

POSTRETIREMENT BENEFITS OTHER THAN PENSIONS

Recommendations Based on a Study of Relevant Standards, Conceptual Frameworks and Current Trends.

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*A Masters Thesis to be presented to the
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Master of Commerce degree in Accounting*

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I certify that, except as noted, this masters thesis is my own work and that all references are correctly reported.

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23 February 1998

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ABSTRACT

The FASB began work in the area of postretirement benefits other than pensions (hereafter OPEB) in the early 1980's. It was to be a long, involved process, culminating in the issue of SFAS 106 in 1990. It was commented at the time that "the proposed standard on nonpension postretirement benefits has been argued to be the most significant accounting change since the adoption of depreciation and the total impact of the standard on corporate profits has been estimated at between \$200 billion and a trillion dollars" (Espahbodi et al, 1991, pp 325).

It was SFAS 106 and the well-documented effects thereof that heralded the development of other international accounting standards dealing with OPEB.

There is currently little guidance in South Africa as to how OPEB should be both accounted for and disclosed in financial statements. Although AC 305 has been issued, this is merely a guideline and compliance therewith is not compulsory. There is currently some confusion as to whether AC 116, dealing with pensions, applies to other postretirement benefits. In light of this, this thesis aimed to propose an acceptable method of accounting for OPEB in South Africa bearing in mind the possible reactions of management to the disclosure of an OPEB liability and the needs of users of financial statements, who in understanding the complex issues surrounding the provision of postretirement benefits will need extensive disclosures. The IASC's harmonisation process also has to be considered as a South African pronouncement should be consistent with any standards issued by the IASC.

In order to achieve this objective, a literature review was conducted on the conceptual frameworks that have been issued by the FASB, IASC, ICAEW, CICA and the AARF. This was done so as to ensure that OPEB do in fact meet the definitions of liabilities and the recognition criteria as contained in the

various frameworks. The exposure drafts and accounting standards issued by these accounting bodies were then considered so as to determine whether they were in conformity with the conceptual frameworks upon which they are based and to highlight any differences between the accounting treatments and disclosures in the various countries.

This information was used as a basis for the questionnaires which were sent to the financial directors of the Top 100 Companies (representing the preparer group), analysts, shareholders and auditors (representing the user group). Both groups had to be considered so as to recommend an accounting treatment that is generally acceptable.

Differences were found between the conceptual frameworks as well as the various standards and exposure drafts dealing with OPEB that had been released by the international accounting bodies.

The level of knowledge of the respondents to the questionnaires was found to be of a generally low standard. Responses clearly indicated that users need more clarification on OPEB and preparers need the guidance of a South African accounting standard. In light of this, recommendations have been made in respect of an accounting treatment for postretirement benefits other than pensions for the South African environment which remains consistent with the broad principles outlined by the IASC in its accounting for OPEB.

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DETAILS OF ABBREVIATIONS USED:

<i>AARF</i>	Australian Accounting Research Foundation
<i>AAS</i>	Australian Accounting Standard
<i>AICPA</i>	American Institute of Chartered Public Accountants
<i>APBO</i>	Accumulated Postretirement Benefit Obligation
<i>ASC</i>	Accounting Standards Committee
<i>CICA</i>	Canadian Institute of Chartered Accountants
<i>ED</i>	Exposure Draft
<i>EIC</i>	Emerging Issues Committee
<i>EPBO</i>	Estimated Postretirement Benefit Obligation
<i>FASB</i>	Financial Accounting Standards Board
<i>FERF</i>	Financial Executive Research Foundation
<i>GAAP</i>	Generally Accepted Accounting Practice
<i>IAS</i>	International Accounting Standard
<i>IASC</i>	International Accounting Standards Committee
<i>ICAEW</i>	Institute of Chartered Accountants of England and Wales
<i>IOSCO</i>	International Organisation of Securities Commissions
<i>OPFB</i>	Other Postemployment Benefits
<i>SAICA</i>	South African Institute of Chartered Accountants
<i>SFAS</i>	Statement of Financial Accounting Standards
<i>SSAP</i>	Statement of Standard Accounting Practice
<i>UITF</i>	Urgent Issues Task Force
<i>WACC</i>	Weighted Average Cost of Capital
<i>PYA</i>	Prior Year Adjustment

CHAPTER 1 : INTRODUCTION

1.1 BACKGROUND

As part of an employee's remuneration package many employers are offering benefits that will only be received by employees after they have retired. FASB Statement 106 (1990) states that postretirement benefits other than pensions 'include, but are not limited to, postretirement health care, life insurance provided outside a pension plan to retirees, and other welfare benefits such as tuition assistance, day care, legal services and housing subsidies provided after retirement.' (para 6). Of these so-called 'other postretirement benefits' (henceforth referred to as OPEB) postretirement health care is likely to be the most significant in terms of cost and prevalence (as evidenced by the FASB Preliminary Views, 1982). This thesis therefore refers specifically to postretirement health care although it applies equally to all benefits received after retirement.

In the past, although employers had provided their employees with these benefits, the cost in relation to the income of the enterprise was small. Now, with the increases in the number of retirees, the ageing of the world's population, and the rising costs of health care, the cost of providing postretirement benefits has become substantial, and continues to increase.

'Today, about 17% of U S citizens are aged over 60; by 2020 this figure will be 25%.

Overseas, the ageing is even more rapid. In Germany, the proportion over 60 will rise to 30% from about 22%. In Japan, it will go to 31% from 20%. By 2060 the problem will be even worse.'

(Business Day, 18 July 1995)

In recognition of this, and the fact that 'the General Accounting Office (1989) estimated that unrecorded retiree health-care liabilities in 1988 equalled approximately \$227 billion, or one-fourteenth the value of publicly held U S companies' (Martens and Stevens, 1993, pp 287), the FASB felt that accounting for OPEB on the current 'Pay-as-you-go' basis was inadequate (FASB, November 1982, para 4). This cash basis meant that the OPEB expense was only recognised when paid i.e. when the retired employee claimed the benefit.

The FASB sparked debate by suggesting in a 1981 discussion memorandum that OPEB, like pensions, constituted a form of deferred compensation. Accordingly, the costs of providing these postretirement benefits should be matched to the benefit derived from the service rendered by the employee. This so called 'accrual' accounting recognises the expenses related to OPEB years before such expenses are actually paid. This more prudent approach spreads the postretirement benefit cost to the employer over the service period of the employee.

As a result of the fact that to date there had been no accounting standard dealing with OPEB, the issue of funding for other postretirement benefits had generally been overlooked. Funding is defined in FASB 106 as 'the program regarding the amounts and timing of contributions by the employer(s), plan participants, and any other sources to provide the benefits a postretirement benefit plan specifies' (1990, para 518). This means that on the accrual basis of accounting, an expense for OPEB will be charged to the income statement and a liability will have to be recognised, as the payment of the expense has not taken place as yet. As OPEB are generally unfunded (Martens and Stevens, 1993, pp 287) no netting off of the liability and plan assets is possible and the liability must be disclosed in the balance sheet, in the interests of fair presentation.

' In recent years the costs of medical care and medical-aid have increased enormously and together with the fact that the average life expectancy is growing it becomes evident that the possible cost in respect of postretirement benefits will have a corresponding increase. The obvious consequence of this is that the potential liability in respect of

the postretirement benefits is also likely to increase. The omission of this potential significant liability could cause the financial statements to be false or misleading.'

(Dickinson, 1994, pp 33)

Such a disclosure will cause Earnings per Share (EPS) figures to drop and will produce poorer results when ratio analysis is performed. For these reasons it may not be welcomed by management who may argue against the disclosure of OPEB in financial statements. This is considered in Chapter 2 which deals with the conceptual framework criteria for recognition in financial statements.

However, the recognition of a liability for OPEB could prove problematic as recognition requires the quantification of an OPEB liability. This in effect means that an enterprise providing OPEB to its employees has to estimate the payments it expects to make once the employee has retired. This is a complicated task which will require the assistance of actuaries to predict future health care costs and the life expectancies of employees, based on previous experience and various predictions. The agreement (known as the substantive plan) reached between employer and employee must be taken into account, as often the employer does not undertake to meet all the health care costs of the employee after retirement but only a portion of them. Once the total estimated postretirement benefit costs to the employer on a per employee basis have been estimated, these future costs are then discounted back to present value equivalents using an appropriate discount rate and then in turn allocated to an employee's years of service.

As FASB Statement 106 states :

'...the accumulated postretirement benefit obligation is measured using actuarial assumptions and present value techniques to calculate the actuarial present value of the expected future benefits attributed to periods of employee service. Each assumption used shall reflect the best estimate solely with respect to that individual assumption. All assumptions shall presume that the plan will continue in effect in the absence of evidence that it will not continue.

Principal actuarial assumptions include the time value of money (discount rates); participation rates (for contributory plans); retirement age; factors affecting the amount and timing of future benefit payments, which for postretirement health care benefits consider past and present per capita claims cost by age, health care cost trend rates, Medicare reimbursement rates and so forth; salary progression (for pay related plans); and the probability of payment (turnover, dependency status, mortality and so forth).'

(FASB, 1990, para 30)

As can be seen, the quantification of an OPEB obligation is a complex process which necessitates the use of approximations and estimates. For this very reason it may be difficult to make any comparisons between the OPEB liabilities of different companies, as the assumptions used may differ.

The accrual basis of accounting for OPEB will also have deferred tax implications. For tax purposes the full postretirement benefit expense can only be deducted when it is actually paid, whereas for accounting purposes, the expense is stated in present value terms and spread over the service period of the employee. Therefore, a deferred tax asset is created. It is important to note that this asset will be stated in present value terms and not at the amount that will actually be saved in tax when the postretirement benefit is eventually paid. This treatment of deferred tax differs from that which is normally encountered where the deferred tax asset is stated in future terms i.e. the eventual tax saving expected.

Recommendations of how to measure the OPEB obligation and the related disclosure requirements will be considered in detail in chapters 3 to 8 where the official pronouncements that have been issued on other postretirement benefits are discussed. This involves a review of all standards, exposure drafts and technical releases issued by the FASB, ICAEW, CICA, AARF, SAICA and IASC

These pronouncements will be compared and contrasted and their effects documented. Chapter nine is a brief summary of the standards and current international trends as regards other postretirement benefits. Chapter 10 details the research methodology followed in this thesis and Chapters 11 and 12 focus on

questionnaires sent out to preparers and users of financial statements in South Africa in order to determine the most appropriate method of accounting for and disclosing details of OPEB.

1.2 RESEARCH PROBLEM TO BE ADDRESSED

The problem being addressed is to propose an acceptable method of accounting for OPEB in South Africa bearing in mind the possible reactions of management to the disclosure of an OPEB liability (as discussed earlier) and the needs of users of financial statements, who in understanding the complex issues surrounding the provision of postretirement benefits will need extensive disclosures. The harmonisation process adopted by the IASC will also be considered in recommending an accounting treatment for the South African environment.

For these reasons, questionnaires have been used. In this way it is hoped that both parties will be satisfied. Although at the moment, it is widely acknowledged that a liability exists, recognition of such has been slow and where recognition has been made, it has had a serious impact on financial statements (for example, Anglo American Corporation, Rembrandt and Otis Limited).

Although substantial progress has been made in issuing accounting standards dealing with postretirement benefits other than pensions abroad (for example, FAS 106 and the IAS's E54), there is still no South African standard dealing specifically in this area. As there is some doubt as to whether the revised AC116 applies to OPEB, the only South African pronouncement dealing specifically with this area has been guideline AC 305, the compliance with which is recommended but not compulsory. The fact that there is no known research on user needs and preparers' willingness to disclose information on OPEB in South Africa means that many issues have not as yet not been explored. For the various reasons mentioned above, this study will:

1. review literature so as to suggest suitable disclosures,
2. assess preparers and users' needs, and
3. address the South African situation specifically.

1.3. LIMITATIONS OF THIS RESEARCH STUDY

Although the research study does apply to all postretirement benefits other than pensions, the standards and the literature on this issue have concentrated mainly on postretirement health care. This is due to the fact that studies undertaken by the FASB revealed this to be the most material (substantial) OPEB provided to retirees (FASB, 1982, pp 3). This research was later proved by the effect of SFAS 106 on the likes of IBM, General Motors and McDonnell Douglas (Baker and Hayes, 1995, pp 13) due to the provision of postretirement health care. Therefore, although some of the terms (e.g. health care cost trend rate) may not apply to all OPEB, the general principles do.

The questionnaires were sent to listed companies only, as the literature concentrated upon the experiences of the listed companies. This is due to the fact that the information is readily available in the form of published financial statements.

Problems were encountered in determining the effects of any pronouncements dealing with OPEB in some countries. The experiences in the U S have been extensively documented. The fact that little has been written about the effects experienced in Canada and Australia may be due to the fact that, like the UK, the provision of OPEB is rarer than in the United States (ICAEW, 1992, para 1), or simply that the standard setters in these countries have been slower to deal with OPEB than the FASB.

1.4 STRUCTURE OF THIS STUDY

Chapter 2 : Considers OPEB in terms of the relevant conceptual frameworks.

Chapter 3 : Highlights standards and current practice in the United States.

Chapter 4 : Details standards dealing with OPEB released in the United Kingdom, and the effects thereof.

Chapter 5 : Examines Canadian standards and experiences.

Chapter 6 : Reviews any Australian OPEB standards and their effects.

Chapter 7 : Highlights the stance adopted by the IASC.

Chapter 8 : Reviews the South African situation regarding OPEB.

Chapter 9 : Summarises trends internationally.

Chapter 10: Details the research methodology adopted.

Chapter 11: Evaluates the opinions of preparers of financial statements based on a questionnaire.

Chapter 12: Evaluates the opinions of users of financial statements based on a questionnaire.

Chapter 13: Draws conclusions from both the users and preparers surveyed.

Chapter 14: Conclusions and recommendations.

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CHAPTER 2 : THE CONCEPTUAL FRAMEWORK

2.1. INTRODUCTION

Pronouncements dealing with OPEB all call for the implementation of accrual accounting (SAICA, July 1995, para 6-9). Such a shift from the cash to the accrual basis has had far reaching effects. IBM was forced to report its first recorded net loss in history in 1991, General Electric's pre-tax earnings were reduced by \$2.7 billion and Lockheed Corporation's pre-tax profits fell by \$1 billion. (Harper et al, 1991, pp 52).

When the FASB issued its exposure draft dealing with OPEB (14 February 1989), 467 letters were received commenting on it. The strongest and most theoretically correct arguments against the implementation of exposure drafts and accounting standards will be found in the conceptual frameworks upon which the pronouncements are based. For this reason, it is important to establish whether there is consistency between the framework and the corresponding standard.

In recent years there has been a concerted move towards international accounting harmonisation leading to comparative financial statements and like treatments of similar transactions throughout the world.

“As the volume of international financial operations and cross border investments continues to surge, the need for a common language of business in financial statements is increasing in urgency.”

(Diamond et al, 1991, pp 25).

It therefore becomes important to consider the similarities and differences that exist between the conceptual frameworks upon which standards are based. An in-depth analysis of the standards that have been issued to date will follow in later chapters.

This chapter focuses on the definition of a liability, the recognition criteria, and cost versus benefit constraints. These were the three areas most cited in the 110 letters commenting on the FASB exposure draft which disagreed that a recognisable liability for OPEB exists.

2.2 THE LIABILITY

2.2.1. INTRODUCTION

Previously, companies have accounted for postretirement benefits other than pensions on a pay-as-you-go basis. This meant that an expense related to OPEB was only recognised as an expense in the income statement when it was paid i.e. after the retirement of the employee.

This is materially different from the manner in which pensions are accounted for and resulted in a mismatch of costs and benefits. The employer would enjoy the benefits of the services rendered by the employee before recognising the full costs associated with his employment. This has been criticised by the standard setting bodies in the UK, the USA, Canada, Australia and by the IASC, all of whom suggest that OPEB should be accounted for on the accrual basis.

Application of the accrual basis requires that a portion of the present value of future costs be matched to the benefit of employing the employee. This means putting a charge through to the income statement earlier than on the cash basis and recognising a liability for the payment of the OPEB which will be made after the retirement of the employee.

As OPEB are generally unfunded in the U S (Cheney, 1989, pp 18), there is no possibility of netting the liability off against plan assets that will be utilised to finance the liability, as is always done with pensions.

The implementation of the accrual basis of accounting therefore results in the disclosure of an OPEB liability in the balance sheet. In terms of Watts and Zimmerman's positive accounting theory (1978), as

discussed in Mathews and Perera (1991), some companies may be resistant to the introduction of such a liability due to its detrimental effect on financial position and ratio analysis.

The purpose of this section is to determine whether OPEB do in fact meet the definition of a liability per the various conceptual frameworks so as to refute any argument to the contrary and to ensure uniformity exists - a liability as defined in the US will also be viewed as such in the UK etc.

2.2.2. DEFINITIONS

The conceptual frameworks of Australia, Canada, the UK, the USA and the IASC were all considered. These were chosen due to the fact that these are the countries from which OPEB standards have been considered in future chapters.

The liability definitions contained in the conceptual frameworks all specify three separate criteria which must be met before an element can be treated as a liability,

1. The existence of a present obligation,
2. which has arisen as a result of a past transaction or event, and
3. which will result in the transfer of economic benefits.

2.2.3 PRESENT OBLIGATION

The first criterion specified is that a present obligation must exist. The question as to when an enterprise is truly obligated has long been debated - should a legal interpretation be applied or is this too narrow for accounting purposes?

