PRACTICE GUIDELINE 3

ACTUARIAL PRACTICE IN RELATION TO AASB 119 EMPLOYEE BENEFITS

April 2018

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Preface to Practice Guideline 3

Practice Guideline 3 (PG 3) is the Australian adaptation of International Standard of Actuarial Practice 3: Actuarial Practice in Relation to IAS 19 Employee Benefits (“ISAP 3”) as adopted by the International Actuarial Association (“IAA”) Council 11 April 2015 and amended for conformance changes 23 April 2017.

ISAP 3 provides guidance to Members when performing actuarial services in connection with International Accounting Standard 19 (IAS 19) Employee Benefits. Australian Accounting Standard AASB 119 Employee Benefits is based on IAS 19 Employee Benefits issued by the International Accounting Standards Board (IASB).

The Reporting Entity is responsible for all the information reported in its financial statements, including information reported in accordance with AASB 119. This means the Reporting Entity is responsible for the categorization of employee benefit plans, the choice of actuarial assumptions and methods used to measure employee benefit obligations, and disclosures about employee benefit plans. AASB 119 encourages, but does not require, a Reporting Entity to involve a qualified actuary in the measurement of all material post-employment benefit obligations.

In practice, a Member may advise on a range of issues arising from the application of AASB 119, including the measurement of short-term, post-employment, termination, or other long-term employee benefits and disclosures in the financial statements.

ISAP 3 is intended to:

- Facilitate convergence in standards of actuarial practice in connection with IAS 19 (AASB 119) within and across jurisdictions;
- Increase Reporting Entities’ and their auditors’ confidence in Members’ contributions to reporting of Employee Benefits in accordance with IAS 19
- Increase public confidence in actuaries’ services for IAS 19 purposes; and
- Demonstrate the IAA’s commitment to support the work of the International Accounting Standards Board (IASB) in achieving high-quality, transparent, and comparable financial reporting internationally, as envisaged by the Memorandum of Understanding between the IAA and the IASB.

Based on the nature and extent of the differences between PG 3 and ISAP 3, the Institute has assessed that there is “strong convergence” between PG 3 and ISAP 3. That is, PG 3 materially conforms to international standards of the IAA, with allowance for local modification to fit local conditions. However, given the differences, it should be noted that compliance with PG 3 will not necessarily result in compliance with ISAP 3. Therefore, where a Member is required to perform work in conformity with ISAP 3 (e.g. because the work is being undertaken in an overseas jurisdiction) the Member should refer to the specific requirements of ISAP 3.

The principles and requirements of PG 3 are consistent with ISAP 3, but provide some additional guidance on Australian issues:

- Section 2.2 has been expanded to include approximate methods typically adopted in Australia.
- Section 2.5 has been expanded to cover hybrid arrangements common in Australia.
- Additional guidance on setting salary inflation assumptions has been added to section 2.6.
- Further information on various Australian matters has been included in Appendix A to PG 3.

A number of other minor changes have been made principally for consistency with local conditions and for clarification purposes.

A full tabulation of the differences between PG 3 and ISAP 3 is set out in the Appendix B to PG 3.

1. General

1.1. Purpose

This Practice Guideline (PG) provides guidance to Members when performing actuarial services in connection with AASB 119. Its purpose is to increase Intended Users' confidence that:

(a) Actuarial services are carried out professionally and with due care, consistently with AASB 119, and taking into account the Reporting Entity's accounting policies;

(b) The results are relevant to their needs, are presented clearly and understandably, and are complete; and

(c) The assumptions and methodology (including, but not limited to, models and modelling techniques) used are disclosed appropriately in the Member's Report.

1.2. Classification

1.2.1. This PG has been prepared in accordance with Council's Policy for Developing Documents to Guide and Regulate Professional Practice, as varied from time to time. It must be applied in the context of the Institute's Code.

1.2.2. This PG is not mandatory.

1.2.3. Nevertheless, if the Professional Services provided by a Member are covered to any extent by this PG, a Member should consider explaining any significant departure from this PG to the Principal, and document such explanation.

1.2.4. Services covered by this PG are Applicable Professional Services for the purposes of PG 1.

1.3. Scope

This PG provides guidance to Members when providing actuarial services for a Reporting Entity's preparation of an actual or pro-forma financial statement for any type of Employee Benefit the Reporting Entity determines to be covered by AASB 119. Members providing actuarial services in connection with AASB 119 that are outside of this scope (for example, a Member advising an auditor or advising a potential buyer regarding an acquisition) should consider the guidance in this PG to the extent relevant to the assignment.

