

Subject 4: The Influence of  
International Accounting Standards on  
Pension and Insurance Programs and  
the Progress to a Global Standard

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June 25, 2002

“Nothing, it has been said, is  
duller than accounting — ...”

*The New Yorker*, April 22 & 29, 2002

# Agenda

- FRS 17
- Comparison with FAS 87 & IAS 19
- The Influence on Benefits
- Recent Press Focus
- Progress to a Global Standard

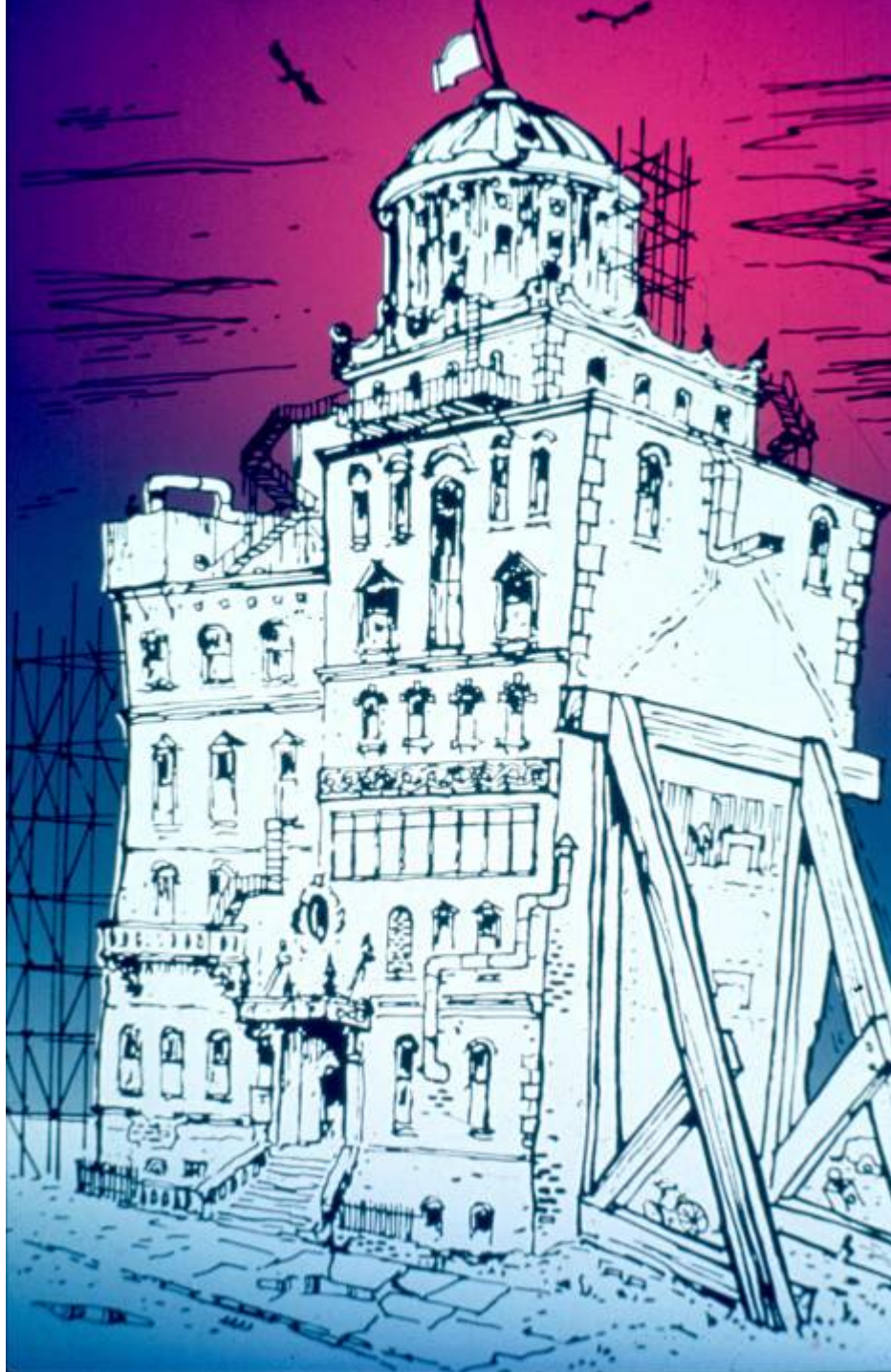


# IASB – The Global Standard-Setter

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- A common conceptual framework