OPEB, unlike pensions, are seldom evidenced by a written agreement between employer and employee, but often based on a mutual understanding. As a result of this informal agreement there is always the possibility that the employer may cease providing OPEB to employees.

'As recently as three years ago, many strongly believed that where there was no legal obligation attached to providing such benefits, the liability was avoidable and therefore accrual accounting was inappropriate.'

(Sullivan, 1989, pp 14)

Ijiri recognised the narrowness of the application of the pure legal enforceability criterion and commented that :

'A commitment is said to be firm if it is unlikely that its performance can be avoided without a severe penalty. A penalty is considered severe if in the normal course of business an enterprise would perform what is required under the commitment rather than incur the penalty.'

(quoted in Arthur Andersen, 1984, pp 40)

FASB Statement 106 specifically states that it would be unlikely that an employer could terminate existing obligations without incurring some cost - being the dissatisfaction of employees, possible strike action or compensating increases in take-home pay etc. (para 126).

Even though the legal enforceability of the OPEB obligation as far as the employer is concerned 'may be questionable, this is not sufficient to preclude an item's qualifying as a liability.' (FASB, 1985, para 36) and an obligation 'may be binding because of social or moral sanctions or custom.' (FASB, 1985, para 40).

Sullivan has noted that :

'There is great concern among employers that upon recognition of an accrual for postretirement benefits in the financial statements, courts, lawyers and others might cite this change in accounting rules as evidence that a legal liability exists for such benefits.' (Sullivan, 1989, pp 17)

This means that a legal liability may be created as a result of better disclosure, however the clarification of a company's stance as regards OPEB to its employees will be welcomed by users of financial statements and draw management's attention to the potential cost of providing such benefits.

In conclusion, there seems to be widespread agreement that if an entity is currently paying OPEB to retired employees, or has done so in the past, then in the absence of any evidence to the contrary, it can be assumed that the entity will continue to offer postretirement benefits other than pensions in the future. Therefore, an obligation does exist and the first criterion of the liability definition has been complied with.

2.2.4. PAST TRANSACTION OR EVENT

FASB Statement 106 states (FASB, 1990, para 23) that the event obligating the employer is the rendering of services in exchange for future benefits by the employee. Therefore, if an employee becomes entitled to postretirement benefits from the first day of employment then it is from that first day that the liability of the employer arises and continues until the date of retirement. If an employee becomes entitled to postretirement benefits after a specific number of years in service then the 'event' giving rise to the obligation will be the rendering of services by the employee after the specified number of years. If an employer commences the provision of OPEB to existing employees then the 'event' is the service provided by the employees from the date upon which they qualify for OPEB.

In summary, a liability arises as soon as the employees render services that entitle them to OPEB.

2.2.5. SACRIFICE OF ECONOMIC BENEFITS

The third requirement is that a sacrifice of economic benefits takes place.

The phraseology of this requirement differs slightly from country to country, with the Canadian framework suggesting that the settlement of the obligation 'may' result in the sacrifice of economic benefits, the IASC stating that such sacrifices are 'expected' and the US saying that they are 'probable'. Neither Australia nor the UK introduce any of these uncertainty terms in their definitions, but merely state that economic benefits will be sacrificed in the settlement of the obligation. It is submitted that these differences will have no effect from country to country as no enterprise will be eager to recognise liabilities on the slightest chance that a sacrifice of economic benefits might occur - rather obligations will only be acknowledged when it is highly likely that a sacrifice of economic benefits will occur.

One must however consider whether completeness will be achieved - will all obligations be acknowledged or will enterprises claim that there is too small a probability of an outflow of economic benefits?

Although there is no absolute certainty that an outflow of economic benefits will occur in the settlement of the actual obligation, costs will be incurred in the avoidance of the obligation (as discussed earlier).

Therefore, a transfer of economic benefits occurs regardless of the manner in which the obligation is eventually settled.

All three criteria have been complied with.

2.2.6. OTHER CONSIDERATIONS

The Canadian conceptual framework liability definition is the only one that stipulates that in order to meet the definition of a liability, the obligation must be settled at a specified determinable date (FASB, 1994, pp 19). Sometimes the timing of the payments of the postretirement benefits made by the employer in terms of the OPEB obligation cannot be determined before they are made due to the very nature of OPEB i.e. payment of health care when retired employee becomes sick etc. Even though payment is expected to be made some time after retirement, the actual date and amount cannot be determined beforehand. The

Canadian definition is tempered by a clause stating that obligations that will be settled on the occurrence of a specified event or on demand will also meet the definition of a liability. As a retirees' medical costs, for example, will only be paid when a retired employee becomes sick, it can be said that OPEB meet the liability definition as a specified event has occurred.

2.2.7 CONCLUSION

Five conceptual frameworks were considered in this section in order to establish whether the postretirement benefits provided by an employer meet the definition of a liability.

In all cases, the liability definitions stipulated by the frameworks could be applied to OPEB.

2.3 THE RECOGNITION CRITERIA

2.3.1. INTRODUCTION

As previously discussed, the accrual basis of accounting for OPEB requires the recognition of a liability in the financial statements.

It has already been established that the liability definitions have been met, now the recognition criteria will be considered.

2.3.2. THE RECOGNITION CRITERIA

The conceptual frameworks considered agree that 'recognition' is the process of including an item in the financial statements of an enterprise and 'involves depiction of the item in words and by a monetary

amount and the inclusion of that amount in the statement totals.' (ICAEW, July 1992, para 1). If a liability complies with the definition but not the recognition criteria, then it is advisable not to quantify it on the face of the balance sheet, but rather to disclose it as a contingent liability in the notes to the financial statements.

All the conceptual frameworks, with the exception of the American one, specify probability and measurability as the recognition criteria. As stated in the IASC framework :

'An item that meets the definition of an element should be recognised if -

- it is probable that any future economic benefit associated with the item will flow to or from the enterprise; and
- the item has a cost or value that can be measured with reliability.'

(IASB, 1990, para 83).

The US framework states that :

'An item should be recognised when all of the following criteria are met -

- the item meets the definition of an element of the financial statements,
- it has a relevant attribute measurable with sufficient reliability,
- the information about it is capable of making a difference in user decisions (relevant),
- the information is representationally faithful, verifiable and neutral (reliable).'

(FASB, 1984, para 63).

As can be seen from the above definitions both conceptual frameworks refer to a 'measurement' criterion - the preparers of financial statements must quantify the liability at the amount that represents the sacrifice of economic resources which will be made by the entity to settle the liability.

With the exception of the FASB all the other frameworks refer to the probability criterion meaning that liabilities should only be recognised as such when the preparers of financial statements believe that economic resources will actually be sacrificed.

The FASB refer to 'relevance' and 'reliability'. It must now be established whether or not the use of these different terms will have any effect on the recognition of the OPEB liability - is it possible that a liability that would be recognised in the US is not recognised anywhere else? It is therefore necessary to consider each term separately.

2.3.3. MEASUREMENT

The measurement of the OPEB liability is based upon estimates and approximations in order to determine what the future cost per employee is likely to be and when it is likely to be paid. This future cost is then discounted back at what is seen to be an 'appropriate' rate to attain a total present cost of the future obligation. This total cost is then allocated on a 'suitable' basis to the estimated years of service of the employee in an attempt to match the benefit derived from the service rendered by the employee to the future cost that will be incurred by the employer. Questions arise as to whether the estimation of a liability in this manner could ever be termed reliable. Indeed, respondents to a survey undertaken by the FASB establishing preliminary views on OPEB, expressed doubt as to whether reliable measurement was possible, and the suggestion was made that disclosure of OPEB as a contingent liability might be preferable to quantification in the balance sheet (FASB, 1990, para 40). The FASB refuted this suggestion by saying that even though the quantification was based on estimates, the disclosure of an amount representing a liability in the balance sheet was more reliable than the non-disclosure of such an amount - implying that no such liability exists (FASB, 1990, para 29).

The Trueblood Report conceded that only cash can be measured precisely, and that everything else is less precise (pp 45). Therefore one must ask how reliable the measurement should be if 100% reliability is not possible to qualify for recognition. The FASB define reliability in terms of representational faithfulness

and neutrality, therefore provided that the OPEB liability is estimated using neutral data, the preparers of financial statements have achieved a 'best estimate'. This means that the amount disclosed in the balance sheet does not have to be absolutely accurate but rather that it has been estimated in a neutral manner and fairly represents the liability that the preparers feel will have to be settled.

In order to calculate the estimated OPEB liability, use is made of a health care cost trend rate, the average number of years of service, details of average health care costs and a discount rate. The health care cost trend rate is the rate at which health care costs are expected to rise annually. This rate can be obtained from medical aid societies. The average number of years of service rendered per employee can be obtained from looking at service records, similarly, life expectancies are available as the information is used for pensions. Although none of this information guarantees the correctness of the estimate it does mean that it will be neutral. It is only the discount rate that may be susceptible to manipulation.

The FASB have stipulated that 'the assumed discount rates should reflect the rates at which an amount invested at the measurement date in a portfolio of high quality debt instruments would provide the necessary future cash flows to pay benefits where due.' (FASB, 1993, pp 4). Unfortunately, the payment dates of the OPEB can only be estimated based on probabilities and averages.

The weighted average cost of capital (WACC) is inappropriate as a discount rate due to the fact that it leads to circular reasoning - the WACC is used to determine the value of the liabilities which in turn are used to determine the WACC. The discount rate used for pensions may not be applicable as payment of pensions is fixed over time. Perhaps the best suggestion was made by Eli Amir (1993, pp 723) in his call for the use of a 'firm-specific measure of the return of equity'. Although no clarification was provided as to whether an accounting or market rate was being referred to, both are reasonably easy to calculate.

In conclusion, although it is unlikely that the OPEB liability can be estimated accurately, it can be measured reliably through the use of neutral approximations and rates. It is in the interest of representational faithfulness that a liability be disclosed in the balance sheet, as an estimate of an obligation is preferable to the omission of such an obligation which could lead a user of financial statements to believe that no such liability exists.

2.3.4 PROBABILITY

The term 'probability' was used in the recognition criteria specified in every framework except for the American one. The term is used to refer to the degree of uncertainty that the future economic benefits associated with the item will flow to or from the enterprise. (SAICA, 1990, para 85). In other words, a liability should only be disclosed in the financial statements if it is probable that a sacrifice of economic resources will occur when the liability is settled.

It is unlikely that preparers of financial statements will disclose liabilities if it is improbable that a payment will occur, as additional liabilities have a detrimental effect on ratio analysis. Therefore the purpose of the probability criterion is to ensure that a liability is recognised even when there is less than 100% certainty that a sacrifice of economic benefits will take place.

A survey conducted by Arthur Andersen and documented in their 1984 publication of the Objectives of Financial Statements discussed the different interpretations of the term 'probable'. In Australia the term is taken to mean 'more likely than not' - therefore any chance of an outflow of economic benefits in excess of 50 % will mean the recognition of a liability. The situation in Canada however is somewhat different with the term being interpreted as meaning 'highly likely' i.e. a likelihood of either 80% or 90%. This is cause for concern as it may mean that the same liability will be recognised in Australia and not in Canada, hampering the harmonisation process and compatibility. Unfortunately, the survey did not extend to other countries and hence no information is available on the interpretation of 'probability' elsewhere. (pp 54).

In conclusion the use of the word 'probability', may cause incompatibilities in the recognition of the OPEB liability .

2.3.5 RELEVANCE

There seems to be wide-spread agreement that :

‘relevant information is data, whether in the past, the present or about other people’s forecast of the future, that a decision maker can use to improve his own predictions about the future.’

(ICAEW, 1981, pp 37).

The U S framework specifies that a liability will only be quantified in the balance sheet if its disclosure makes a difference to user decisions (FASB, 1978, para 5). This means that only relevant information should be disclosed in the financial statements. In order to determine whether information is relevant, attention has to be given to the parties who use the financial statements and the purposes for which they use the information contained therein.

In order for information to be relevant it must be useful. This usefulness can only be determined by looking at the different users and their respective needs. The FASB lists the users of financial statements as including ‘owners, lenders, suppliers, potential investors and creditors, employees, management and directors...’ (FASB, 1980, para 24). Investors need the information to assess the riskiness of their investment and the ability of the enterprise to pay dividends. Employees will be interested in all information related to remuneration, pensions and other postemployment benefits. Lenders need to assess the ability of an enterprise to repay amounts that have been lent to it. Other users are interested in the profit made by the enterprise, its general ability to meet its commitments and future prospects.

As far as the disclosure of an OPEB liability is concerned, investors will be interested in the disclosure of any additional liability as it adds to the riskiness of their investment. Employees will use the OPEB information disclosed in the financial statements to assess their rights to postretirement benefits because,

as previously discussed, these liabilities are not always evidenced by formal contracts between employer and employee. This information will be used in the making of financial decisions - as far as investors are concerned the decision involves the buying of additional shares or the selling of the shares already held. As far as employees are concerned the decision will be remaining in the same job or resigning. Lenders will decide whether to call their loans in or extend them and creditors will decide whether to grant credit based upon the ability of an enterprise to meet its existing obligations.

There can be no doubt that the disclosure of OPEB information assists various users in the making of economic decisions, and is therefore relevant. The only criterion still to be considered before an element can be recognised in U S financial statements is the reliability criterion.

2.3.6 RELIABILITY

Reliability has been defined by the FASB as meaning that information is represented faithfully, is neutral and free from bias (FASB, 1984, para 75). This criterion is closely linked to the measurement criterion already discussed.

OPEB is different from other contingent liabilities as the uncertainty regarding the amount to be paid by the enterprise on behalf of or to employees arises as a result of the nature of the liability itself and not the circumstances surrounding it. The only time that the liability can be measured with any certainty is on settlement.

If the OPEB liability is determined using neutral information it can be said to be free from bias. Although uncertainty will always surround the exact amount of the liability, if it has been estimated based on neutral information then it can be said to be free from bias and therefore reliable. It should always be remembered that quantifying the liability on the face of the balance sheet is more reliable than the omission of such an estimate, which implies that no such liability exists.

2.3.7 CONCLUSION

This section has tried to determine whether the OPEB liability should be recognised in the financial statements. In order to be recognised the recognition criteria must be complied with. The criteria differed in the US from the other conceptual frameworks considered. This could have a detrimental effect on harmonisation as it may mean recognition in one country but not in another. Arthur Andersen recognised this in their 1984 publication by saying that :

'To be recognised as a liability, future sacrifice must be measurable. Its occurrence must be probable, and the amount must be subject to reasonable quantification. When these measurability criteria are met, the estimate is both relevant and reliable.'

(pp 36).

Therefore, if a liability is both measurable and probable it is automatically relevant and reliable. This means that there is compatibility between the recognition criteria of the UK, Australia, Canada, the USA and those stipulated by the IASC.

In all cases, the recognition criteria were complied with and as a result disclosure should be made on the face of the balance sheet.

2.4. COSTS vs. BENEFITS

2.4.1 INTRODUCTION

The previous two sections have established that an employer's OPEB liability should be quantified in the balance sheet. All the conceptual frameworks considered however, contain the requirement that items should only be disclosed if the 'benefits derived from information exceed the cost of providing it' (SAICA, 1990, para 44). This in effect means that preparers of financial statements may still avoid disclosing an OPEB liability on the grounds that to quantify such an obligation is costly and exceeds any possible benefit that may be derived therefrom.

2.4.2 COSTS

The FASB and ICAEW are in agreement that the costs of providing financial information 'include costs of collecting, processing and reporting it...also having it audited...also the cost of adapting to new procedures if information requirements are changed.' (ICAEW, 1981, pp 23).

Both have conceded that these costs are often difficult to measure due to the problems surrounding the isolation of costs as regards the separate items disclosed. The FASB have commented that 'an effect of uncertainty is to increase the cost of financial reporting in general and the cost of measurement and recognition in particular.' (FASB, 1985, para 45). The uncertainty in the quantification of the OPEB liability and the procedures involved in attempts to quantify the liability have been mentioned earlier. As a result of the complexities involved, 'the emphasis must be on disclosure of relevant information, and on

explanation of the procedures adopted and important assumptions made.' (ICAEW, 1981, pp 76). This in turn increases the costs of disclosure.

The costs involved may be extensive. Concern has been expressed that this cost calculation should contain 'the opportunity loss from disclosure, which can result in loss of competitive advantage or losses from a weakened negotiating or legal position' (Anthony, 1983, pp 77). Although 'no objective calculation in aggregate quantitative terms is possible' (FASB, 1980, para 141), there can be no doubt that the OPEB disclosure is costly. These costs should be exceeded by the benefits derived from the additional disclosure.

2.4.3 BENEFITS

The benefits associated with additional disclosures are probably more difficult to assess than the costs.

This was recognised by the FASB :

'Most of the costs of providing financial information fall initially on the preparers while the benefits are reaped by both preparers and users. There are costs of using information as well as preparing it, and much published information would be compiled for the preparers' own use even if providing it to stockholders and others were not required. The preparer enjoys other benefits too, such as improved access to capital markets, favourable impact on the enterprise's public relations and so on.'

(FASB, 1980, para 136).

Benefits enjoyed by some of the users are obvious; employees would be assisted in determining the extent of their remuneration benefits, lenders in assessing the ability of the enterprise to meet its commitments and other users would be assisted in making economic decisions. Preparers may also benefit as the

implementation of Statement 106 may lead to better financial decisions and will, in all probability lead to the funding of previously unfunded obligations. The FASB has also argued that an entity will find that much of the information needed to disclose an OPEB liability will already be available to them, being that used in the calculation of pension costs, provided pension schemes exist.