1.4. Compliance

A Member may fail to follow the guidance of this PG but still comply with it where the Member:

1.4.1. Complies with requirements of Law that conflict with this PG;

1.4.2. Complies with requirements of the Code or a Professional Standard applicable to the work that may conflict with this PG; or

1.4.3. Departs from the guidance in this PG and provides, in any Report, an appropriate statement with respect to the nature, rationale, and effect of any such departure.

1.5. Relationship to PG 1

Compliance with PG1 is a prerequisite to compliance with this PG. References in PG 1 to "this PG" should be interpreted as applying equally to this PG 3, where appropriate.

1.6. Defined Terms

This PG uses various capitalised terms whose precise meaning is defined in the Glossary to this PG (Appendix C), the Glossary of General Defined Terms Used in Practice Guidelines, or the Code.

1.7. Cross References

This PG refers to the content of AASB 119, including any interpretations from the AASB as issued through August 2015. If AASB 119 is subsequently amended, restated, revoked, or replaced after August 2015, the Member should consider the guidance in this PG to the extent it remains relevant and appropriate.

1.8. Effective Date

This PG is effective for actuarial services performed with respect to a financial statement for a reporting period ending on or after 1 April 2018.

2. Appropriate Practices

2.1. Knowledge of Accounting Requirements

The Member should have or obtain sufficient knowledge and understanding of AASB 119, Interpretations issued by the AASB that are relevant to AASB 119, relevant paragraphs of other Australian Accounting Standards to which AASB 119 specifically refers, and the Reporting Entity's relevant Accounting Policies, if any. Members are reminded of their professional experience obligations under the Code.

If the Member:

(a) Is uncertain whether another accounting standard is relevant to the actuarial services; or

(b) Discovers that a specific component of the actuarial services may be subject to alternative interpretations of AASB 119, an Interpretation issued by the AASB that is relevant to AASB 119, a relevant paragraph of other Australian Accounting Standards to which AASB 119 specifically refers, or relevant Accounting Policies,

the Member should seek guidance from the Principal, and treat the guidance as information to which PG 1 paragraph 2.3, Reliance on Others, applies.

2.2. Materiality

The Member should understand the distinction between materiality with respect to the actuarial services, the preparation of financial statements in accordance with the relevant Australian Accounting Standard, and the auditing of those financial statements.

2.2.1. When appropriate for the Work, the Member should seek guidance from the Principal or Reporting Entity regarding materiality with respect to the preparation of its financial statements and take that guidance into account when performing the actuarial services.

2.2.2. In applying PG 1 paragraph 2.4, Materiality, the Member's threshold of materiality with respect to the actuarial services should not be greater than the Reporting Entity's threshold of materiality with respect to the preparation of its financial statements, if it is known. The Principal or Reporting Entity (not the user of the financial statements) is the Intended User of the actuarial services when assessing materiality with respect to the actuarial services.

2.2.3. In all following paragraphs of this PG, any use of "material", "materially", or "materiality" is with respect to the actuarial services.

2.2.4. The Member may use approximate methods such as a roll forward in place of a full valuation. The Member may consider materiality when advising the Reporting Entity on the approach to the roll forward and in particular, the time period between the effective date of the data and the reporting date. In relation to the provision of a valuation update (or roll forward):

(a) Using data that is more than 12 months old is normally not advisable. However, in some circumstances, a Member may agree with the Principal or Reporting Entity that using older data may be suitable (for example, consideration of materiality against the Reporting Entity's global materiality thresholds.).

(b) The Reporting Entity may use short-hand estimation techniques for long service leave calculations between full actuarial valuations. It is acceptable for a Member to advise the Reporting Entity on an appropriate short-hand method to apply for a period following a full valuation.

(c) AASB 119 specifically requires consideration of interest rate and market price movements (that is, changes in the discount rate and investment performance) when a valuation update is used. In most cases, these key variables are capable of having a material impact.

(d) Other actual experience or variations from assumptions that may be taken into account include:

i. actual employer and member contributions;

ii. salary growth or pension increases, which are materially different from those expected;

iii. demographic experience that is materially different from that expected;

iv. settlements, curtailments and other material scheme changes; and

v. other material events of which the Member has been advised.