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$$DR = CR$$



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Dr =

Asset

or

Expense



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Dr =

Asset

or

Expense

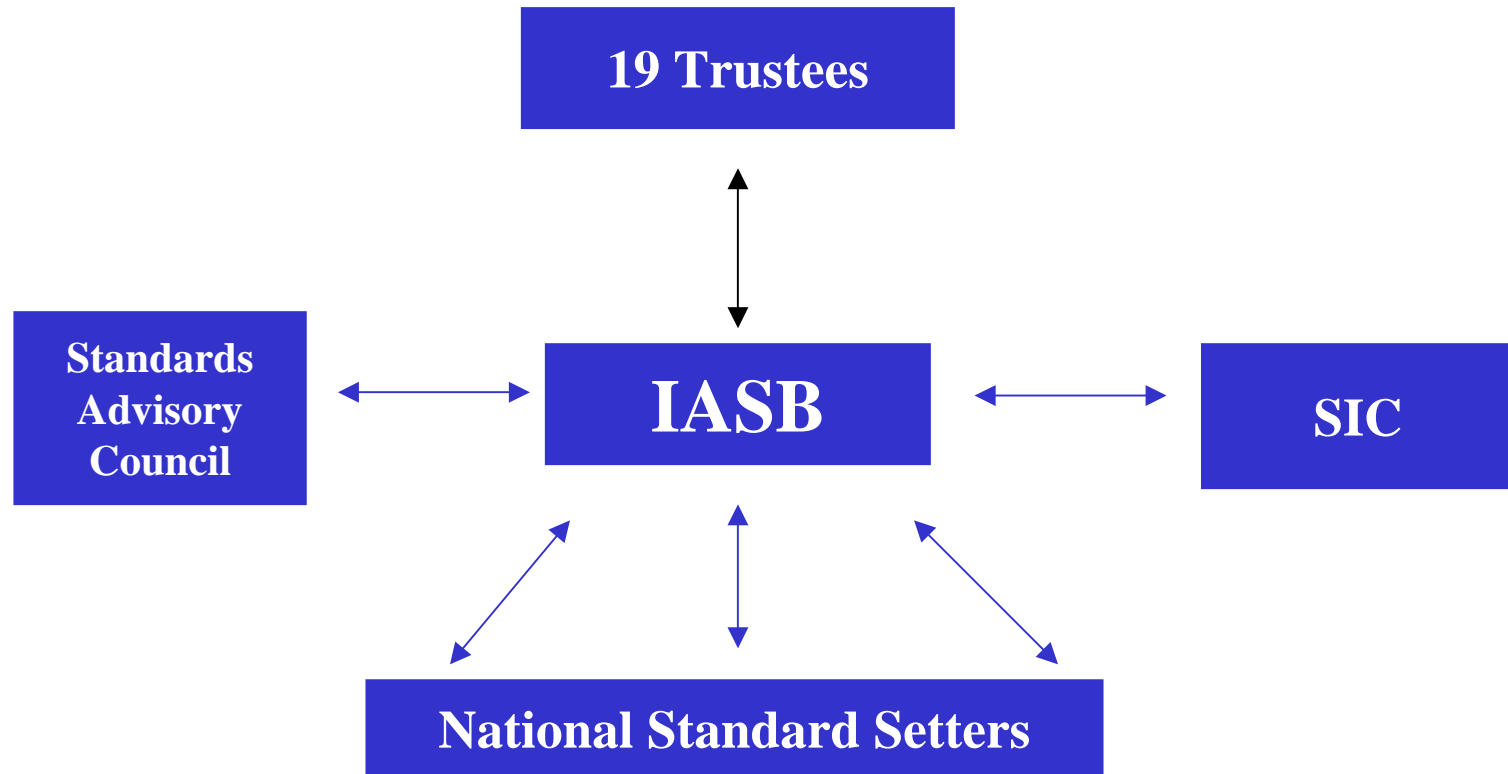
or

Whatsit



# IASB Structure

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# Problems with SSAP 24

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- Too many options
- Inadequate disclosure
- Incomprehensible results
- Out of date

# International Harmonisation: ®

## Measurement

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### *Scheme liabilities*

- FAS 87, IAS 19 and FRS 17: Projected unit method discounted at AA bond rate

### *Scheme assets*

- IAS 19 and FRS 17: market value at the balance sheet date
- FAS 87: market values averaged over a period of up to five years

# International Harmonisation: Recognition

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## *Vested past service cost*

- IAS 19 and FRS 17: recognise immediately
- FAS 87: spread forward

## *Actuarial gains and losses*

- FRS 17: recognise immediately in STRGL
- IAS 19 and FAS 87: spread forward in p/l



# Alternatives

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- Profit (years 1, 2)                      £20m
- Year 1    Change in Fund -   £33m
- Year 2    Change in Fund +   £33m
- Expected working life of 10 years



# Pensions

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	£m
Deficit	10
Less 10% of liabilities	<u>4</u>
	<u>6</u>

Spread over 10 year working life

Deficit per accounts - £600,000



# Alternative 1 – Australia

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- Loss Year 1             $20 - 33 = -13$
- Profit Year 2            $20 + 33 = 53$

(Change 500%)



# Alternative 2 – USA/IASC

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- Year 1 Profit       $20 - 3.3 = 16.7$
- Year 2 Profit       $20 + 0.3 = 20.3$