There is always a trade-off between costs and benefits. It is submitted that a compromise has been reached as in none of the pronouncements issued on OPEB is 100% accuracy called for, but rather an explanation of the uncertainties and assumptions is required. In this manner costs, although high, can be contained to a reasonable level and the benefits at this cost level maximised.

2.5 CONCLUSION

This chapter has looked at the definitions of liabilities, the recognition criteria and the cost versus benefit requirements as contained in the conceptual frameworks considered. This analysis was done to ascertain whether OPEB commitments would qualify for recognition in financial statements or whether preparers could argue against recognition on conceptual grounds.

The conceptual frameworks of the USA, the UK, Canada, Australia and the framework issued by the IASC have all been considered. It has been found that in all cases, the definition of a liability was complied with and all the recognition criteria were met.

Three important conclusions can now be drawn :

1. Consistency does not always exist among the countries considered due to the differing interpretation of 'probability'. This means that an OPEB liability may not always be recognised in all these countries . The methods of measuring the liability and the required disclosures in countries where recognition has occurred have not been considered at this point.

2. All the official pronouncements on OPEB that are calling for accrual accounting are consistent with the conceptual frameworks upon which they are based.
3. Preparers of financial statements cannot use the conceptual frameworks as a basis for arguing against the recognition of an OPEB liability, as the OPEB obligation complies with the requirements of the frameworks.

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CHAPTER 3 : THE UNITED STATES

3.1. INTRODUCTION

In the United States, 'three out of four midsize and larger employers provide health care benefits for their retirees' (Carmichael et al, 1992, pp 26.51). This practice evolved from the introduction of the Medicare program in 1965, with some employers providing benefits up until retirees reach age 65 and become eligible for Medicare, and others providing lifetime benefits. The reason for the introduction of this form of benefit is explained by Carmichael, 'employers found that, for relatively few dollars, Medicare supplements, as they were called, bought much employee goodwill.' (1992, pp 26, 52).

However, the cost of providing this OPEB has risen dramatically in the last few years and can no longer be viewed as costing 'relatively few dollars'. 'During recent decades the cost of medical care has risen at an average rate of more than 40% (in total), which is twice the average inflation rate of the same period. Total medical costs, which were approximately 6% of the gross national product in the mid-1960's reached 12% in 1980 and continue to rise.' (Carmichael et al, 1992, pp 26.52).

Predictions for the future paint an even bleaker picture.

'Several factors indicate that the demands on our health care system will greatly increase, perhaps to crisis proportions, as we enter the twenty-first century:

1. The changing nature of health care problems during the 20th century.

This country's major health problems, in terms of cause of death, have changed from acute to chronic diseases. By definition, chronic disorders, such as cancer and cardiovascular diseases are long-term problems, often with associated disability, in which onset may begin in the first three decades of life and remain subclinical in manifestation until the fourth, fifth and sixth decades of life.

2. An increase in chronic disorders will result in more Americans needing health care for a longer period.

3. The impact of the post-World War II baby boom.

The rise in the birth-rate, beginning in the 1940's and lasting through to the early 1960's, has caused various social, economic and political problems as a larger number of individuals have entered each age category during the past thirty years. During the next twenty years, the predominant proportion of our population will reach the age when the most prevalent chronic diseases begin to be clinically manifested.'

(Carmichael et al, 1992, pp 402).

Similarly, the general life expectancy of the population is increasing. 'The average life expectancy at birth in 1900 was around 50, increasing to 68 by 1950 and to 75 by 1987. While people 65 and older have 16.4 years of life remaining, on average, they have only about 12 years of healthy life remaining.'

(Kronenfeld, 1993, pp 70).

Due to the fact that the average U S Corporation has a small number of retirees relative to the size of the work force, the costs reflected in the income statement on the pay-as-you-go basis have been relatively small with no indication of the actual level of costs that will be incurred in the future. The provision of OPEB has not been treated as a form of deferred compensation and as a result the matching concept has been overlooked. In an attempt to rectify the situation, the FASB added a project on postemployment benefits other than pensions to its agenda in 1979.

3.2 BACKGROUND

The FASB recognised that 'existing accounting pronouncements did not specifically address accounting for most postemployment benefits other than pensions' (FASB, 1981, pp i). Because of this, the FASB undertook a project to review how an employer should account for the obligations and costs incurred in connection with postemployment benefits provided to employees.

A discussion memorandum analysing issues relating to pensions and OPEB was released on February 19, 1981. At this stage the biggest concern was how OPEB should be accounted for, and no consideration was given to the manner in which these obligations should be measured. Consideration was however given to what actually constituted other postemployment benefits - with detailed discussions of death, disability, lack of work benefits, health insurance and termination indemnities. The significance of OPEB was highlighted, as 'a limited 1978 survey showed that 27 out of 30 large US companies provided postretirement benefits other than pensions' (FASB, 1981, pp 93), and respondents were asked to comment on this aspect.

The discussion memorandum recognised the key areas in the question of the accounting treatment as being:

- i. Whether OPEB are sufficiently similar to pensions to warrant similar accounting treatments, and
- ii. Cost/benefit constraints.

A public hearing was held in July 1981 following the release of the discussion memorandum. In November 1982 the Board issued its preliminary views on the February 1981 memorandum stating that 'the preliminary views are a step toward an exposure draft of a Statement of Financial Accounting Standards, but they are not themselves an Exposure Draft.' (FASB, 1982, pp i).

It was found that the most significant OPEB offered to employees is health care insurance, based upon the comments of the respondents to the discussion memorandum. The Board's preliminary views required the 'accrual of the cost of postemployment health care over the periods in which employees render service' (FASB, 1982, pp v). Consequently, the Board felt that the pay-as-you-go and terminal funding (accruing the cost of OPEB at retirement) approaches to accounting for OPEB were not appropriate.

However, some issues still had to be addressed. The issue of measurement of OPEB obligations had not been considered although 'some Board members suggest that it would be difficult, and perhaps inappropriate to specify a uniform measurement approach for such benefits. Accordingly, one of the possibilities to be considered in the Invitation to Comment was that the measurement approach should be determined on a case-by-case basis by those who are familiar with the facts and circumstances affecting a particular plan'. (FASB, 1982, para 135). Similarly, the attribution of the OPEB costs over the years of service rendered by the employees and transitional adjustments (arising on a move from the cash to the accrual basis) were still unresolved.

In an attempt to rectify the situation, on April 19 1983, the FASB released a second discussion memorandum, analysing additional issues relating to Employers' Accounting for Pensions and Other Postemployment Benefits. This discussion memorandum considered three different methods of measuring a postretirement benefit obligation, being :

- i. Any consistently applied attribution approach that recognises cost systematically over periods of employee service.
- ii. A consistently applied attribution approach that allocates benefits to years of service and then computes the actuarial present value of benefits attributed to service to date.
- iii. A consistently applied attribution approach that projects estimated total benefits at retirement and then calculates the level cost that will be sufficient, together with accumulated interest, to provide these benefits.

and called for respondents to give some indication as to which basis they preferred.

Similarly, the treatment of the transitional adjustment was considered. Should a prior year adjustment be made representing the change from the cash to the accrual basis, or should the liability be recognised prospectively by gradual accrual over the remaining service period of active participants or some other transition period? Calls were made for comments on this issue as well as on the information relating to postemployment benefit plans that should be disclosed.

In 1984, the subject of accounting for postemployment benefits other than pensions was identified as a separate project, due to the fact that the Board, in considering comments on the second discussion memorandum, felt that accounting issues relating to other postemployment benefits were being overshadowed by pension issues.

Recognising that the issue of OPEB was far from resolved, the Board released FASB Statement No. 81 'Disclosure of Postretirement Health Care and Life Insurance Benefits' as an interim measure in 1984. A task force was appointed in December 1986 and in April 1987 FASB Technical Bulletin No. 87-1 'Accounting for a Change in Method of Accounting for Certain Postretirement Benefits' was issued 'to provide guidance to employers making a voluntary change in their method of accounting for postretirement health care benefits and postretirement life insurance benefits provided outside a pension plan.' (FASB, 1990, para 515).

Between February 1987 and October 1988, 29 public Board meetings and 3 public task force meetings were held, culminating in an Exposure Draft, 'Employers' Accounting for Postretirement Benefits Other than Pensions', issued in February 1989. As part of the standard setting process, a field test, sponsored by the Financial Executives Research Foundation, was conducted on twenty-five companies who were implementing the exposure draft.

More than 475 letters were received by the Board in reaction to the exposure draft. In October and November 1989 public hearings were held, at which 62 organisations and individuals presented their views over the five days in which hearings were held. The Board reconsidered many of the proposals originally made in the Exposure Draft at the 28 public Board meetings held during 1989 and 1990. The

task force met at a public meeting in June 1990 to discuss the Board's tentative conclusions on employers' accounting for postretirement benefits and SFAS 106 was issued in December 1990.

3.3. SFAS 106

3.3.1. INTRODUCTION

Statement of Financial Accounting Standards No. 106 was issued by the FASB in December 1990, being the culmination of ten years' work in this area.

The statement was first applicable for fiscal years beginning after 15 December 1992, but this was delayed until 15 December 1994 for plans outside the United States.

3.3.2 OVERVIEW

SFAS 106 defines postretirement benefits as including but not limited to 'postretirement health care, life insurance provided outside a pension plan to retirees, and other welfare benefits such as tuition assistance, day care, legal services and housing subsidies provided after retirement' (FASB, 1990, para 6), and is applicable to any arrangement 'regardless of its form or the means or timing of its funding' (FASB, 1980, para 8).

The statement is applicable to all OPEB offered to employees by employers regardless of whether such benefits have been formally documented or not. In cases where the understanding between employer and employees differs as to the nature and amounts of OPEB provided from that which has been documented, then the accounting treatment should be based upon the former, hereafter, 'the substantive plan'.

SFAS 106 cannot be applied to payments made on retrenchment i.e. 'benefits offered after employment but before retirement, such as temporary benefits after a layoff' (FASB, 1990, para 133), as non-retiree postemployment benefits are considered to be a form of compensation for not working rather than OPEB

which constitutes a delayed payment of compensation for working. These should be accounted for in terms of SFAS No. 112.

SFAS 106 calls for the recognition of an expected postretirement benefit obligation (EPBO) which represents the actuarial present value of the future postretirement benefits expected to be paid to or for an employee, including benefits payable to the employee's beneficiaries and dependants. 'This differs from the projected benefit obligation in pension accounting in that the EPBO represents the value of all future postretirement benefits, not just those that have been attributed to employees' service as of the reporting date.' (Carmichael et al, 1992, pp 26.54).

'This EPBO is recognised over the years of service rendered by an employee. The accumulated postretirement benefit obligation (APBO) represents the portion of the EPBO that has been attributed to employees' service to date. If all employees have reached their full eligibility date, the APBO would be the same as the EPBO.' (Carmichael et al, 1992, pp 26.54).

Therefore a 'service cost' will be disclosed in the income statement representing the portion of the EPBO that is attributed to the current year's service rendered by employees. As a result of the fact that the APBO is measured on the present value basis, an adjustment must be made on an annual basis in order to restate the existing APBO to its present value. This adjustment is termed the 'interest cost component' and should be disclosed separately from the 'service cost component' in the income statement.

SFAS 106 applies equally to both funded and unfunded plans. Where an enterprise has funded its OPEB obligations, the return earned by the plan assets should be shown separately on the face of the income statement, thereby reducing the two cost components previously discussed.

As a result of implementing SFAS 106, and thereby applying the accrual method of accounting for OPEB, there will be an amount of accumulated postretirement benefit obligation which should have been matched to years of service already rendered i.e. prior year service costs and related interest cost components.

SFAS 106 allows a choice of accounting treatments dealing with this unrecognised transition obligation.

Either-

- i. By immediate recognition of the cumulative effect of the accounting change through income.

Although a prior year adjustment was considered, the Board felt that this would be 'inconsistent with how subsequent adjustments of the transition obligation are recognised and would diminish the understandability and usefulness of the financial statements' (FASB, 1990, para 266), or

- ii. By amortising the transition obligation over the employees' remaining years of service, or twenty years whichever is the longer. (This alternative differs from the transition period stipulated in the exposure draft of fifteen years, as a longer transition period was generally favoured by the respondents to the exposure draft.)

Although the first treatment meant that the recognition of the often substantial transition obligation would have a dramatic impact upon the reported earnings of an entity, often causing large losses, several U S companies decided to adopt this method (e.g. General Motors). Others elected to spread the impact over the period allowed in terms of the second treatment.

An example illustrates the points made so far:

Expected postretirement benefit obligation (Jan 1, 1993)	\$20 000 000	
Accumulated postretirement benefit obligation (Jan 1, 1993)	\$12 000 000	
Recognised accrued postretirement benefit cost (Jan 1, 1993)	\$ 0	
Transition obligation	\$12 000 000	1
Service cost	\$ 750 000	2
Net Periodic Postretirement Benefit Cost for 1993:		
Service cost	\$ 750 000	
Interest cost on APBO (rate of 8%)	\$ 960 000	
Return on Assets	\$ 0	3
Amortisation of transition obligation (over 20 years)	\$ 600 000	

Net Period Postretirement Benefit Cost	\$ 2 310 000	

Pay-as-you-go cost charged to expenses under current (previous) practice \$ 700 000

NOTES:

1. The transition obligation is equal to the APBO because the plan is unfunded and there is no recognised accrued postretirement benefit cost for this employer.
2. Service cost represents the portion of the EPBO that is attributed to employees' service during the current period.
3. This employer continues to operate the plan on a pay-as-you-go basis rather than prefunding it, i.e. no plan assets.

(Carmichael et al, 1992, pp 192).

(A more detailed example is supplied as appendix 1).

SFAS 106 recognises that the measurement of an OPEB obligation is often characterised by inherent uncertainty, with extensive use being made of 'actuarial assumptions and present value techniques to calculate the actuarial present value of the expected future benefits attributed to periods of employee service. Each assumption used shall reflect the best estimate solely with respect to that individual assumption. Principal actuarial assumptions include the time value of money, participation rates (for contributory plans), retirement age, factors affecting the amount and timing of future benefit payments which for postretirement health care benefits consider past and present per capita claims cost by age, health care cost trend rates, Medicare reimbursive rates, salary progression (for pay related plans) and the probability of payment.' (FASB, 1990, para 30).

In order to emphasise the uncertainty element of the measurement of the OPEB obligation, SFAS 106 requires the disclosure of health care cost trend rates, the weighted average of the assumed discount rates and the rates of compensation increase used to measure the accumulated postretirement benefit obligation, as well as the effect of a one percentage point increase in the assumed health care cost trend rates for each

future year on both the service and the interest cost components and the accumulated postretirement benefit obligation (FASB, 1990, para 74).

Mention has been made in SFAS 106 of the Medicare program as it may impact upon the obligations of the employer. 'Medicare is the broadest health insurance program the federal government operates, covering more than 95% of those 65 and over, as well as disabled persons under 65 who meet certain criteria....The rules of what care is actually covered are quite complex, but generally physician services, in-patient care and limited post-hospitalisation care in a nursing home or through home health services are covered. Medicare does not cover most long term care services, out of institution drugs, dental care, eyeglasses, hearing aids or other medical devices.' (Kronenfeld, 1993, pp 73). As a result, employers offering OPEB to retired employees need to take Medicare reimbursive rates into consideration when estimating the claims that will be submitted by retirees. Unfortunately, Medicare pays nothing towards medication, the most important health cost of the elderly.

SFAS 106 has rigorous disclosure requirements as the Board wanted to 'enhance the ability of users of the employer's financial statements to understand the extent and effects of the employer's undertaking to provide postretirement benefits to its employees by disclosing relevant information about the obligation and cost of the postretirement benefit plan and how these amounts are measured.' (FASB, 1990, para 5).

For this reason, the Board calls for a description of the substantive plan, the type of the benefits provided, the funding policy and a description of the types of assets held in order to fund the liability.

A reconciliation of the accumulated postretirement benefit obligation and the funding of the plan is required, showing :

1. The fair value of the assets.
2. The accumulated postretirement benefit obligation, identifying separately the portion attributable to retirees, other fully eligible plan participants and other active participants.
3. The amount of unrecognised prior service cost.

4. The amount of unrecognised net gain or loss.
5. The amount of any remaining unrecognised transition obligation or transition asset.
6. The amount of net postretirement benefit asset or liability recognised in the statement of financial position, which is the net result of combining the preceding five items.

(FASB, 1990, para 74).

An example is provided in paragraph 486 of the appendices to Statement 106 :

Accumulated postretirement benefit obligation	(\$257 000)
Plan assets at fair value	\$ 73 000

Funded Status	(\$184 000)
Unrecognised net gain	(\$ 44 575)
Unrecognised prior service cost	\$ 33 000
Unrecognised transition obligation	\$ 195 000

Accrued Postretirement Benefit Cost	(\$ 575)

An unrecognised net gain or loss is defined as a 'a change in the value of either the APBO or the plan assets resulting from experience different from that assumed or in a change in an actuarial assumption'. SFAS 106 does not require the recognition of these gains or losses in the period in which they arise but does require amortisation over the remaining service period of active plan participants if certain requirements are met.