2.3. Proportionality

In applying PG 1 paragraph 1.6, Reasonable Judgement, in particular paragraph 1.6.3, the Member should take materiality into account. The degree of refinement in specific assumptions or methods recommended by the Member should be consistent with the impact on the actuarial services. Examples include, all of which are subject to the Member's Professional Judgement:

(a) The Member may use simplified approaches to recommending assumptions when those assumptions will not materially affect the results or are proportionate for the actuarial services. For example, when an employee benefit plan pays primarily lump sum benefits at termination or retirement, the choice of mortality assumption may have little impact on the liabilities. As a second example, for certain work-related accident or injury benefits, the projected benefit cash flows may be so uncertain as to make a highly refined approach to selecting the discount rate disproportionate.

(b) In lieu of collecting new employee census data at the Measurement Date, the Member may appropriately adjust results using data collected at a different date when doing so will not materially affect the results.

(c) The Member may apply or amend assumptions selected for other purposes (such as to determine funding of the employee benefit plan) or demographic assumptions used at a prior Measurement Date when those assumptions are reasonable for AASB 119 purposes at the current Measurement Date.

(d) The Member may apply simplified methods to attribute benefits to periods of service when doing so will not materially affect the results.

2.4. Constructive Obligations

The Member may rely on representations made by the Principal regarding the existence and nature of any Constructive Obligations arising from the Reporting Entity's employee benefit practices or policies. When doing so, the Member should be guided by PG 1 paragraph 2.3, Reliance on Others.

If it becomes apparent to the Member in the course of performing the actuarial services that significant uncertainties exist regarding such representations, the Member should seek clarification from the Principal. If the uncertainty is not resolved to the Member's satisfaction, the Member should be guided by PG 1 paragraph 2.5.4, Data Deficiencies.

This guidance does not impose additional duties on the Member beyond the scope of the actuarial services to search for or analyse Constructive Obligations that go beyond formal plans or agreements.

2.5. Categorisation of Employee Benefit Plan

The Reporting Entity is responsible for determining the categorisation of its employee benefit plans under AASB 119 as short-term, defined benefit post-employment, defined contribution post-employment, termination, or other long-term.

2.5.1. The Member may advise the Principal regarding the categorisation of an employee benefit plan. When providing such advice, the Member should exercise Professional Judgement when an employee benefit plan has characteristics of multiple categories (such as retirement plans that combine elements of defined benefit and defined contribution plans, or employment-related injury benefits that include both medical care and wage replacement).

2.5.2. If the Member is uncertain as to the Reporting Entity's categorisation of an employee benefit plan, the Member should seek guidance from the Principal.

2.5.3. The Member should treat the Reporting Entity's categorisation of its employee benefit plans as a prescribed methodology to which PG 1 paragraph 2.8, Assumptions and Methodology Prescribed, applies.

2.5.4. Note that there are definitions of defined benefit and defined contribution plans set out in AASB 119. A superannuation plan that is a defined contribution (DC) plan for legal or prudential purposes may be a defined benefit (DB) plan for accounting purposes in some limited cases (for example, a target funding arrangement in a defined contribution plan).

2.5.5. In Australia, it is relatively common to have DB plans with DC sections. AASB 119 does not specifically consider the treatment of hybrid plans. However, it does envisage situations where more than one plan may be covered by the one legal structure, for example group administration plans.

2.5.6. If the DB and DC components of a hybrid plan are treated separately that means that the expense should be calculated separately in accordance with the DB and DC requirements of AASB 119 and appropriate disclosure made. The separate treatment is a matter of accounting policy and hence the responsibility of the Reporting Entity, and subject to review by its auditors. A Member should make it clear whether their Report includes the expense of both components, or only the DB component (and therefore whether the Reporting Entity should separately add the expense of any DC components in addition to the DB costs set out in the report).

2.5.7. When a surplus is being used to meet accumulation contributions, the total expense may include the surplus amounts credited to members' accounts. Where the use of surplus is material, it may assist users of the Member's report to have documentation on the approach taken and separate disclosure of the amounts met from surplus.

2.5.8. When the benefit for an individual is the greater of DB and DC formulae, it may be appropriate to treat the entire benefit as DB or to treat the benefit as DC with a DB top-up. Again, the substance of the arrangement may be an important consideration.

2.6. Actuarial Assumptions

The Reporting Entity is responsible for selecting assumptions that are unbiased, mutually compatible, and represent the Reporting Entity's best estimates of the variables that will determine the ultimate costs of its Employee Benefits. The Member may advise the Principal regarding the selection or reasonableness of some or all of the assumptions to be used in the actuarial services. In doing so, the Member should be guided by paragraphs 2.6. to 2.9. of PG 1, taking into account AASB 119's requirements regarding assumptions used to measure defined benefit post-employment plans, termination benefits, or other long-term benefits. In particular, when using prescribed assumptions, the Member should be guided by PG 1 paragraph 2.8, Assumptions and Methodology Prescribed.