(Change 21.5%)



# Alternative 3 – FRS 17

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■ Year 1	Profit	20
	STRGL	-33
■ Year 2	Profit	20
	STRGL	+33



# Problems

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- Reduction in Asset
  - UK tax changes
  - 2 years negative returns on equity
- Increase in Liabilities
  - Low interest rates
  - Longevity



# Future of Accounting

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- All assets and liabilities on balance sheet
- Components of income shown
- Tell it as it is
- Fair values

# Comparison

	FAS 87	IAS 19	FRS 17
Measurement date	Up to three months before balance sheet date	Balance sheet date	Balance sheet date
Plan assets	Market-related (over up to five years) or market value	Market value; also reimbursements	Market value
Actuarial gains and losses	Optional 10% corridor, then spread over EAWL	Optional 10% corridor, then spread over EAWL	Recognized immediately in STRGL
Prior service cost	Spread over EAWL	Vested – immediately; non-vested – spread over period to vesting	Vested – immediately; non-vested – spread over period to vesting
Limit on prepaid pension cost	No	Yes	Yes
Balance sheet adjustment	AOCL possible	No	No; (PBO-assets) on balance sheet

# Accumulated Other Comprehensive Loss

- Minimum liability = ABO – market value of assets (if > 0)
- Additional liability = minimum liability – accrued pension cost + prepaid pension cost (if > 0)
- Intangible asset = lesser of additional liability and the sum of the unrecognized prior service cost and transition obligation
- Accumulated other comprehensive loss = additional liability – intangible asset

# The Influence on Benefits

- Greater volatility of expense
- Easier to focus on the cost of benefits



Changes in:

- Design
- Funding
- Investment

# Effect on Design

- Cost of changes easier to understand
- Move to defined contribution
  - FAS 87
    - Not likely if pension income
  - FRS 17

“State’s largest union fears the introduction of FRS 17 will lead many companies to close defined benefit schemes”

*Irish Times* May 29, 2002

“Final salary schemes under siege, says NAPF”

*Pensions World* January 2002

# Effect on Design

- Reduction in benefits
  - Postretirement medical
  - Cash balance plans in the US
- Increases in benefits not granted
  - Pension increases
  - Negotiated increases
- Restructuring and severance

# Acquisition & Divestitures

- Easier to determine the purchase price adjustment if assume defined benefit liability or postretirement medical
- If possible, leave defined benefits and postretirement medical with seller and set up defined contribution plan and no postretirement medical for future
- FAS 88, IAS 19 and FRS 17 effect for seller

# Effect on Funding

To avoid AOCL

- Pay additional employer contributions
- Limitation in some countries, e.g., Japan
- Calculation of ABO
- Measurement date differs from balance sheet date

*Note: Prepaid pension cost can exceed overfunding on a PBO basis*

# Effect on Investment

- Transition under FAS 87
  - Purchase annuities to obtain settlement gains
- Asset allocation under FRS 17

“Why move to bonds? John Ralfe explains why Boots bucked the trend.”  
*The Actuary* March 2002

“(Some) UK Pension Funds Reduce Stockholdings Below 60%”  
*Financial Times* April 30, 2002

# Transition from FAS 87 to IAS 19

- Liability for defined benefit plans
- Prior service cost and losses under FAS 87 create problems
- May decide not to comply
- If do comply, most take hit immediately

# Effect on Financial Statements

- FAS 87: pension income in the '90's may have increased market values of companies, leading to more pension income
- FRS 17: deficit in a pension plan may lead to decreased market values, leading to larger deficits
- FRS 17: dividend payments may be restricted



## Recent US Press Focus

“I’m a sporting type, and I would love to make a large bet with the CFO of ... or with their actuaries or auditors, that over the next 15 years, they will not average the rates they’ve postulated.”

Warren Buffett on the Stock Market

*Fortune Magazine* December 10, 2001

# Recent US Press Focus

- Expected rate of return
  - “SBC Boosts Estimate on Returns from Pension Fund, Aiding Net”  
*Wall Street Journal* March 7, 2002
- Pension income
  - “IBM’s Overfunded Pension Plan Won’t Pump up Bottom Line as Much This Year as It Has in the Past”  
*Wall Street Journal* March 14, 2002
- S&P “Core Earnings” report

# Progress to a Global Standard

- 1993: IOSCO agrees set of core standards for cross-border listings
- 1995: IOSCO and IASB develop workplan
- 1998: IASB approved set of core standards
- 2000: IOSCO recommends with supplementation as necessary
- 2000: SEC Concept Release

# Progress to a Global Standard

- 2002: EU mandates use of IAS for all publicly traded companies from 2005 with two year delay for certain companies (7,000 companies)
- 2002: SEC Chief Accountant targets 2005 for convergence
  - Principles rather than rules based
  - Infrastructure, training and progress in regulatory oversight
- 2005: One standard? Any open defined benefit plans left?