SFAS 106 discusses both plan amendments and plan curtailments in detail. Plan amendments are 'changes in the existing terms of a plan...increasing or decreasing benefits, including those attributed to years of service already rendered' (FASB, 1990, pp 202). When an amendment increases benefits it is termed a 'positive amendment'. SFAS 106 calls for the amortisation of prior service costs arising from a

positive plan amendment over the remaining years of service to the full eligibility date of each plan participant. The Statement has been criticised for its use of 'form over substance' - a direct contradiction of the conceptual framework upon which it is based- as the costs of providing OPEB are fully accrued at the full eligibility date although this may be some time before the employee retires and actual payment begins. Negative plan amendments, those reducing benefits and the liability of the employer are set off first against any unrecognised net gains that may exist and then against any unrecognised transition obligation. Only the excess of this is amortised over the remaining years of service. As such this treatment is consistent with that of FASB Statement No. 87 dealing with pensions, 'the Board concluded that these constraints on recognition of the effects of a negative plan amendment are necessary because the effects of reducing a plan promise should not be recognised before the original promise, including the unrecognised transition obligation is recognised.' (FASB, 1990, para 290).

Plan curtailments are defined as 'events that significantly reduce the expected years of future service of active plan participants or eliminate the accrual of defined benefits for some or all of the future services of a significant number of active plan participants' (FASB, 1990, pp 196). SFAS 106 specifies that in the event of a plan curtailment, either a curtailment gain or loss could arise :

' The accumulated postretirement benefit obligation may be decreased (a gain) or increased (a loss) by a curtailment -

- a. To the extent that such a gain exceeds any unrecognised net loss (or the entire gain, if an unrecognised net gain exists), it is a curtailment gain.
- b. To the extent that such a loss exceeds any unrecognised net gain (or the entire loss, if an unrecognised net loss exists), it is a curtailment loss.'

(FASB, 1990, para 98).

If a net loss exists 'it shall be recognised in income when it is probable that a curtailment will occur and the net effect can be reasonably estimated. If the sum of these effects is a net gain, it shall be recognised in income when the related employers terminate or the plan suspension or amendment is adopted' (FASB,

1990, para 99). This treatment is consistent with the prudence concept outlined in the FASB conceptual framework.

3.3.3 CONCLUSIONS ON SFAS 106

SFAS 106 is a comprehensive document consisting of 115 paragraphs. Due to the complexity of the subject matter, it was published together with five appendices, being an extensive explanation of the basis for conclusions drawn in the actual standard, a comparison of the treatment of OPEB with that of pensions as specified in Statement 87, illustrations, a glossary (included in this thesis as appendix 4) and background information on the issue of SFAS 106.

The FASB document dealing with OPEB is the most comprehensive and detailed pronouncement in this area, addressing many of the practical problems often encountered (e.g. plan amendments and plan curtailments) that have been avoided by other statements on OPEB. In fact, other countries have based their pronouncements on the FASB document, as it was this body that first recognised the need for some guidance in this area.

However, criticism of SFAS 106 has been widespread with Sullivan commenting that 'although the ED (now replaced with SFAS 106) follows a conceptually pure approach to accounting for postretirement benefits, it has serious practical problems...we can ill afford another major standard that may score well on the scale of conceptual purity but one that will not receive general acceptance because of its stringent recognition criteria, its complexity, its failure to acknowledge the pragmatic issues confirmed during the project and because it tries to accomplish too much too soon....' (Sullivan, 1989, pp 15).

Sullivan has isolated various areas of contention -

1. The statement is inconsistent in its approach to the measurement of the OPEB liability.

It requires the estimation of 'future technology changes and utilisation' projecting health care costs for several years into the future, while at the same time precluding assumptions about future plan

amendments which management may have both the ability to control and the intention to implement.’ (Sullivan, 1989, pp 15).

SFAS 106 specifies that plan amendments shall only be included in the computation of the expected postretirement benefit obligation once contractually agreed to (para 28).

Similarly, this seems to be inconsistent with the rest of SFAS 106 where the accounting treatment is based upon the substantive plan rather than a documented agreement, on the grounds of substance over form.

2. The standard does not specify a discount rate (as is done in the Australian pronouncement) to be used in obtaining the present value of the postretirement benefit obligation, but does suggest that ‘employers shall look to rates of return on high quality, fixed income investments currently available whose cash flows match the timing and amount of expected benefit payments’ (FASB, 1990, para 31). Sullivan contends that such a rate would create excessive volatility in reported periodic income and suggests a degree of precision that is unattainable (pp 16). He suggests that an alternative would be making use of an internal return on equity rate, (as discussed in chapter two this is consistent with the recommendation made by Eli Amir). An alternative would be to follow the approach adopted in Australia - to stipulate the use of a risk-adjusted government bond rate.

The Board has also come under severe criticism for spreading the transition obligation over twenty years, as this amortised expense has nothing to do with future years. Due to the response to the exposure draft, which stipulated the transition obligation be amortised over a period of 15 years, SFAS 106 allows either amortisation over 20 years, the average remaining service life of employees or immediate recognition. Indeed, the Canadian body, CICA, has also questioned the choice of an arbitrary allocation period, but has not suggested a more suitable alternative (CICA, 1993).

However, it must be borne in mind that the Board itself stated that it ‘believes the accounting recognition required by this statement should result in more useful and representationally faithful financial statements. However, this statement is not likely to be the final step in the evolution of more useful accounting for postretirement benefit arrangements.’ (FASB, 1990, para 4).

3.4. EFFECT OF SFAS 106

Trouble was encountered in the initial implementation of SFAS 106 and because of the unusually high number of enquiries received (from preparers, auditors and others) and the inherent complexities of accounting for postretirement benefits other than pensions, the FASB staff decided that a Special Report should be issued as an aid in understanding and implementing Statement 106. 'A Guide to the Implementation of Statement 106 on Employer's Accounting for Postretirement Benefits Other than Pensions: Questions and Answers' was published by the FASB in August 1993. It addresses issues that were not tackled in the Statement and provides practical examples and illustrations in an attempt to facilitate compliance with Statement 106.

The need for this Special Report was probably highlighted by the OPEB impact study. This field test, which was sponsored by the Financial Executives Research Foundation (hereafter FERF), measured the financial impact of Statement 106 on 26 companies, all of which had revenue exceeding \$250 million in 1988, representing manufacturing, financing and mining industries, and which offered OPEB to their employees. The study found that 'Several companies were unable to participate in the study test because they could not gather the necessary information.' (Cheney, 1989, pp 16). Roland Laing, FERF director of research stated that :

'...We never guessed it would be such an awkward and arduous task to merge the necessary variety of personnel data and insurance claims. One very large corporation said a dozen people had to spend substantial time on the project. Its bill for computer time spent retrieving raw data from a claims tape provided by two insurance carriers came to \$30 000, which did not include any time spent processing the information.' (Cheney, 1989, pp 17).

The survey revealed the effect that accrual accounting for OPEB would have on U S corporations.

1. It was found that expenses for postretirement health benefits would increase. 'First year expense was between three and five times the pay-as-you-go amounts for most field test companies. However,

some 'highly mature' companies had multiples of expense to benefit payments of under three times. At the other extreme, some immature companies had multiples of expense to benefit payments of over 10 times the pay-as-you-go amounts.' (Akresh, 1989, pp 34).

The break-up of these costs is illustrated below:

The components of expense as a percentage of the total expense in the year of adoption.

	Highly Mature	Mature	Immature
Service Cost	4-16%	11-25%	25-52%
Interest Cost	40-65%	45-56%	34-46%
Transition Amortisation	30-41%	25-37%	14-29%

(Akresh et al, 1989, pp 35).

2. It was found that 'higher expenses would increase recorded liabilities and reduce net worth, which would have an impact on debt-to-equity ratios' (Cheney, 1989, pp 15).

A similar study conducted by the Sherlock company (a research and polling company) found that three-quarters of health care analysts interviewed felt that equity valuations of companies with large retiree bases would be negatively affected, impairing their share performance. This view was confirmed by research conducted by Espahbodi et al in 1991, where it was found that significant negative abnormal returns were experienced around the issuance of the exposure draft on nonpension postretirement benefits. This research was refuted by Khurana and Louder (1994), who documented a 'significantly insignificant market reaction to the exposure draft of SFAS 106' (pp 376). The two findings can be reconciled by examining the enterprises included in the studies. Espahbodi et al based their research on a sample of 'primarily non-regulated firms' while Khurana and Louder based theirs on the public utility industry, where some relief from SFAS 106 is offered by SFAS 71, 'Accounting for the Effects of Certain Types of Regulation' (FASB, 1992). This means that the

effect of SFAS 106 on share performance is dependent on the 'expected regulatory action for a given firm.' (Khurana and Loudder, 1994, pp 378).

3. Further, 'the higher expenses generated by accrual accounting would not be deductible under current tax laws... under Statement No. 96, Accounting for Income Taxes, a portion of the higher expense under accrual accounting may fall right to the bottom line with no offsetting tax benefit, directly reducing net income.' (Cheney, 1989, pp 17). This is explained further by Meenan and Dankner (1990, pp 34) :

' The higher expense under accrual accounting would not generally be deductible under current tax laws because the deductions are based on actual benefit payments. Unlike pensions, few tax advantages exist for advance funding, although some companies have begun to lobby for tax deductions for prefunding retiree health care costs....'.

Statement 106 states that 'companies must reduce deferred tax assets by a valuation allowance if, based on available evidence, it is more likely than not (a likelihood of more than 50%) some or all of the deferred tax assets will not be realised' (Gregory et al, 1995, pp 71). Since the introduction of SFAS 106, other postretirement benefits have constituted the major component of many companies' total deferred tax assets (Cocco et al, 1994, pp 89); and for this reason, consideration must be given to whether an allowance is required. 'Evidence such as strong history of earnings should be considered, but the timing of the reversals makes estimating future income a complex process. The temporary postretirement differences will reverse, but generally not for many years. It is unusual for it to take less than 20 years for benefit payments to be greater than postretirement benefit expenses recorded in the Income Statement....and predicting such amounts so far in advance is extremely difficult.' (Cocco et al, 1994, pp 91).

Therefore, SFAS 106 has not only caused measurement problems in terms of liabilities, but also in terms of the corresponding deferred tax asset that can be recognised. An issue which has not yet been addressed by the FASB is the inconsistency of the measurement basis used to calculate a deferred tax asset. Usually the historic cost method is used meaning that the asset is undiscounted.

In the case of OPEB, as the liability and the current expense are both in present value terms, the deferred tax asset relating to OPEB must be similarly valued. As a result financial statements could very well contain a deferred tax asset which has been calculated in a number of different ways (for example, the portion of the deferred tax asset relating to fixed assets is at historical cost, whereas that relating to OPEB is at current cost) this could hamper the relevance and reliability of the quantification of the deferred tax asset.

The effect of SFAS 106 on corporate America has been dramatic. 'The Wall Street Journal commented that the proposed standard on nonpension postretirement benefits has been argued to be the most significant accounting change since the adoption of depreciation and the total impact of the standard on corporate profits has been estimated at between \$200 billion and a trillion dollars. IBM alone, who elected to adopt the standard early, recorded a \$2.3 billion charge against its first quarter of 1991 earnings' (Espahbodi et al, 1991, pp 325), and the effect on IBM continues, as shown by appendix 2.

As corporate America realised the extent of its OPEB liabilities and the effect that this would have on its financial statements, drastic steps were (and in some cases are still being) taken in an attempt to reduce obligations and costs, all of which have been well documented (see below). Many firms have adopted 'cafeteria' benefits that 'allow the employer immediate savings by reducing the company's immediate premium outlaysaves administrative time....and provides the employee an opportunity to choose the very benefits that are most important to his or her family' (Miller, 1995, pp 61). General Motors, which had to make a charge of \$20.8 billion, representing 70% of its book value, on adoption of SFAS 106 (Baker and Hayes, 1995, pp 13), have employed a Pharmaceutical Benefit Manager in an effort to reduce its drug costs. 'Our health care enrollee group of 1.6 million people has more retirees than active employees, an increasing company-wide average (currently 47%), and, as you'd expect, increasing utilisation. Seventy five percent of drug expenditures are for enrollees age 50 and older.' (Losh, 1995, pp 37). For this reason, General Motors has implemented a program which encourages the use of generic

drugs and has limited the number of pharmacies that provide drugs to their employees and retirees so as to improve discounts and reduce pharmacy dispensing fees.

In other attempts to reduce the cost of OPEB, companies have adopted a 'managed cost' approach. A company called Control Data has implemented a 'Staywell Program', the primary focus of which is behavioural risks related to chronic degenerative diseases, such as cardiovascular disease and lung cancer. 'The basic premise was that it would be less expensive to prevent these diseases than to pay for them after they have already developed.' (Cataldo and Coates, 1986, pp 324).

As a result, the Staywell Program focuses on smoking cessation, weight control, fitness behaviour, stress management and nutritional practices related to the reduction of cholesterol, salt and sugar. Continued studies on the success of the Staywell Program have suggested that 'the program has been successful in initiating positive normative change in targeted areas. These changes are perceived by both nonparticipants as well as by participants, and become greater during the program's second year.' (Cataldo and Coates, 1986, pp 334).

Probably the most controversial effect of SFAS 106 has been the reaction of the McDonnell Douglas Corporation (MDC) to the issue of the FASB pronouncement. On 1 January 1993 MDC terminated health care benefits of its non-union employees. The primary reason for this step cited by the MDC management was the issuance of the FASB Statement No. 106, claiming that 'the termination was necessitated by the issuance of FASB 106, and that without the termination the economic condition of MDC would be adversely affected.' (Baker and Hayes, 1995, pp 14). This move has been widely criticised.

'The management justifies its action to deprive the employees of compensation that they earned, pointing to FASB 106 as the motivating factor for its action, when in fact it was its perceived need to downsize, make layoffs and cut costs in the face of reductions in the defence industry which actually caused the action. The management needed to look for the most vulnerable group in the non-union, retired employees, who were unable to defend themselves against the power that the management possessed.' (Baker and Hayes, 1995, pp 1).

Indeed, research has shown that the financial performance of MDC in the years prior to the issue of FASB 106 (1989-1992) was substantially below that of the rest of the industry. The effect of terminating these benefits was a curtailment gain of \$1.1 billion which absorbed most of the impact of the \$1.3 billion charge made to the income statement in terms of SFAS 106. It therefore seems ironic that 'less than nine months after the termination of the employee health benefits, MDC stated in a press release and letter to employees that it had recorded the highest earnings in its history.' (Baker and Hayes, 1995, pp 22).

It would seem that McDonnell Douglas had used the issue of SFAS 106 as an excuse to curtail their employee benefits and hence improve their financial position and performance. But this is not an isolated incident. Cristea et al (1993) recognised that 'since publication of the proposed standard in 1989, several companies have announced the reduction of retiree health benefits. A few companies have even cancelled the benefits altogether. In most instances, company spokespersons blamed the impending Statement No. 106' (pp 108). This leads to the conclusion that perhaps the most dramatic result of FASB 106 has not been improved relevance and reliability of financial statements, but rather the negative impact it has had upon the welfare of employees.

3.5 CONCLUSION

The work done by the FASB in the area of other postretirement benefits is generally considered to be the most comprehensive and detailed of all studies undertaken by international accounting bodies.

It was only after ten years of research that SFAS 106 was issued and it has been acknowledged by the FASB that this is not intended to be the final pronouncement on OPEB. Other accounting bodies have based their guidelines on OPEB on the FASB document.

The effect of FASB 106 has been well-documented and hotly debated, the reason being the large number of companies that provide OPEB and the related costs involved.

'About 81% (41%) of US companies with more (less) than a thousand employees provide nonpension postretirement benefits, such as health care and life insurance, to former employees and their dependants.

The US General Accounting Office estimated the aggregate unfunded PRB obligation of private employers at approximately \$402 billion in 1988.(GAO 1989).’ (Amir, 1993, pp 704).

This chapter has considered OPEB from a U S perspective, commenting briefly on the requirements of FASB 106 and the effects thereof on share prices, management action, financial performance and deferred tax implications.

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CHAPTER 4 : THE UNITED KINGDOM

4.1. INTRODUCTION

Although it has been acknowledged that postretirement benefits other than pensions are 'still relatively rare in the UK' (ICAEW, 1992, para 1) the need for some pronouncement dealing with this issue was recognised as early as May 1988 with the release of SSAP 24, Accounting for Pension Costs, which clearly states that 'although this statement primarily addresses pensions, its principles may be equally applicable to the cost of providing other postretirement benefits' (para 75). However, it was still unclear whether this meant that SSAP 24 was binding as regards OPEB. The debate was cleared up by Technical Release 756, "Statement by the Accounting Standards Committee on the Application of SSAP 24 'Accounting for Pension Costs' to Other Postretirement Benefits", issued in July 1989, that categorically stated that paragraph 75 was indicative only.

However, the issue of SFAS 106 by the FASB in 1990 drew attention to OPEB once again and as a result, the Urgent Issues Task Force released Abstract 6 in November 1992. UITF Abstract 6 stated that postretirement benefits other than pensions are liabilities and should be recognised as such in financial statements. For this reason SSAP 24 was made mandatory when accounting for postretirement benefits other than pensions, although some relief was provided in the form of a two year transition period. The statement is fully effective in accounting periods ending on or after 23 December 1994. Disclosure requirements are laid down in UITF Abstract 6 for periods ending before this.

4.2. PERIODS ENDING BEFORE 23 DECEMBER 1994

UITF Abstract 6 recognises that 'FAS 106 discusses the subject in considerable detail and it may therefore also provide a useful source of guidance for non-US schemes.