2.6.1. General Approach for Selecting Assumptions – When advising the Principal on the selection or reasonableness of actuarial assumptions, the Member should:

(a) Identify the types of assumptions needed to perform the actuarial services.

(b) Evaluate information relevant to each type of assumption:

i. With respect to financial assumptions, the Member should review market-implied expectations and other information at the Measurement Date. Examples of such information include:

- Corporate or government bond yields;
- Yields on nominal and inflation-indexed debt;
- Recent changes in relevant price indices (such as general or medical price inflation indices) and forecasts of inflation;
- Employment data and projections;
- Other relevant economic data; and
- Analyses prepared by experts.

The Member may also consider the Reporting Entity's expectations regarding assumptions where the Reporting Entity can influence future experience.

ii. With respect to demographic assumptions, the Member should review information that, in the Member's Professional Judgement, is relevant to the population covered by the Reporting Entity's Employee Benefits. With respect to reviewing the experience of the covered population, this guidance does not impose additional duties on the Member beyond the scope of the actuarial services. Examples of such information that may be reviewed by the Member include:

- The experience of the covered population to the extent credible;
- Analyses prepared by experts such as published tables or experience studies;
- Studies or reports on general trends relevant to the particular demographic assumption; and
- Relevant factors known to the Member that may affect future experience such as the economic conditions of the geographic area or industry, availability of alternative employment, and the Reporting Entity's human resource policies or practices.

The Member may also consider the Reporting Entity's expectations regarding assumptions where the Reporting Entity can influence future experience.

(c) Select an appropriate format for each type of assumption, taking into account materiality (see 2.2) and proportionality (see 2.3) (for example, mortality rates typically vary by gender and age, and when material and proportionate to the actuarial services might also vary by calendar year, employment type, location, or other factors).

(d) Recommend assumptions that in the Member's Opinion are unbiased, mutually compatible, and, if adopted by the Reporting Entity, would be appropriate to represent the Reporting Entity's best estimate.

2.6.2. Mortality Assumption - When advising the Principal on the selection or reasonableness of the mortality assumption, the Member should reflect expected changes in plan members' future mortality rates when material and proportionate to the actuarial services. Examples of methods for reflecting future mortality rates include using a matrix including separate mortality tables for each year or year of birth or projecting the mortality rates for an appropriate period.

2.6.3. Discount Rate Assumption - When advising the Principal on the selection or reasonableness of the discount rate assumption, the Member should take into account AASB 119's requirement that the discount rate reflect market yields at the Measurement Date on high-quality corporate bonds if the market for such bonds is deep or government bonds otherwise, where such bonds are consistent with the currency and estimated term of the employee benefit obligation. The Member may use a variety of approaches to identify a discount rate assumption that satisfies this requirement, including the following:

(a) Full Yield Curve - The Member may recommend a full spot-rate yield curve for discounting projected benefit cash flows. The Member may develop an appropriate yield curve from bond yield data at the Measurement Date. Alternatively, the Member may apply a third party's yield curve, which the Member has determined is appropriate for the purpose of selecting an AASB 119 discount rate (or has adjusted so as to make it appropriate). When applying a third party's yield curve, the Member should be guided by PG 1 paragraph 2.3, Reliance on Others.

i. Bond Universe - When developing a yield curve or assessing the appropriateness of a third party's yield curve, the Member should consider the characteristics of the bond universe used to create the yield curve, including currency and, for corporate bonds, quality. The Member should also consider whether adjustments are needed to deal with "outliers"—bonds with substantially different yields than the yields on most bonds of similar quality and duration included in the universe—or with bonds that have special characteristics, such as call features.

ii. Curve Fitting, Interpolation, and Extrapolation -When the Member is constructing the yield curve from the available bond data in the same currency, the Member should exercise Professional Judgement in applying appropriate curve-fitting, interpolation, or extrapolation techniques to estimate yields at durations where the Member considers the bond market data unreliable or such data do not exist. Such techniques may take into account (with an appropriate spread or other adjustment) other market data sources such as yields on government or lower-rated corporate bonds, the swaps market, or yields on government or corporate bonds in other currencies with market-observable yields at durations beyond the longest duration bond in the same currency as the Employee Benefits and which the Member, having applied Professional Judgement, considers appropriate for this purpose.

