685
Year 4	12,919,125
Year 5	13,671,576
Year 6 to Year 10	22,662,030
Year 11 and above	753,195,021

# Disclosures – sensitivity analysis

- Sensitivity Analysis

Particulars	December 31, 2019	
	PVDBO (in SAR)	%age
Current Liability (a)		
+1% Discount Rate (b)		
-1% Discount Rate (c)		
+1% Salary Increase Rate		
-1% Salary Increase Rate		
+10% Withdrawal Rates		
-10% Withdrawal Rates		
1 Year Mortality age set back		
1 Year Mortality age set forward		

We use the results to drive the duration.  
 $Duration = \frac{(c) - (b)}{0.02 * (a)}$

- Change one assumption at a time and keeping other assumptions constant

# Composition of the report

- The report includes the following
  - Scope
  - Data used, reliance and limitations
  - Assumptions used and rationale of the assumptions
  - All required disclosures
- The other relevant disclosures are
  - Employees projections as per the selected withdrawal rate
  - Cash flow projections (EOSB payable as per the assumptions used)
  - Liability / Expense projections

# Issues in implementing IAS 19

- Adjustment of expense
  - Normally the employee wise expense is being calculated by HR modules
  - How to adjust the expense as per actuarial valuation
  - How to reflect OCI
  - Sudden change in the liability as at the valuation date; options available are valuation more frequent than annual, use expected expense provided in the report by dividing the expense by 4 for quarterly reporting, third option could use the expected expense as percentage of salary for monthly accruals.
- Employees will be paid as per the Labor laws. We are just providing the accrual pattern.
- Like any regulatory disclosures, IAS 19 requirement is also considered as meeting the audit requirement. However, the systematic accrual offered by the exercise is completely ignored.