Whilst methods already adopted for accounting for pension costs under SSAP 24 are generally to be utilised, measurement in accordance with FAS 106, including use of the transitional 20 year spreading option will be deemed to satisfy SSAP 24 principles for full provision.' (1992, para 7).

As a result of changing from the cash to the accrual basis, the transitional adjustments relating to previous years can either be made retrospectively i.e. as a prior year adjustment or spread over the remaining service lives of current employees, or over twenty years as allowed by SFAS 106.

The following information should be disclosed:

- a general description of the nature of the benefits provided and the approximate number of employees to whom these benefits are provided.
- an estimate of the OPEB liability, or the reason(s) why no reliable estimate can be made.
- disclosures relating to any expected tax relief.
- the amount of expense recognised in the period in relation to these benefits on both the accrual and the cash basis, if a material difference exists between them.
- details of the accounting policy.

(ICAEW, 1992, para 10).

It should be noted that these disclosures represent an introduction to the treatment of OPEB and are not nearly as stringent nor as extensive as the requirements of either SSAP 24 or SFAS 106.

4.3. SSAP 24

Due to the stance taken by the ASC, that of applying statements on pensions to other postretirement benefits, the accounting treatment in the UK differs markedly from that in the US, where OPEB have been treated separately.

SSAP 24 is not a technical document, but rather concentrates on the disclosure aspects of pensions and OPEB, as 'sufficient information should be disclosed to give the user of the financial statements a proper understanding of the impact of the pension arrangements on the group's and/or the company's financial statements.' (ICAEW, 1988, para 45). It is in stark contrast to SFAS 106, which provides numerous illustrations and practical examples. As a result of applying an already issued document to the area of OPEB there are many issues unique to other postretirement benefits that are not explored in SSAP 24.

Unlike the U S standard, SSAP 24 places some emphasis on the role of the actuary in the assessment of postretirement benefits. OPEB fall into the category of 'defined benefit schemes' i.e. 'a scheme in which the rules specify the benefits to be paid and the scheme is financed accordingly' (ICAEW, 1988, para 61), and therefore require actuarial evaluations. The disclosure requirements for a defined benefit scheme in terms of SSAP 24 are arduous. The following must be disclosed:

1. The fact that the scheme is defined benefit.
2. Whether the scheme is funded or not.
3. The accounting policy.
4. The funding policy if it differs from the accounting policy.
5. The date of the last actuarial valuation, whether or not the actuary is independent, the results of the most recent actuarial valuation - including disclosure of ;
 - i. the actuarial method used and a brief description of the main actuarial assumptions,
 - ii. the market value of the scheme assets at the date of the last actuarial valuation,
 - iii. the level to which the scheme is funded, in percentage terms,

- iv. comments on any material actuarial surplus or deficiency indicated by the level of funding.
6. The charge made to the income statement for the period, explaining any difference from that of the previous year.
7. Details of any provisions or prepayments in the balance sheet.
8. The amount of any deficiency on a current funding level basis.
9. Any commitment to make additional payments.
10. The accounting treatment adopted in respect of a refund made in accordance with the statement.

(1988, para 88).

As can be seen from the above, no mention is made of plan curtailments, plan amendments, multiemployer plans or employers with two or more plans, all of which are comprehensively dealt with in SFAS 106. Instead, extensive disclosure of the actuarial valuation is required.

It should be noted that the charge made to the income statement does not have to be split into various components as required by SFAS 106. No mention is made of service costs, interest costs, prior service costs nor any gains or losses. Similarly, although disclosure is made of the funded status of the OPEB plan, no reconciliation is required in terms of SSAP 24.

SSAP 24 provides no guidance for the measurement of the OPEB liability, although mention is made of discounting. 'If a scheme is unfunded, the provision of pension costs (and OPEB) is assessed and reviewed on a discounted basis and adjusted each year by an amount comprising two elements: a charge for the year (equivalent to a contribution in a funded scheme) and interest on the unfunded liability' (ICAEW, 1988, para 40). No guidance as to what discount rate to apply is given. No mention is made of expected inflation rates or per capita claims cost by age. For these reasons it is submitted that preparers of financial statements will in all likelihood refer to SFAS 106 in determining the extent of the OPEB liability and will merely consult SSAP 24 for disclosure purposes.

It is important to note that 'even if it is not recognised as a liability, an obligation to meet postretirement benefits constitutes a financial commitment which is required to be disclosed in terms of paragraph 50(5) of Schedule 4 to the Companies' Act of 1985.' (ICAEW, 1992, para 10).

SSAP 15, Accounting for Deferred Tax, makes specific mention of other postretirement benefits and 'permits preparers of financial statements, where they consider it appropriate in their particular circumstances, to use the same recognition criteria for the deferred tax implications of pensions and other postretirement benefits as in accounting for the obligations to provide these benefits' (ICAEW, 1992, para 12A), although in recognising a deferred tax asset the normal rules relating to recoverability should still be applied.

SSAP 24 has been widely criticised as it has been argued that it has not made company accounts more comparable nor more useful to readers (Ternent, 1995, pp 26). Due to the complex nature of OPEB 'even the experts must rely heavily on the disclosures that are required. Unfortunately, even the required disclosures do not give a complete picture and the reader must guess some of the clues as well as some of the answers. For some reason, too, the flexibility and sketchiness of the disclosures have often (perhaps usually) been used to obfuscate or to withhold information.' (Ternent, 1995, pp 27).

It is interesting to note that SSAP 24 does not even require the disclosure that was specified in an ASC Discussion Paper, The Use of Discounting in Financial Statements, issued in December 1989. This discussion paper specified that 'in order to assist the user of financial statements the following disclosures are necessary:

1. the accounting policy in respect of discounting
2. the rate used
3. timescale involved
4. the balance sheet value of the items that have been subject to the discounting process
5. the undiscounted amount.'

(ICAEW, 1989, para 42).

This means that disclosures which have already been recognised as useful and would undoubtedly 'give the user of the financial statements a proper understanding' (ICAEW, 1988, para 45) have been ignored.

For this reason Ternent has argued that fuller disclosure should be made. It has even been suggested that 'the best answer may well be to scrap SSAP 24 altogether rather than tinkering with it' (Ternent, 1995, pp 27), as 'the non-expert is quite likely to be even more misled by a mixture of accounting theory and actuarial guesswork than he was in the days before the standard' (Ternent, 1995, pp 27). The withdrawal of SSAP 24 may well become a reality as it may no longer be adequate after the implementation of a new Pensions Act which was expected to be released sometime in 1997, but had not yet been issued at the time of completing this thesis.

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TABLE A: COMPARISON OF ACCOUNTING PRONOUNCEMENTS			
	SFAS 106	Abstract 6	SSAP 24
	15-Dec-92	Prior to 23.12.94	After 23.12.94
BASIS	Comprehensive, ground-breaking standard.	Does not detail calculations, but refers preparers to SFAS 106 for guidance.	A pension standard that concentrates on disclosure and actuarial valuations.
TRANSITION ADJUSTMENT	Immediate recognition or spread over 20 years.	Allows either a prior year adjustment or spread over 20 years. Therefore, either retrospective or same as SFAS106 treatment.	
EMPLOYEE DISCLOSURE	-	Employee benefits provided and the approximate number of employees who receive the benefits.	
LIABILITY DISCLOSURE	Amount recognized and amount unrecognized.	Estimate of OPEB liability or if this is not possible, the reason why.	
EXPENSE DISCLOSURE	Differentiate between: *service cost *interest cost *actual return on assets amortization of unrecognized transition obligation.	Expense on both the cash and the accrual basis if there is a material difference between them. Any expected tax relief.	Expense made to the Income Statement, explaining any difference from the charge made in the previous year.
POLICY DISCLOSURE	Accounting and funding policy.	Accounting policy.	Accounting and funding policy.
ASSUMPTION DISCLOSURE	Health care cost trend rate, discount rate as well as the effect of a 1% change in these rates.	-	-
BENEFIT CHANGES	Comprehensive examples of plan curtailments, amendments, terminations and mulitemployer plans are provided and various disclosures are required.	-	-
ACTUARIAL DISCLOSURE	-	-	*Date of last actuarial valuation. *Actuarial method and main assumptions made. *Market value of plan assets. *% of plan funded.

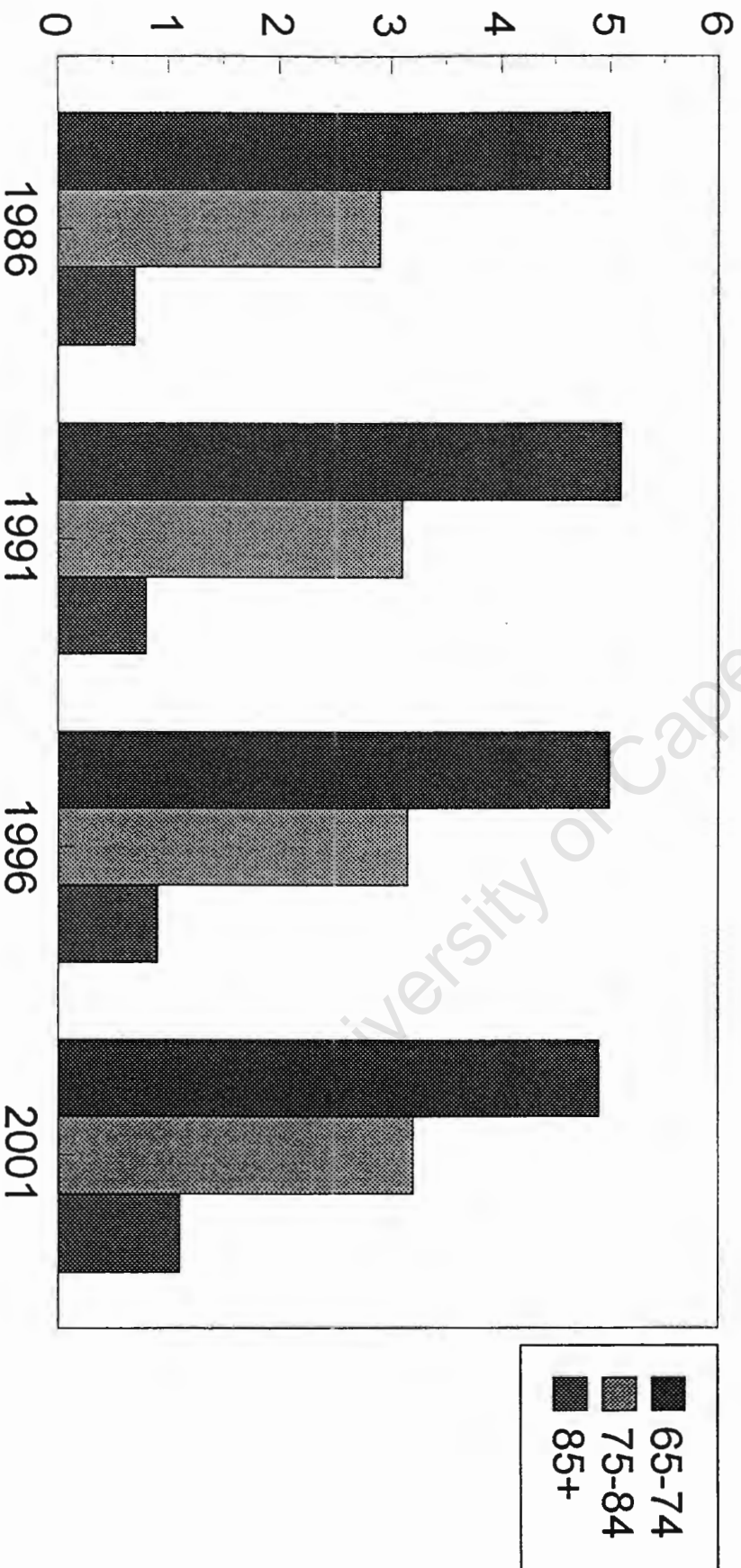
4.4. SOCIAL IMPACT

In a survey conducted by the ASC, documented in The Corporate Report, it was found that 71% of respondents (largest 300 of the Times 1000, of which 166 replied) recognised a responsibility to employees 'to treat all those who work for the firm fairly both during and after their employment.' (1975, pp 12). 'Fair treatment' may mean that many employers are providing pensions and other postretirement benefits to their employees. Although the provision of OPEB, particularly health care, is not as popular in the UK as in the United States, due to the fact that the former has welfare, the ICAEW did consider the issue important enough to bring to the attention of the Urgent Issues Task Force.

As in the United States, the cost of providing health care is rising at an alarming rate. This is due to the fact that the average age of the population is increasing, see below, Davey and Popay, 1994, pp 126. The graph shows that the 85+ age group is continuing to increase at a rapid rate while smaller increases will be experienced in the size of the 75-84 age group and the 65-74 age group between now and the year 2001. In general, an increased proportion of the population will be over the age of 65.

Figure 1

Projected population aged over 65 years
United Kingdom / millions



This means that the demand for hospital services by elderly people will increase as, for example, technological changes such as new anaesthetics have made it much safer to operate on elderly people. This means that OPEB taking the form of health care will become more material in the future.

4.5. CONCLUSION

The ICAEW has not dealt with the accounting treatment of OPEB as a separate issue, but rather applied SSAP 24, which deals with pensions, to other postretirement benefits. Although this is superior to having no guideline at all in this increasingly complex and material area, it is a different approach to that specified in SFAS 106 and therefore could lead to problems in the comparability of UK and US financial statement disclosures. As mentioned previously, preparers of financial statements have been advised to consult FASB 106 in the measurement of the OPEB obligation, but then provide disclosure in terms of the ICAEW document, SSAP 24. This seems a questionable situation as the disclosures of SSAP 24 have often been criticised (Ternent, 1995) and are substantially different from the disclosures required by the US standard. The result could be inconsistency and incomparability of financial statements within the United Kingdom itself and between the UK and the United States.

Sadly, it seems as though the country that recognised that 'social accounting will be an area of growing concern to the accounting profession and one in which it has an opportunity to help develop practical reporting techniques' (ASC, 1975, pp 57) has failed to come to a satisfactory conclusion on the issue of accounting for OPEB, failing to 'communicate economic measurements of and information about the resources and performance of the reporting entity useful to those having reasonable rights to such information.' (ASC, 1975, pp 18).

CHAPTER 5 : CANADA

5.1. INTRODUCTION

To date the Canadian Institute of Chartered Accountants (hereinafter CICA) has not dealt with the accounting treatment of other postretirement benefits in a standard. However, the fact that these benefits do exist has been recognised by the Emerging Issues Committee (EIC), and abstracts of issues surrounding the treatment of OPEB have been published.

5.2. EIC-5

EIC-5 was issued in April 1989, being the first time postretirement benefits other than pensions had been dealt with by CICA. The Emerging Issues Task Committee recognised that OPEB can take the form of dental care, supplemental health care or life insurance. Although no mention was made of day care or legal assistance (as specified in SFAS 106) the list provided in EIC-5 is in no way exhaustive.

The abstract recognises that at the time (1989), there were three different methods of accounting for OPEB,

- i. The pay-as-you-go method under which costs are recognised as incurred by the retirees and paid by the employer.
- ii. The method whereby an estimated liability for benefits to be provided is accrued at the time an employee retires, and
- iii. The current accrual method whereby a current service cost is actuarially determined and accrued in the accounts.

As a result of the fact that no Canadian standard existed at the time the Committee conceded that any method used in practice would have been acceptable under Canadian GAAP. In order to facilitate some comparisons between financial statements that make use of the different accounting treatments, the following had to be disclosed :

- i. A general description of the postretirement benefits other than pensions provided and
- ii. A description of the accounting policies followed for these benefits.

This disclosure is consistent with that required by CICA 1505, Disclosure of Accounting Policies, but the fact that three alternative treatments were allowed was inconsistent with the treatment of pensions and obligations as specified by CICA 3460, in which pensions, due to the fact that they constitute a form of deferred compensation, are treated in accordance with the third (iii) accounting method, i.e. the current accrual method.

Therefore, it is submitted that while EIC-5 did signify the recognition of the OPEB issue by CICA, it did not deal with any of the more complex areas of this issue, nor did it provide any significant guidance on dealing with OPEB to both the preparers and users of financial statements. Perhaps most worrying was the statement contained in EIC-5 that 'the Committee does not plan any further discussions on this issue', meaning that it believed that the question of how postretirement benefits other than pensions should be accounted for had been adequately dealt with.

5.3. EIC-49

Realisation that EIC-5 was not sufficient came in 1993, after the FASB had issued their comprehensive SFAS 106. In an attempt to rectify the situation, EIC-49 was released on 16 October 1993.

This abstract concentrated on the effect of a change from the cash (pay-as-you-go) accounting basis to the accrual basis of accounting for OPEB as specified by SFAS 106. The FASB pronouncement applies to

Canadian holding companies with US subsidiaries, as well as Canadian subsidiaries with US holding companies. As a result, it was expected that several companies would indeed experience the effects of transitional adjustments.