A Member using this approach may also determine a single weighted-average discount rate based on the yield curve (as described in 2.6.3.b) for the Reporting Entity's use in the financial statement disclosures.

(b) Single Weighted-Average Discount Rate Based on Yield Curve - The Member may recommend a single weighted-average discount rate assumption determined by:

i. Projecting cash flows on and after the Measurement Date of benefits attributed to employee service up to the Measurement Date;

ii. Applying an appropriate yield curve (as described in 2.6.3.a above) to determine the present value of the cash flows projected in 2.6.3.b.i; and

iii. Calculating a single weighted-average discount rate that produces substantially the same present value determined in 2.6.3.b.ii.

(c) Single Weighted-Average Discount Rate Based on Bond Model - The Member may recommend a single weighted-average discount rate assumption determined by:

i. Projecting cash flows on and after the Measurement Date of benefits attributed to employee service up to the Measurement Date;

ii. Applying a bond model to identify a portfolio of bonds — appropriately selected from the bond universe described in 2.6.3.a.i — that generates substantially the same cash flows projected in 2.6.3.c.i. At durations where the Member considers the bond market data unreliable or such data do not exist, the Member should apply techniques as described in 2.6.3.a.ii. above; and

iii. Calculating a single weighted-average yield on the bonds in the portfolio.

When applying a third party's bond model, which the Member has determined is appropriate (or has adjusted so as to make it appropriate) for the purpose of selecting an AASB 119 discount rate for measuring the cash flows, the Member should be guided by PG 1 paragraph 2.3, Reliance on Others.

(d) Alternative Approaches - The Member may use alternative approaches to those described above. When doing so, the Member should understand the data and assumptions on which the approach is based and the circumstances in which it can be applied appropriately. The alternative approach should take into account both the duration of the projected benefit cash flows attributed to employee service up to the Measurement Date and their shape (that is, whether the cash flows over time are smooth or lumpy). Subject to materiality (see 2.2) and proportionality (see 2.3), examples of alternative approaches include, but are not limited to:

i. The Member may recommend a single discount rate that, in the Member's Professional Judgement, approximates the weighted-average rate that would be determined under one of the preceding approaches.

ii. The Member may apply a market index or other reference rate, with adjustments if appropriate. The Member should have sufficient understanding of the bond data and methodology used to construct the index or reference rate to conclude that it is appropriate for the purpose of selecting an AASB 119 discount rate for measuring the present value of the defined benefit obligation (or has adjusted so as to make it appropriate). When applying a market index or other reference rate, the Member also should be guided by PG 1 paragraph 2.3, Reliance on Others.

2.6.4. General Price Inflation Assumption - When the Member is advising the Principal on the selection or reasonableness of a general price inflation assumption, the Member should review market-implied expectations and other information at the Measurement Date. Examples of such information include:

(a) Changes in price indices;

(b) Implicit price deflators;

(c) Yields on nominal and inflation-indexed debt (taking into account the effect of any significant supply-demand imbalances);

(d) Forecasts of inflation;

(e) Relevant regional factors;

(f) Central bank monetary policy;

(g) Other relevant economic data; and

(h) Analyses prepared by experts.

2.6.5. Medical Cost Assumptions - When the Member is advising the Principal on the selection or reasonableness of medical cost assumptions, the Member should consider estimated future changes in the cost of medical services, which may differ significantly from general price inflation. When material and proportionate to the actuarial services, the Member should consider separate assumptions for major cost components such as hospital services, drugs, medical devices, other medical services, and administrative expenses. The Member also should consider different assumptions for different future time periods.

2.6.6. Other Assumptions Regarding Future Benefit Amounts - For some types of Employee Benefits, future benefit amounts under the plan may reflect factors other than general price inflation or future medical costs. When the Member is advising the Principal on the selection or reasonableness of an assumption about future benefit amounts, the Member should identify relevant factors that, in the Member's Professional Judgement, are likely to have a material effect on future benefit amounts under the plan. Depending on the type of employee benefit plan, examples of relevant factors may include:

(a) Merit or promotional salary increases;

(b) Investment returns on actual or notional assets;

(c) Changes in benefit utilisation or delivery patterns;

(d) Changes in social insurance benefits;

(e) Changes in offsets of benefits provided by other parties; and

(f) Expected changes in mandated benefits.