There are numerous ways in which this adjustment can be dealt with:

1. In terms of CICA 3460, prospective application, with the transitional balance being amortised in a rational and systematic manner over an appropriate period of time, which normally would be the expected average remaining service life of the employee group covered by the plan. Such an adjustment is also allowed in terms of CICA 1506, which states that 'the new accounting policy should be applied retroactively unless the change is made to comply with an Abstract of an issue discussed by the CICA Emerging Issues Committee that permits prospective application.' (CICA, 1990, para 11).
2. Retroactive application (in accordance with CICA 1506), with either a restatement of prior periods, meaning that a prior year adjustment (PYA) would have to be made, or no restatement of prior periods meaning that either a cumulative adjustment is made against net income or against the opening balance of retained earnings.
3. Follow the alternative treatment allowed in terms of SFAS 106, in which the transitional adjustment is recognised over twenty years where plan participants' average remaining years of service is less than twenty years (para 254). Such concessions were made as 'the Board recognised that the magnitude of the obligation and the limited availability of historical data on which to base its measurement suggest the need for a pragmatic approach.' (FASB, 1990, para 252). However, the FASB did stipulate that the phasing in recognition of the transitional obligation should not result in slower recognition of an employer's postretirement benefit obligation that would result from continuation of the pay-as-you-go (cash) method. (para 254).

The EIC abstract contains a discussion of these three alternatives, commenting that 'the Committee considers that the transitional provisions of CICA 3460, when considered together with the future

recognition approach established by SFAS 106, provide directly analogous guidance in this situation.' (EIC, 1993). This means that the first alternative (method 1) is considered to be superior, although CICA does allow the implementation of method 2. The FASB alternative treatment (method 3) has been criticised by CICA, 'the option of recognising the transitional balance over the arbitrary 20 year period permitted by SFAS 106 is not considered appropriate in Canada' (EIC, 1993), finding it no substitute for a 'rational and systematic manner over an appropriate period of time' (EIC, 1993). Although no guidance is given in the abstract as to the meaning of 'rational', 'systematic' or 'appropriate', it would seem that either equal annual amounts or other actuarial methods would be appropriate. EIC-49 calls for the disclosure of the transition method used, as well as the disclosures required by EIC-5.

5.4. CONCLUSIONS ON EIC-49

Limited guidance had, up to this point been given by CICA as regards the treatment of OPEB. Unlike the UK, the accounting for other postretirement benefits has not been based on that of pensions. Rather, SFAS No. 106 has been cited as a reference, with CICA making adjustments where it felt they were necessary. This must have created some confusion for preparers of financial statements as no CICA pronouncement dealt with the more basic issues of OPEB but focused on criticising the allowed alternatives contained in SFAS 106.

A reason for this unsatisfactory situation is the fact that Canada is a member of the IASC, which is undertaking an OPEB project, and hence the issue of any pronouncement by CICA has been deferred until such time as the IASC have issued their standard so as to avoid any incompatibilities.

TABLE B: COMPARISON OF ACCOUNTING PRONOUNCEMENTS			
	SFAS 106	EIC-5	EIC -49
	15-Dec-92	Apr-89	15-Oct-93
BASIS	Comprehensive, ground-breaking standard. Only allows the accrual basis of accounting for OPEB.	Emerging Issues Committee release discussing issues surrounding a particular topic. Allowed three different methods of accounting: *the pay-as-you-go method *whereby an estimated liability for benefits is accrued at the time an employee retires. * the accrual basis.	Emerging Issues Committee release discussing issues surrounding a particular topic. This abstract concentrated on the change from the cash to the accrual basis.
TRANSITION ADJUSTMENT	Immediate recognition or spread over 20 years.	No guidance given.	Came to the conclusion that the transition adjustment should be spread over the average remaining service life of the employee group covered.
EMPLOYEE DISCLOSURE	-	General description of postretirement benefits provided.	-
LIABILITY DISCLOSURE	Amount recognized and amount unrecognized.	Only necessary if using accrual basis or accruing on retirement.	-
EXPENSE DISCLOSURE	Differentiate between: *service cost *interest cost *actual return on assets *amortisation of unrecognized transition obligation.	No guidance given.	-
POLICY DISCLOSURE	Accounting and funding policy.	Accounting policy adopted.	-
ASSUMPTION DISCLOSURE	Health care cost trend rate, discount rate as well as the effect of a 1% change in these rates.	No guidance given.	-
BENEFIT CHANGES	Comprehensive examples of plan curtailments, amendments, terminations and mulitemployer plans are provided and various disclosures are required.	No guidance given.	-
ACTUARIAL DISCLOSURE	-	-	-

5.5. RECENT DEVELOPMENTS

CICA stated in October 1993 that 'no further discussions on this (OPEB) issue are planned' (EIC, 1993) but spent a considerable amount of time on OPEB during 1995. In January, OPEB was recognised as a project to be undertaken, taking into consideration both CICA 3460 and SFAS 106. This project was to be undertaken by a Task Force which constituted members of CICA as well as members of the Canadian Institute of Actuaries.

Four crucial areas have been identified by the Task Force:

1. Should the substantive or the written plan form the basis of accounting?

Under SFAS 106 the substantive plan is used but CICA 3460 specifies the use of the written plan.

2. Should a settlement rate be used as the discount rate or should a long-term rate be used?

SFAS 106 specifies the use of a settlement rate whereas a long-term rate is used for pension accounting in Canada. Consistent with Statement 87, a settlement rate was defined in the FASB exposure draft dealing with OPEB as 'the interest rates inherent in the amount at which the postretirement benefit obligation could be effectively settled' (FASB, 1990, para 188). Although this definition was omitted from SFAS 106, FASB has stated that omission of the phrase 'is not intended to reflect a substantive difference between the requirements of Statement 87 and Statement 106' (FASB, 1990, para 188). Thus the settlement rate should still be applied in terms of SFAS 106. In the Canadian Pension Statement, the discount rate applied to obtain the present value of the liability is calculated with reference to the assets that will be used to satisfy the obligation.

The question is really one of consistency, should the Canadian pronouncement on OPEB be consistent with that of the Canadian standard dealing with pensions or with the US standard on OPEB?

The fact that the majority of other postemployment benefit obligations are unfunded means that a long-term average rate of return on plan assets may not be available for use in discounting. This means that the settlement rate may be the only alternative.

3. The third question revolved around the attribution period. The US standard requires that the attribution periods end on the date the employee becomes fully eligible for the benefits, rather than at the date of retirement, although this later date is the date on which claims are made. The American standard has been widely criticised (see above) for this so-called 'application of form over substance'. This criticism seems to stem from the fact that additional benefits are still being earned in the years before retirement in the case of pensions. With postretirement benefits other than pensions accrual should stop at the date at which full eligibility has been achieved, in the interests of representational faithfulness.
4. The fourth area highlighted was the FASB's minimum amortisation method, in which the 'unrecognised net gain or loss shall be included as a component of net postretirement benefit cost for a year if, as of the beginning of the year, that unrecognised net gain or loss exceeds 10% or greater of the accumulated postretirement benefit obligation or the market related value of plan assets. If amortisation is required, the minimum amortisation shall be that excess divided by the average remaining service period of active plan participants.' (FASB, 1990, para 59).
Amortisation of an unrecognised net gain results in a decrease in net periodic postretirement benefit cost; amortisation of an unrecognised net loss results in an increase in net periodic postretirement benefit cost.

5.6. EXPOSURE DRAFT

In response to the IASC's E54 released in October 1996, CICA issued 'Employees' Future Benefits' in June 1997, dealing with all accounting employment issues including pensions, compensated absences, post-retirement and post-employment benefits. The exposure draft is a compromise between SFAS 106 (due to the fact that a number of Canadian companies have to comply with SFAS 106 as their holding companies are American) and E54 (as Canada is a member country of the IASC). As noted by CICA, 'the

IASC proposals are similar but not identical, to the US requirements.' (CICA, 1997, pp 1). for more detail refer the IASC chapter.

CICA has elected to make use of an actuary where SFAS 106 does not mention that an actuary is necessary, and E54 only encourages the use of an actuary and does not prescribe the use of one.

Similarly, the disclosures required by CICA are less extensive than those specified by SFAS 106 and in some cases less arduous than those specified in E54 (for example, CICA does not call for the breakdown of the income statement cost into its various components as required by both SFAS 106 and E54, and there is no requirement to disclose the effect of a 1% change in assumed discount rates and health care cost trend rates on the liability in Canada although such information is necessary in the US.)

Consistent with earlier releases, the 20 year minimum amortisation period specified in SFAS 106 is not allowed in terms of the Canadian exposure draft, in which transitional adjustments can either be made retrospectively (PYA) or amortised prospectively over the average remaining service lives of employees.

The four contentious issues as mentioned above have been resolved as follows:

1. The substantive plan should form the basis of accounting.
2. Discount rates are determined with reference to market interest rates, and settlement rates should be used if settlement with a third party is possible.
3. Cost should be attributed from date of hire to date at which an employee obtains full eligibility for benefits.
4. The 'corridor approach' of amortising net gains or losses as specified by FASB in SFAS 106 has been adopted by CICA.

It would therefore seem that CICA has taken the principles as laid down in both E54 and SFAS 106 and applied them to the Canadian situation, adapting disclosures so as to cut the cost of disclosure to preparers without decreasing the benefit of the disclosure of OPEB to users.

(For a full comparison of the CICA exposure draft, SFAS 106 and previous Canadian accounting releases dealing with OPEB refer to appendix 3.)

5.7. CONCLUSION

Guidance provided by CICA on the treatment of postretirement benefits other than pensions has followed the examples set by FASB and the IASC, with amendments being made to fit the Canadian scene and to facilitate both easier preparation and better understanding.

However, due to the fact that the exposure draft has only recently been issued the effects thereof may not yet have been considered let alone experienced.

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CHAPTER 6: AUSTRALIA

6.1. INTRODUCTION

The Australian Accounting Research Foundation (AARF) issued Australian Accounting Standard 30 'Accounting for Employee Entitlements' (hereinafter AAS 30) in March 1994, following the release of an exposure draft (ED 53) of the same name in August 1991.

6.2. COMPARISON OF ED 53 AND AAS 30

Substantial changes have been made to the original exposure draft upon which AAS 30 is based. These are listed below:

1. AAS 30 does not deal with 'issues relating to the recognition and measurement of an employer's superannuation obligations' (AARF, 1994, preface), as the responses to ED 53 revealed that further consideration was warranted on certain issues.

It is interesting to note that the FASB recognised that pensions and other postretirement benefits are separate issues and as a result undertook the projects separately whereas the UK and the IASC, for example, based their accounting for postretirement benefits other than pensions on their respective pension pronouncements. Australia, however deals with the accounting for postemployment benefits other than superannuation but has yet to address the treatment of superannuation.

2. Major changes have been made as a result of cost-benefit constraints. These changes include a substantial reduction in the extent of required disclosures. 'The disclosures required by the Standard are significantly less extensive than those proposed in ED 53. Many respondents to ED 53 expressed the view that some of the disclosures proposed by ED 53 were not warranted on a cost/benefit basis.' (AARF, 1994, para 6c).

Similarly, ED 53 stipulated that employee entitlement liabilities should be discounted to present value by using 'current, market-determined, risk-adjusted discount rates' (AARF, 1994, para 26). AAS 30, recognised that it may be difficult to determine these rates reliably, and as a result, stated that 'rates attaching to national government guaranteed securities' (AARF, 1994, para 26) should be used to discount estimated cash outflows to their present value, in effect recognising that the costs of assessing the numerous risks attaching to OPEB, outweigh the benefits.

The effect of discounting at the risk-free rate (long term bond rate) as opposed to the market determined, risk adjusted rate is that a lower discount rate will be used giving rise to the quantification of a larger, and hence more conservative liability.

The author is of the view that such amendments are characteristic of the Australian standard setting process, where Standards are given legal backing and as such only 'pronouncements that fully take into account public interest' (Mathews and Perera, 1991, pp 116) are elevated to legal status. This means that standards are 'watered down' so as to achieve compliance, and 'greater government and community involvement in the development of accounting rules'. (Walker, 1987, pp 269).

6.3. OVERVIEW OF AAS 30

Interestingly, AAS 30 is the only official pronouncement dealing with retirement benefits that does in fact define 'employee', 'employer' and 'employee entitlements'. The standard recognises that all individuals who render service to an enterprise, in terms of an employment contract are employees, regardless of the nature of their terms of employment (i.e. permanent or part-time etc.).

AAS 30 came into effect in reporting periods ending on or after 30 June 1995, and applies to all private sector reporting entities as well as those public sector reporting entities that make use of the accrual basis of accounting.

In conformity with the accounting treatment of other postretirement benefits in other countries, AAS 30 calls for the recognition of a liability with respect to these obligations in the financial statements of an enterprise. Unlike the FASB, which called for a transitional adjustment (arising from a change from the cash to the accrual basis) to be recognised immediately or spread over the remaining service lives of employees, AAS 30 calls for a prior year adjustment. This means that the implementation of standards dealing with OPEB will have different results in the US and Australia - the US standard reducing the current and future years' income and the Australian standard reducing retained income, although in some cases it is questionable whether the retained income balance will be sufficient to absorb the entire transitional adjustment.

The accounting treatment specified in the Australian standard is consistent with the conceptual framework upon which it is based, requiring that the income statement form the link between consecutive balance sheets, i.e. a balance sheet approach. This is stated in paragraph 29 of AAS 30:

'This standard requires all employee entitlement liabilities to be measured as at each reporting date. This requirement reflects the need to report reliably on liabilities as at the reporting date and on expenses and revenues for the reporting period.'

This means that the OPEB liability should be estimated at the end of each financial year, the difference between the two being the OPEB expense to be put through the income statement. AAS30 does not require the recognition and disclosure of the separate elements of this expense (i.e. current service cost, interest cost component etc.) as required by SFAS 106 on the grounds that such practice would be costly and not of sufficient benefit to warrant such expenditure.

TABLE C: COMPARISON OF ACCOUNTING PRONOUNCEMENTS		
	SFAS 106 12/15/92	AAS 30 6/30/1995
BASIS	Comprehensive, ground-breaking standard. Only allows the accrual basis of accounting for OPEB. The main aim is usefulness.	Standard covering all forms of employee entitlements, wages and salaries, leave, medical benefits, nonmonetary benefits and retirement and retrenchment payments. Interestingly, Australia does not have a standard on pensions, which are specifically excluded from AAS 30. The main aim is usefulness.
TRANSITION ADJUSTMENT	Immediate recognition or spread over 20 years.	Requires a prior year adjustment.
EMPLOYEE DISCLOSURE	-	-
LIABILITY DISCLOSURE	Amount recognized and amount unrecognized.	The liability relating to OPEB is included in the aggregate employee entitlement liability.
EXPENSE DISCLOSURE	Differentiate between: *service cost *interest cost *actual return on assets amortization of unrecognized transition obligation.	Disclose together with other employee entitlement expenses.
POLICY DISCLOSURE	Accounting and funding policy.	-
ASSUMPTION DISCLOSURE	Health care cost trend rate, discount rate as well as the effect of a 1% change in these rates.	-
BENEFIT CHANGES	Comprehensive examples of plan curtailments, amendments, terminations and mulitemployer plans are provided and various disclosures are required.	-
ACTUARIAL DISCLOSURE	-	-

6.4. CONCLUSION

The AARF have, in line with other international standard setting bodies, released a pronouncement dealing with postretirement benefits other than pensions. Their release represents a more practical approach than SFAS 106 - more of a compromise between theoretical correctness and the limitations of implementation in a business environment. Although the same principles have been applied in both AAS30 and SFAS 106, the two will have different effects. AAS30 being more 'preparer - friendly' and SFAS 106 being more 'user - friendly'. It is the view of the author that in countries where standard setting bodies are reliant upon preparers' acceptance of their standards (e.g. Australia and South Africa) the approach adopted by Australia may be the only feasible option.

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CHAPTER 7 : THE IASC

7.1. INTRODUCTION

The International Accounting Standards Committee (hereinafter IASC) was established in 1973 as 'it had long been argued that different national accounting standards militate against the efficiency of international capital markets and may even impair the ability of corporations to compete effectively for capital in these markets' (Diamond et al, 1991, pp 25). In an attempt to rectify the situation the IASC was formed whose 'programme of standard development is committed to narrowing the differences between financial statements produced in different parts of the world by seeking to harmonise accounting standards'. (Mathews and Perera, 1991, pp 86).

Due to the effect that the work done by the IASC has had, and in all probability will continue to have, on international capital markets, it is closely monitored by the International Organisation of Securities Commissions (hereinafter IOSCO). IOSCO regulates securities and futures markets to such an extent that standards promulgated by the IASC are subject to the approval of IOSCO.

7.2. BACKGROUND

The IASC released a pronouncement (International Accounting Standard 19), 'Accounting for Retirement Benefits in the Financial Statements of Employers' in 1983. Although IAS 19 did not deal with postretirement benefits other than pensions specifically, it did state:

'employment termination indemnities, deferred compensation arrangements, long service leave benefits, health and welfare plans and bonus plans are not dealt with by this statement although if their predominant characteristics are the same as those of retirement benefits, it would usually be appropriate to account for these in a manner similar to retirement benefit plans.' (IASC, 1983, para 1).

This standard has subsequently been revised as required by the Statement of Intent on Comparability of Financial Statements (E32) issued in 1990. The new IAS 19 specifies that the retirement benefit expense in terms of a defined benefit plan (which OPEB meets the definition of) in the current period includes:

- a. the current service cost
- b. amounts recognised in the current period in respect of past service costs of current and retired employees, experience adjustments and changes in actuarial assumptions; and
- c. the result of any plan terminations, settlements or curtailments.

(IASC, 1993, para 24).