Advice provided on the salary increase assumption should be realistic and related to the circumstances of the particular Reporting Entity. The salary increase rate is generally also consistent with current economic conditions and inflationary expectations that may be assessed from several sources, including current market yields, the real yields on government CPI-indexed securities, long term economic forecasts and the inflation assumptions underlying the expected return for each asset class used to determine the expected return on assets. Members may also wish to consider CPI expectations implicit in the yield curve based on models of the yield curve that include an allowance for CPI.

Care should be taken when selecting inflation expectations for consistency with the duration of the benefits being forecast, in particular a Reporting Entity's budget forecasts are typically shorter term and hence would carry more weight for short term assumptions.

If any of these approaches are taken, the salary inflation assumption can vary from year to year with movements in the inflation expectations underlying market yields. Generally, the approach should be consistent from year to year.

2.6.7. Change in Process for Developing Assumptions - The Member generally should apply a consistent process from year to year to develop recommended assumptions for a particular Reporting Entity. When the Member considers it appropriate to change the process used to develop a recommended assumption, the Member should discuss the change with the Principal, and should seek guidance from the Principal regarding whether to make the change, and if so, what, if any, information about the change should be disclosed in the Member's Report. For example, if the Principal determines that the change in the assumption-setting process may be subject to AASB 108, Accounting Policies, Changes in Accounting Estimates and Errors, the Principal may ask the Member to disclose the nature of the change and its general effect in the Report.

2.7. Plan Assets

When the actuarial services take plan assets into account, the Member should be guided by the following:

2.7.1. The requirements of Professional Standard 404 which applies to the valuation of superannuation plan assets when a valuation of the assets is required in conjunction with a valuation of the liabilities.

2.7.2. Asset Values Supplied by Others - The Member may rely on asset values prepared by a third party (such as a trustee or investment manager) and, when doing so, should be guided by PG 1 paragraph 2.3.3, Reliance on Others.

2.7.3. The Member may wish to rely on the superannuation plan's audited financial statements when determining the fair value of plan assets for AASB 119 purposes.

2.7.4. Qualifying Insurance Policies - The Member should distinguish between qualifying insurance policies and other sources of reimbursement for expenditures required to settle a defined benefit obligation. When plan assets include qualifying insurance policies, the Member should appropriately reflect those policies in the calculation of the deficit or surplus. For example, the Member should appropriately differentiate between the Reporting Entity's employee benefit obligations and those that an insurer has assumed.

2.7.5. Asset-Related Benefit Liabilities - When advising on the valuation of benefits where future benefit amounts are affected by the value of plan assets (for example, when benefit levels are linked to the return on plan assets (see 2.6.6.) or depend on whether there is a surplus), the Member should value the Employee Benefits in a manner that is consistent with the nature of the linked assets.

2.8. Asset Ceiling

The asset ceiling is the present value of economic benefits available to the Reporting Entity in the form of refunds from the plan or reductions in future contributions to the plan. AASB 119 requires a Reporting Entity to recognise a net defined benefit asset at the lower of the surplus in the defined benefit plan and the asset ceiling. AASB Interpretation 14 provides guidance on how to determine the asset ceiling. The Member should seek guidance from the Principal whether and how to apply the asset ceiling, having due regard to issues such as legal interpretation of the plan rules or any minimum funding requirements.

2.9. Attribution of Benefits to Service Periods

When advising the Principal on the attribution of plan benefits to service periods, the Member should exercise Professional Judgement to address plan designs whose treatment is not fully specified in AASB 119.

3. Communication

3.1. Disclosures in the Report

In addition to complying with PG 1 Section 3, Communication, the Member should disclose in the Report:

(a) Any material deviation from the guidance in this PG (see 1.4);

(b) Any reliance on the Principal's representations regarding Constructive Obligations (see 2.4); and

(c) Any information regarding a change in the process for selecting assumptions that is requested to be disclosed (see 2.6.7).

APPENDIX A – ADDITIONAL INFORMATION

Note: This appendix is provided only for informational purposes. It is not part of the PG and is not intended to represent an authoritative interpretation of AASB 119. Members should make their own interpretation of AASB 119 based on the Standard itself. If there is any conflict between this Appendix and AASB 119, then the requirements of AASB 119 prevail.

Background

AASB 119 prescribes employers' accounting and disclosure requirements for their Employee Benefits other than share-based payments, which are accounted for in accordance with AASB 2 Share-Based Payment. On 7 August 2015, the AASB published a revised AASB 119.

A key principle of AASB 119 is that it generally requires the cost of providing Employee Benefits to be recognised in the period in which the employee performs services, rather than when the benefit is paid.