In terms of the statement, past service cost, experience adjustments, the effects of changes in actuarial assumptions and the effects of plan amendments in respect of existing employees are spread over the expected remaining working lives, whereas the effects of plan amendments in respect of retired employees should be recognised immediately as there is no future service still to be rendered.

If the employer has elected to account for the transitional adjustment in terms of a prior year adjustment, the immediate recognition of the effect of a plan amendment on costs relating to retired employees is consistent as both the original plan and any amendments thereto have been accounted for. But if the transitional adjustment is being spread over the remaining years of service of active employees the immediate recognition of a plan amendment does not make sense as the original plan has not yet been accounted for in full although changes thereto have been fully recognised.

The IASC standard prescribes the actuarial valuation method that should be used when determining the cost of providing retirement benefits, whereas no such prescription is made in SFAS 106. The benchmark treatment contained in IAS 19 is the accrued benefit valuation method, in terms of which 'the annual current service cost applicable to each employee increases as his or her retirement approaches. This increase occurs because the discounted present value of the benefit earned for service in the current period increases as the date of payment draws closer and the probability of the employee remaining in the plan to retirement increases.' (IASC, 1993, para 43). An alternative treatment has however been allowed, being

the projected benefit method, in terms of which the cost of retirement benefits is spread evenly over all periods of service.

Due to the fact that IAS 19 applies to both pensions and other postretirement benefits, no mention has been made of actuarial assumptions unique to the provision of postretirement health care. The IASC has stated that 'the discount rate assumed in determining the actuarial present value of promised retirement benefits in respect of services rendered to the valuation date reflects the long-term rates, or an approximation thereto, at which such obligations are expected to be settled.' (IASC, 1993, para 48). This is compatible with SFAS 106.

The disclosure requirements specified in IAS 19 are similar to those contained in the ICAEW's SSAP 24, concentrating on the actuarial valuation of the enterprise's obligations. Interestingly, the final disclosure requirement of IAS 19 is a 'catch-all' requirement, stating that disclosure should be made of 'any other significant matters related to retirement benefits, including the effects of a plan termination, curtailment or settlement that affect comparability with the previous period.' (1993, para 51). Finally, IAS 19 requires that the transitional adjustment be spread over the expected remaining working lives of participating employees or as a PYA.

When issuing IAS 19 in 1993, the IAS acknowledged that :

1. IAS 19 concentrated on the income statement and gave little guidance on the balance sheet treatment of retirement benefit costs.
2. IAS 19 did not deal with multi-employer plans.
3. It gave only limited guidance on employment benefits other than retirement benefits.

(IASC, December 1994, pp 17).

It was for the reasons given above, that IOSCO requested that the IASC revise IAS 19 once again.

The IASC undertook a new project on employee benefits in December 1994, the first stage of which:

- identifies and reviews all the accounting issues associated with the project.
- studies national and regional accounting requirements and practice and other relevant material on the topic.

(IASB, December 1994, pp 17).

This work culminated in the release of an Issues Paper in August 1995.

7.3. THE ISSUES PAPER

This lengthy document, 146 pages in total, is titled 'Retirement Benefits and Other Employee Benefit Costs'.

The paper recognised twenty basic issues relating to employer benefits, including recognition, measurement and disclosure. These basic issues are themselves broken down into sub-issues, each one being clearly defined and discussed with reference to the conceptual framework and IAS 19. Unfortunately, the fact that the IASB had adopted such a project, obviously recognising how controversial this area of accounting is and the possible impact that a standard could have, has hampered comparability for a while as the IASB member countries have avoided the issue until such time as the IASB has dealt with it.

7.4. E54 : EMPLOYEE BENEFITS

The intended replacement for IAS 19 was issued in October 1996, in the form of E54, Employee Benefits.

This exposure draft deals with all employee benefits, including wages, salaries, pensions, long service benefits and both post-retirement and post-employment benefits.

It is clear that the IASB has made extensive use of SFAS 106 in the creation of this exposure draft although several important changes have been made which may hamper comparability between IASB

member countries and the US. The most notable of these differences is the possible involvement of the actuary in the valuation of the post-retirement benefits specified in E54. In the United States a 'best estimate' approach is adopted, due to the fact that the very nature of OPEB makes it difficult to estimate the liability exactly. Reasonable assumptions should be made and the effect of changes in the assumptions on the estimated figures disclosed. This implies that the US relies more heavily on the note disclosures than the correctness of the figures themselves. E54 encourages 'an enterprise to involve a professionally qualified actuary in the measurement of all significant post-employment benefit obligations.' (para 54), although it recognises that 'in some cases, estimates, averages and computational shortcuts may provide a reasonable approximation of the detailed computations illustrated in this Standard.' (para 50)

E54 is consistent with SFAS 106 in terms of the components making up the liability as disclosed in the balance sheet and the expense as disclosed in the income statement. E54 specifies the use of a 'Projected Unit Credit Method' to determine the present value of the defined benefit obligations, related current service cost and past service cost (para 60). The same method (although not named) is used in the application of SFAS 106. An example of this method is provided in the exposure draft:

'A lump sum benefit is payable on termination of service and equal to 1% of final salary for each year of service. The salary in year 1 is 10 000 and is assumed to increase at 7% (compound) each year. The discount rate used is 10%. The following table shows how the obligation builds up for an employee who is expected to leave at the end of year five. For simplicity, this example ignores the additional adjustment needed to reflect the probability that the employee may leave service at an earlier or later date.

Year	1	2	3	4	5
Benefit attributed to prior years	0	131	262	393	524
Benefit attributed to current year (1% of final salary)	<u>131</u>	<u>131</u>	<u>131</u>	<u>131</u>	<u>131</u>
Benefit attributed to current and prior years	<u>131</u>	<u>262</u>	<u>393</u>	<u>524</u>	<u>655</u>

Year	1	2	3	4	5
Opening obligation (present value of benefit attributed to prior years)	-	89	196	324	476
Interest at 10%	-	9	20	33	48
Current service cost (present value of benefit attributed to current year)	<u>89</u>	<u>98</u>	<u>108</u>	<u>119</u>	<u>131</u>
Closing obligation (present value of benefit attributed to current and prior years)	<u>89</u>	<u>196</u>	<u>324</u>	<u>476</u>	<u>655</u>

(para 61).

It should be noted that 'an enterprise discounts the whole of a postemployment benefit obligation, even if part of the obligation falls due within twelve months of the balance sheet date.' (IASC, 1996, para 62).

As in the United States, E54 states that an entity should recognise a liability from the date an employee becomes entitled to benefits and full accrual should have been made by the time the right to receive these benefits is no longer conditional on further service (this may be some time before retirement). (para 63).

The IASC recommends that an enterprise should attribute benefits to periods on a straight line basis, and makes no mention of the alternative (as specified in South Africa's AC 116) of the accrued benefit valuation method, whereby the annual current service cost applicable to each employee increases as his or her retirement approaches as allowed in the original IAS 19.

Actuarial assumptions should be unbiased and mutually compatible (para 68), assumptions are made regarding:

- mortality, both during and after retirement,
- rates of employee turnover, invalidity and early retirement,
- claim rates under medical plans,
- discount rates,

-expected rate of return on plan assets, and

-future medical costs.

(para 68).

Discount rates should be determined by reference to market yields at the balance sheet date on high quality fixed-rate corporate bonds. In countries where there is no deep market in such bonds, the interest rate on government bonds should be used (para 75). Note that this could be misleading as often government rates are almost risk-free, whereas the uncertainty of the timing and exact amounts of the payments in respect of post retirement benefits introduces some risk. However, if a government rate is used this will result in a larger liability and hence a more conservative estimation will be quantified.

E54 offers two alternatives for the accounting for past service costs. Version A allows amortisation for current employees and immediate recognition for former employees, version B calls for immediate recognition for all employees. One of these will be eliminated on the release of an accounting standard based on comments received on E54. (para 90). It is difficult to decide which is the more appropriate due to the fact that SFAS 106 uses neither (although version A is allowed, past service costs can be amortised over 20 years if this is longer than the average remaining service life of current employees). Although version B is more conservative it is expected that this immediate recognition may cause companies to disclose losses, and as a result version A may be preferred. The accounting treatments of curtailments and settlements are consistent with SFAS 106.

Multi-employer plans are covered in E54. These are defined as post-employment benefit plans that pool the assets contributed by various unrelated enterprises and use those assets to provide benefits to employees of more than one enterprise, on the basis that contribution and benefit levels are determined without regard to the identity of the enterprise that employs the employees concerned. (para 29). If the multi-employer plan is of the defined benefit type it should be accounted for as such in terms of E54, if insufficient information is available then disclosure should be made of the fact and the plan can be accounted for as a defined contribution plan.

E54 provides guidance on the extent to which a defined benefit asset (rather than a liability) can be recognised, and applies the 'corridor approach' (as specified in SFAS 106) to the recognition of actuarial gains and losses.

Disclosure of the following is required:

- a description of the plan;
- the present value of any unfunded defined benefit obligations;
- the present value of funded defined benefit obligations;
- the market value of plan assets;
- net actuarial gains and losses not recognised;
- past service cost not recognised;
- total assets and liabilities recognised in the balance sheet;
- the total income statement expense split into components consistent with SFAS 106; and
- the principal actuarial assumptions. (IASC, 1996, para 111)

These disclosures differ slightly from those required by SFAS 106, where an actuary is not used and as a result it is necessary to disclose the effect of changes in the estimates that have been used on the liabilities disclosed. Similarly, actuarial assumptions are not disclosed in the United States, although discount rates and health care cost trend rates (which are categorised as actuarial assumptions by the IASC) are disclosed.

The exposure draft was expected to take the form of a standard and become operative for financial statements covering periods beginning on or after 1 January 2001.

However, comments received on the exposure draft have pre-empted the following changes to E54:

- past service costs are to be amortised until entitlement date and not over the remaining working lives of employees,
- actuarial assumptions should only include benefit increases if these increases are specified in the plan, and
- initial adoption of the standard, once issued, should be brought forward to 1999, and on such adoption there should be an option to amortise an increase in the liability over five years.

(IASC, October 1997, pp 11)

If these suggested changes are carried through to the standard, then we will see the amortisation of a transitional adjustment over 5 years, 15 years less than that allowed by SFAS 106.

Unfortunately, due to its recent release the effects of the exposure draft have not as yet been documented.

The fact that it is thought the OPEB are not as popular in the IASC member countries as they are in the United States, may mean that the effects may not be as drastic.

TABLE D: COMPARISON OF ACCOUNTING PRONOUNCEMENTS			
	SFAS 106 15-Dec-92	IAS 19 1-Jan-95	E54 1-Jan-01
BASIS	Comprehensive, ground-breaking standard. Only allows the accrual basis of accounting for OPEB. The main aim is usefulness.	Covers all retirement benefits i.e. pensions and OPEB if similar in substance. Relies heavily on actuarial valuations. Does not provide guidance on how to measure various costs and liabilities, but only on what should be disclosed.	All-encompassing exposure draft dealing with all matters to do with employment. Based on SFAS 106 with modifications.
TRANSITION ADJUSTMENT	Immediate recognition or spread over 20 years.	A choice of either passing a prior year adjustment or spreading the transitional obligation over the expected average remaining years of service of active employees covered in terms of the benefits.	At the moment allows two alternatives, either immediate recognition for all current and past employees or amortization of cost of current employees over expected average remaining years of service.
EMPLOYEE DISCLOSURE	-	A general description of the plan including all employee groups covered.	-
LIABILITY DISCLOSURE	Amount recognized and amount unrecognized.	The actuarial present value of promised retirement benefits at the date of the last actuarial valuation.	Amount recognized and amount unrecognized, split into funded and unfunded.
EXPENSE DISCLOSURE	Differentiate between: *service cost *interest cost *actual return on assets amortization of unrecognized transition obligation.	The amount recognized as income or expense during the period.	Differentiate between: *service cost *interest cost *expected return on assets *actuarial gains and losses *effect of any curtailment or settlement
POLICY DISCLOSURE	Accounting and funding policy.	Accounting and funding policy. The actuarial valuation method used.	-
ASSUMPTION DISCLOSURE	Health care cost trend rate, discount rate as well as the effect of a 1% change in these rates.	-	Health care cost trend rate, discount rate as well as expected rates of return on plan assets.
BENEFIT CHANGES	Comprehensive examples of plan curtailments, amendments, terminations and multiemployer plans are provided and various disclosures are required.	Specifies that plan terminations, curtailments and settlements should be disclosed but no detail is provided as to how this should be done.	Comprehensive examples of plan curtailments, amendments, terminations and multiemployer plans are provided and various disclosures are required.
ACTUARIAL DISCLOSURE	-	Principal actuarial assumptions and any significant changes in these assumptions. Date of last actuarial valuations, and the frequency of the valuations.	Principal actuarial assumptions and significant changes in these also absolute amount of each assumption and not just assumed margin between variables.

7.5. CONCLUSION

This chapter has dealt with the IASC progress as regards postretirement benefits other than pensions. As expected the conclusions reached have been influenced by SFAS 106 and the effects it has had on the American business community. Substantial changes are expected in the United Kingdom, Australia, Canada (evidenced by the release of their exposure draft in June 1997) and South Africa now that the IASC is making substantial progress in its project on postretirement benefits other than pensions.

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CHAPTER 8: SOUTH AFRICA

8.1. INTRODUCTION

The issue of postretirement benefits other than pensions is receiving attention from many different quarters (Pollard, 1995, pp 1), with much comment being made in the South African popular press as the full ramifications of the US's SFAS 106 become clearer.

8.2. BACKGROUND

'Providing benefits such as medical aid and insurance to retired employees have been a way of life for some companies for some time.' (Dickinson, 1994, pp 33). As is the case in the United States and the United Kingdom, health care constitutes the major component of other postretirement benefits offered to employees in South Africa, as evidenced by the fact that medical care is specifically dealt with in AC 305, Accounting for Postretirement Benefits Other than Pensions. This area will therefore be concentrated on. 'The most common way in South Africa of providing postretirement medical benefits is for the employer to pay part or all of the pensioner's medical aid subscriptions.' (Pollard, 1995, pp 7). A recent (1995) Old Mutual Health Benefits Survey found that employers were helping to cover the costs of different types of health care including medicines, hospital care, dental care, doctors, opticians and in some cases physiotherapists. The survey revealed that the largest single cost was medicines (22% of total medical claims), although this figure had declined from the 1994 percentage of 26%.

At present, the South African employer has two alternatives, being the use of either managed or commercial medical aid funds. A managed fund is a 'medical aid scheme run by a large company' (Marud, 1995, pp 6), which means that a fund is administered by the employer itself, with contributions being made to an internal medical aid fund and withdrawals made so as to cover the cost of the claims. A

commercial fund is one 'offered by smaller firms, and their main element is that membership is optional. The company and its employees can choose whether or not to belong to it.' (Marud, 1995, pp 6) - in other words, the fund is administered by an external medical aid enterprise. Due to the fact that the commercial fund removes the risk of being under-funded from the employer to a separate body, the Old Mutual survey found that there was a general trend to move from managed funds to commercial funds as 'many companies are no longer willing to open themselves up to the unlimited liabilities that could flow from a major epidemic or disaster.' (Marud, 1995, pp 6).

8.3. MANAGED FUNDS

Nevertheless, some companies do still have managed funds and have attempted to reduce the risk that they are exposed to in a number of different ways. The most obvious action is an effort to reduce the cost of postretirement health care.

	Action Taken		Effectiveness	
	%	%	%	%
	1994	1995	1994	1995
Allow employee choices	84	73	79	95
Encourage generic drugs	69	68	88	90
Increase delivery system awareness	63	62	86	97
Re-design prescription medicine benefits	39	58	100	100
Specify chronic prescription medicine supplier	25	45	80	96
Implement 'employee wellness' plans	23	44	91	94
Introduce savings plan options	34	29	53	83
Specify doctors	23	20	85	79
Reduce annual benefit limits	39	20	74	90
Specify hospitals	12	18	100	100
Increase cost sharing with employees	41	18	88	95
Re-design retiree medical benefits	14	17	100	100
Shift employees to managed care plan	17	16	100	86
Pay doctors' salary for services	9	13	100	80

TABLE E : Action to Reduce Costs. (Marud, 23 September 1995)

Table E shows the various actions taken by employers who have managed funds so as to reduce the risk of a shortfall in the fund. Some of these actions are themselves costly (e.g. 'employee wellness' plans) indicating the level of risk and expense involved. Indeed, 'there are currently 500 000 pensioner members

including dependants who are members of South African medical aids. Assuming an average age of 70, the value of their contributions is estimated at R8 billion, leaving an unfunded liability of R37 billion.' (Pollard, 1995, pp 3).

'Managed care' referred to in Table E was first used in the United States about twenty years ago, in an attempt to shift financial risk from the managed fund i.e. the employer, to doctors and hospitals. 'A classic way of offering managed care was in a community of people around a particular hospital and a group of doctors. The hospital and doctors would charge everyone in the community a flat monthly rate for medical care, which was then paid for from the pool of money managed by the doctors and hospitals.' (Marud, 1995, pp 6). In this way some control could be exercised over doctors' fees (a reduced rate could be negotiated as specified doctors treat all employees) and generic medicines could be used, further reducing costs.

8.4. COMMERCIAL FUNDS

As explained above, once an employer makes use of a commercial fund rather than a managed fund, some financial risk is removed, as the employer is only responsible for the payment of subscriptions once an employee has retired. 'Often these are set at a discount even to the young members' subscription rate. The discount, however, is being phased out in many schemes thereby increasing the employer's immediate costs.' (Pollard, 1995, pp 9).