Categorisation of Employee Benefit Plans

AASB 119 defines four categories of Employee Benefits (excluding equity share-based compensation):

- Short-term benefits expected to be settled wholly before 12 months after the end of the annual reporting period in which the employees render the related services, such as wages, salaries, and social security contributions; paid annual leave and paid sick leave; profit-sharing and bonuses and non-monetary benefits (such as medical care, housing, cars, and free or subsidised goods or services) for current employees.

- Post-employment benefits, such as defined contribution retirement plans, pensions, lump sum payments on retirement, post-employment life insurance, and post-employment medical care. This category is further broken down between defined benefit and defined contribution plans:

  - Under a defined contribution plan, the Reporting Entity pays fixed contributions into a fund but has no legal or Constructive Obligations to make further payments if the fund does not have sufficient assets to pay all of the employees' entitlements to post-employment benefits;

  - A defined benefit plan is a post-employment benefit plan other than a defined contribution plan.

- Other long-term Employee Benefits, such as long-service leave or sabbatical leave, jubilee or other long-service benefits, and long-term disability benefits.

- Termination benefits payable as a result of the Reporting Entity's decision to terminate the employee or the employee's decision to accept an offer of benefits in exchange for termination of employment.

Accounting Treatment Depends on Categorisation

Short-term benefits and defined contribution post-employment benefits

For short-term benefits or defined contribution post-employment plans, the undiscounted amount of the benefits or contributions expected to be paid is recognised in the accounting period the employee renders service.

Defined benefit post-employment plans and other long-term Employee Benefit

Defined benefit post-employment benefits and other long-term Employee Benefits are generally attributed to employees' service. The employer recognises a liability/asset in the statement of financial position equal to the present value of these benefits attributed to service through the Measurement Date (the "present value of the defined benefit obligation"), minus the fair value of plan assets at the Measurement Date. This net liability/asset is called the net defined benefit liability/asset. The net asset recognised on the employer's statement of financial position is limited to the "asset ceiling," defined as the present value of economic benefits available to the employer as refunds from the plan and/or as reductions in future contributions.

Employers must recognise service cost and net interest (on the net defined benefit liability/asset) in the profit or loss. Service cost includes the cost of benefits attributed to service during the accounting period, changes in the defined benefit obligation due to plan amendments or curtailments occurring in the accounting period, and gains or losses from settlements occurring in the accounting period. Net interest is calculated by applying the discount rate (used to measure the defined benefit obligation) to the net defined benefit liability/asset, adjusted for contributions and benefit payments during the accounting period.

All other changes in the net defined benefit liability/asset, including the difference between actual investment return and the expected return determined using the discount rate, changes in the defined benefit obligation from discount rate or other assumption changes, and experience gains and losses, are recognised immediately in Other Comprehensive Income (OCI) or, for other long-term-Employee Benefits, in profit and loss.

AASB 119 provides a special rule for certain long-term disability or employment-related injury benefits. When the level of benefit is the same for any employee regardless of years of service, the expected cost of those benefits is recognised when an event occurs that causes a long-term disability or employment-related injury.

Termination benefits

Termination benefits are triggered by the termination of employment, and are recognised when the Reporting Entity can no longer withdraw the offer of those benefits or, if earlier, when the Reporting Entity recognises associated restructuring costs. Termination benefits may take various forms, such as lump sum payments, pension benefit enhancements, or salary continuation for a specified period.

Allowances for Tax

Taxes are payable by Australian superannuation funds on concessional contributions and investment earnings on superannuation assets. AASB 119 includes requirements to make financial assumptions about taxes payable by the plan on contributions relating to service before the reporting date or on benefits resulting from that service, when determining the Defined Benefit Obligation. Other taxes, payable by the plan and not included in those assumptions, are deducted when determining the return on assets.

Allowance for expenses and insurance premiums

Australian superannuation funds also typically include death and disability insurance benefits. In defined benefit plans the sponsoring employer may meet the cost of that insurance and non-investment expenses incurred in running the plan.

On-costs

For long service leave, some on-costs will be payable in addition to salary payments during the period of leave depending on whether the underlying benefits are taken in-service or paid on exiting the employer. These on-costs may also vary by State and possibly sub-class of membership (for example, superannuation fund).

Payroll tax is generally levied on both forms of benefit payments, whereas workers compensation is only generally levied on benefits taken in-service (although there is some uncertainty regarding whether or not a workers compensation on-cost should be allowed for in long service leave calculations).

The application of superannuation costs to payments will depend on the actual employer's practice.

Financial Statement Disclosures

AASB 119 requires the Reporting Entity to disclose information in its financial statement that:

- Explains the characteristics of defined benefit plans and risks associated with them;
- Identifies and explains the amounts in the IFRS financial statement arising from defined benefit plans; and
- Describes how its defined benefit plans may affect the amount, timing, and uncertainty of the Reporting Entity's future cash flows.
- Actuarial services in connection with AASB 119 often include assisting Reporting Entities in meeting these disclosure objectives. Areas where the Member may provide particularly valuable input include:
  - Disclosures about plan characteristics or risks that are unusual, Reporting Entity-specific or plan-specific, such as post-employment medical benefit plans with no

lifetime claims limit, plan-specific limitations on refunds of surplus to the employer, concentrations of plan assets in one class of investments, or counter-party risk associated with expected insurance recoveries;

- Disclosures about existing risk management strategies such as enterprise risk management, asset-liability matching, or longevity swaps;

- Explanation of amounts in the financial statement, including the reconciliation of amounts shown in the financial statement from the beginning to the end of the year;

- The appropriate level of aggregation or disaggregation of employee benefit plans according to their characteristics and risks;

- Disclosures about how defined benefit plans may affect the amount, timing, and uncertainty of the Reporting Entity's future cash flows (such as expected funding contributions);

- Disclosures about the maturity profile of the defined benefit obligation; and

- Disclosures about the significant assumptions used to determine the present value of the defined benefit obligation, their "reasonably possible" variation, and the consequent change in the present value of the defined benefit obligation at the Measurement Date.

Discount Rates

The Actuaries Institute and the G100 have arranged for the monthly publication of an Australian high quality corporate bond yield curve. That published corporate bond yield curve may provide a basis for determining the yield on high quality corporate bonds with an appropriate duration.

Paragraph Aus83.1 of AASB 119 requires not-for-profit public sector entities to use the market yield on Government bonds for the discount rate.

APPENDIX B: COMPILATION OF DIFFERENCES BETWEEN PG 3 AND ISAP 3

(a) Hyperlinks removed and replaced with capitalised terms.

(b) Formatting and paragraph number changes made.

(c) References to ISAP changed to Practice Guideline (PG).

(d) References to ISAP 1 changed to PG 1.

(e) The reference to ISAP 1A has been deleted pending equivalent Australian guidance.

(f) The term “actuary” changed to “Member”.

(g) Added a new Section 1.2 “Classification”, which sets out the basis on which the PG was prepared, that it is not mandatory and that a Member should consider explaining any significant departure from the PG to the Principal and document such explanation. Services under PG 3 are designated as Applicable Professional Services for the purposes of PG 1.

(h) Added additional commentary to Section 2.2 on approximate methods typically adopted in Australia.

(i) Added additional commentary to Section 2.5 on the possibility of differences between the categorisation of plans for accounting and Australian legal purposes.

(j) Added new paragraphs 2.5.4 to 2.5.8 covering hybrid arrangements common in Australia.

(k) Added additional guidance on setting salary inflation assumptions in sub-section 2.6.6.

(l) Added a new 2.7.1, noting the requirements of Professional Standard 404.

(m) Renumbered the existing 2.7.1, 2.7.2, and 2.7.3.

(n) Added a note on audited financial statements to the renumbered 2.7.2.

(o) Added details on Australian superannuation taxes, practice with allowing for insurance premiums and expenses in superannuation, on costs on long service leave and the G100 yield curve to the Additional Information Appendix.

APPENDIX C: GLOSSARY

AASB 119 – Australian Accounting Standard 119 Employee Benefits, including any Interpretations from the Australian Accounting Standard Board, as issued through August 2015.

Accounting Policies – as defined in AASB 108

Constructive Obligation – as defined in AASB 137.

Employee Benefit – as defined in AASB 119.

IAS 19 – International Accounting Standard 19 Employee Benefits, including any Interpretations from the International Financial Reporting Interpretations Committee or the Standing Interpretations Committee thereon, as issued through September 2014.

Measurement Date – The date as of which the value of an asset or liability is presented, whether or not the actual calculations have been made as of a different date and rolled forward or back to the measurement date.

Opinion - An opinion expressed by a Member and intended by that Member to be relied upon by the Intended Users.

Reporting Entity – as defined by the Australian Accounting Standards Board in the Statement of Accounting Concept 1 Definition of the Reporting Entity.