Experience has shown that with the 'increased costs of medical care and the fact that the average life expectancy is growing' (Dickinson, 1994, pp 33), 'the old members ... are being charged lower subscriptions than the value of the benefits they are consuming within the medical scheme' (Pollard, 1995, pp 6) because of cross-subsidisation. Therefore even though the employer's subscription payments

in relation to retirees, will in all probability be inadequate, he has no further liability to the commercial fund.

The Old Mutual survey found that a great deal of cross-subsidisation was taking place, meaning that younger employees' subscriptions were being raised in order to subsidise the medical costs of retirees. However, the fact that a greater number of younger employees are choosing not to join medical aid funds as they cannot afford (and object to) this cross-subsidisation has meant that there may be insufficient money in the fund. As a result, commercial funds have recognised the need to pre-fund, thereby budgeting for future costs, as shown in figure 2. (Marud, 1995, pp 6).

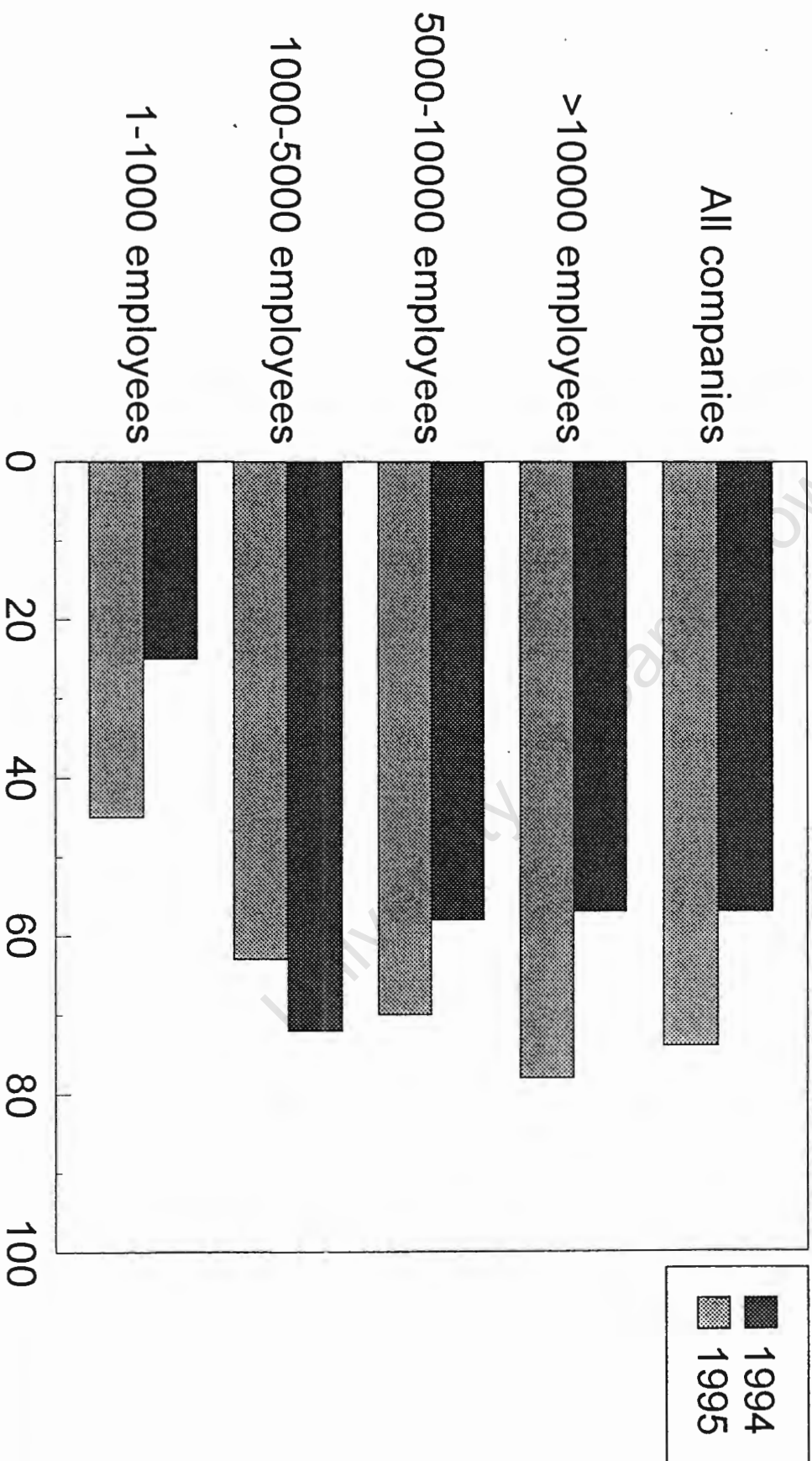
'The survey found an increase to 74% from 57% in 1994 in funds that intended to prefund for future pensioner liabilities....Figures Old Mutual put out last year showed that if medical schemes had been treated like pension schemes over the years, about R35 billion should have been put away for the future. Instead, all that was put away was R1 billion leaving a R34 billion deficit...estimates were that it would take 15 to 20 years of prefunding before medical schemes had built up to the R35 billion level.'

(Marud, 1995, pp 6).

Figure 2 also reveals that although there has been a total increase in the companies intending to prefund, there are still funds (with 1000 to 5000 employees) who have not yet dealt with the problem of funding the OPEB liability.

Figure 2

Intention to prefund for pensioners



Although 71% of companies make use of cross-subsidisation of pensioners, the younger members of medical aid schemes are opting out because the costs are too high. It may therefore be necessary for commercial funds to hold the employer responsible for any shortfall in the postretirement medical benefit.

8.5. SOUTH AFRICAN PRONOUNCEMENTS

8.5.1. AC116

In the past, South Africa has only had one accounting standard dealing with postretirement benefits - being AC116, 'Retirement Benefit Information', issued in September 1986 - although it dealt mainly with pensions. In fact, paragraph 3 went so far as to preclude health and welfare plans from the scope of the statement, merely stating that plans with similar characteristics to pensions should have the same note disclosure as that specified by SAICA in AC 116.

It has been found that 'the most common practice to date to account for postretirement benefits has been on the cash basis' (Dickinson, 1994, pp 34) with the transition to the accrual basis requiring the recognition of a previously unrecognised liability that is 'often significant' (Dickinson, 1994, pp 33).

8.5.2. AC 305

In light of the inadequate accounting treatment referred to above, and the work that has been done in this area internationally, AC 305, 'Accounting for Postretirement Benefits Other than Pensions' was issued by SAICA in July 1995. The 'three hundred series' are not standards of generally accepted accounting practice (GAAP) but opinions issued by the Accounting Issues Task Force in order to 'provide authoritative guidance to preparers, auditors and users of financial statements thus facilitating the standardisation of accounting treatments.' (SAICA, 1990, para 3).

AC 305 recognises that the most significant portion of OPEB is generally medical costs, stating that 'it is not unusual for in-house medical schemes to have postretirement benefits that include the payment of

medical aid subscriptions by the employer on behalf of the retired employee or for the enterprise to subsidise increased medical contributions arising after retirement of the employee.' (SAICA, 1995, para 2). The opinion clearly states that 'each enterprise should evaluate the extent of its obligation by reference to relevant documentation and custom' (SAICA, 1995, para 2) -recognising that unlike pensions, OPEB can vary substantially from one employer to another and are not regulated by the Pension Funds Act.

The opinion recognises that it may be difficult (or perhaps impossible) to measure the obligation of the enterprise reliably, but it is in the interests of fair presentation to disclose details of their practices.

AC 305 includes a brief review of OPEB accounting practices in the UK and the USA and then discusses the conceptual framework definition of a liability and the recognition criteria in order to establish consistency between the framework and the opinion.

Interestingly, AC 305 is based upon SFAS 106 rather than the IASC pronouncement, recognising the detailed study which has been undertaken by the FASB as more comprehensive.

As with SFAS 106, a 'transition obligation' (AC305, 1995, para 14) must be brought into account either:

- a. immediately, or
 - b. on a delayed basis i.e. amortised as an expense on a straight line basis over a selected period. Unlike the US, no optional limit of 20 years is applied, although it does state that 'the period should not exceed the average remaining service period of active participants, and the delayed recognition should not result in less rapid recognition than accounting for the obligation on a 'pay-as-you-go' basis.'
- (para 14).

The disclosure requirements set down in AC 305 are the minimum that should appear in financial statements, and are similar to the disclosure requirements for pensions as specified in AC 116, but differ substantially from the disclosure requirements as specified in SFAS 106, which seems inconsistent when AC 305 is supposed to be based upon the latter.

8.5.3. THE REVISION OF AC 116

In October 1995, the South African Institute of Chartered Accountants issued Exposure Draft 104 (hereinafter ED 104), 'Retirement Benefit Costs', based on IAS19. This exposure draft remained largely unchanged and became the revised AC116 in December 1996.

The aim of this was to provide guidance on how retirement benefits should actually be accounted for as the previous AC 116 had concentrated on disclosure requirements. The newer AC 116, however, also requires more extensive disclosure than the original AC 116.

Once again, AC 116 does not deal with postretirement benefits other than pensions specifically, but paragraph 5 states that "many employers provide other forms of employee remuneration or post-employment benefits including deferred compensation arrangements, long service leave benefits, health and welfare plans and bonus plans. These arrangements are not dealt with by this statement although it is appropriate to account for and disclose their costs in a similar manner to the costs of retirement benefit plans if the substance of an arrangement is the same as that of a retirement benefit plan".

As retirement benefit plans, as defined by AC 116, 'are arrangements whereby an enterprise provides benefits for its employees on or after termination of service (either in the form of an annual income or as a lump sum) when such benefits, or the employer's contributions towards them, can be determined or estimated in advance of retirement from the provisions of a document or from the enterprise's practices' (para 6), it is not clear whether OPEB fall within the scope of AC 116. OPEB appear to be excluded in terms of paragraph 5, but included in terms of paragraph 6 as they meet the definition of retirement benefit plans. This has led to some confusion and has meant that many companies are not applying AC 116 to OPEB.

The new standard details the actuarial valuation methods to be used in accounting for retirement benefits. It specifies the use of an accrued benefit valuation method as the benchmark treatment for determining the costs of retirement benefits, but allows the use of a projected benefit valuation method as an allowed alternative (therefore in line with IAS 19).

AC 116 specifies that 'under a defined benefit plan, the expense in the current period includes:

- a) the current service cost
- b) amounts recognised in the current period in respect of past service costs of current and retired employees, experience adjustments and changes in actuarial assumptions, and
- c) the result of any plan terminations, settlements or curtailments.'

(SAICA, December 1996, para. 25).

The current service cost is recognised as a expense in the current period.

For existing employees, past service costs, experience adjustments, the effects of changes in actuarial assumptions and the effects of planned amendments should be recognised as an expense or income over their expected remaining working lives. (para 29).

Any expense relating to plan terminations, curtailments and settlements should be recognised immediately. Any gain should be recognised as income in the period in which the termination, settlement or curtailment occurs. (para 34).

The effect of plan amendments in respect of retired employees in a defined benefit plan should be measured as the present value of the effect of the amended benefits and should be recognised as an expense or as income in the period in which the plan amendment is made. (para 39).

The above treatment relating to retired employees is consistent with the conceptual framework as it is in terms of the prudence concept. The confusion that had been caused by ED 104 allowing a change from the cash to the accrual method being recognised over the remaining working lives of participating employees (para 55) has been removed in AC 116. In ED 104, obligations relating to retirees could be spread over a number of years but changes to these obligations (i.e. plan amendments) had to be recognised immediately. The option of spreading the change from the cash to the accrual basis is not offered by AC 116, which specifies that the change should be accounted for in accordance with the statement dealing with changes in accounting policy. This change distinguishes AC116 from IAS 19 upon which it is based.

SAICA have recognised that the IASC is currently undertaking a project to revise IAS 19 (upon which AC 116 is based), however a final standard is only expected to be approved in March 1999, meaning that

AC 116 was necessary, as without it, there would have been no recent South African statement dealing with the recognition and measurement of retirement benefit costs for a considerable period of time.

**TABLE F: COMPARISON OF DISCLOSURE REQUIREMENTS
AC 305, FASB 106 and both old and new AC 116s.**

	<i>AC 305</i>	<i>Old AC 116</i>	<i>FASB 106</i>	<i>New AC 116</i>
Main Aim	Fair presentation	Understandability	Usefulness	Fair presentation
Disclosure of Policies	Accounting and funding policy.	Accounting policy, funding policy if it differs from accounting policy.	Accounting and funding policy.	Accounting policy, whether plan funded and actuarial valuation method used.
Employees	Employee benefits and groups covered.	Proportion of employees covered.	-	Employee group covered.
Expense	Total expense for the period.	Differentiate between: *current service cost *experience adjustments *past service costs	Differentiate between: *service cost *interest cost *actual return on assets amortization of unrecognized transition obligation.	Amount recognized as income or expense during the period.
Liability	Amount recognized as well as amount still to be recognized.	-	Amount recognized and amount unrecognized.	Actuarial present value of promised retirement benefits.
Plan Assets	Shown at fair value.	-	Fair value, split into type of assets.	Fair value of plan assets.
Actuarial valuation	*Amount of valuation *Frequency *Date of last valuation *Principal assumptions	*Date of next valuation *Recommendations *Date of valuation *Opinion of actuary	-	*Amount of valuation *Frequency *Date of last valuation *Principal assumptions and changes therein.
Estimates	-	-	Disclose: *health care cost trend rate. *weighted average of discount rates. *effect of 1% increase in health care cost trend rates.	-
Comparability	-	-	-	Any other significant matters related to terminations, curtailments and settlements that may effect comparability.

Whereas SFAS 106 is a comprehensive and technical document which concentrates on the mechanics of accounting for OPEB, AC 305 does not deal with the accounting issues in any depth, but rather focuses upon disclosure in an attempt to achieve fair presentation. Such an approach is consistent with AC 116 which strives to make sufficient disclosures so as to enable the users of financial statements to understand the retirement benefit information. However, AC 305 does not specify that the effects of a percentage point increase in estimated rates be disclosed. For a document whose main aim is fair presentation, such a disclosure would be relevant and emphasise the fact that extensive use of estimates has been made.

In conclusion, although SAICA has recognised that some guidance was needed in the area of postretirement benefits other than pensions, as the older AC 116 was not being applied to OPEB, the issue of AC 305 is something of a compromise. The opinion concentrates on disclosure requirements which combine elements of both the older AC 116 and SFAS 106, but provides little guidance on accounting practices. The reason for this has probably been given by Monica Singer, who was SAICA's Technical Director, as she said that 'it would be impossible to make the recommendation compulsory in the short-term, the result would cripple many SA companies, so a phased in approach will probably be adopted.' (Sharpe, 1995, pp 3), with AC 305 representing the first step. The uncertainty regarding the applicability of the new AC 116 to OPEB has only complicated the accounting and disclosure requirements relating to postretirement benefits other than pensions.

8.6 REACTION TO AC 305

'While the accounting practice was not immediately compulsory in SA, any local company that was a subsidiary of a US company would have to adopt the US standard as would any SA company wanting a listing on the New York Stock Exchange...therefore the alignment of SA's accounting standards with the rest of the world would make it difficult for SA companies to avoid addressing the issue.' (Sharpe, 1995,

pp 3). It is thought that AC 305 will force companies to take a new look at their postretirement benefits, and improve their accounting treatments and disclosures accordingly.

'Actuarial sources have said that the new accounting practice would also have a huge impact on companies' balance sheets, with the omission of this potentially significant liability leading to false or misleading financial statements.' (Sharpe, 1995, pp 3). This means that, Sharpe, who is an actuary, has recognised that the application of AC 305 will result in fairer presentation.

The opinion has been criticised by Pollard (1995, pp 20), as he states that 'the guidelines fail to separate the liability into its two components, namely the subscriptions liability and the age subsidy liability. Until this distinction is made, interpretation of the liability will differ widely, which is contrary to what an accounting standard is supposed to achieve i.e. conformity in interpretation.' The subscriptions liability is defined as 'the present value of the medical scheme subscriptions which the employer can be expected to pay for its current and future pensioners' (Pollard, 1995, pp 5), whereas the age subsidy liability is 'the present value of the excess of postretirement claims over contributions.' (Pollard, 1995, pp 6).

If use is made of commercial funds, the employer is only responsible for the subscriptions liability, if a managed fund is used, the employer is obliged to cover both the subscription and the age subsidy liability. Unfortunately, AC 305 states that 'the liability should be the present value of the estimated future costs of providing the benefits' (para 13) - this causes confusion as it is no longer clear whether the benefits are the subscriptions or the actual medical coverage enjoyed by the members. Pollard goes on to comment that 'if the accounting profession wishes to make only the subscriptions liability a mandatory item in the employer's financial accounts, then a strong case could be made for the medical scheme to bring the age subsidy liability into its financial accounts.' (1995, pp 21).

Sanlam has suggested that in reaction to the issue of AC 305 employers will :

1. Consider the costs and risks relating to offering OPEB.
2. Evaluate possible alternatives to the OPEB currently being offered by the employees.

3. Investigate possible funding opportunities for the previously unfunded liability.
4. Change the accounting treatments and disclosures in the financial statements in compliance with AC 305.

(Ferreira, 1995).

8.6.1. ACTUARIAL CONCERNS

' The South African Accounting Guideline AC305 recognises the accounting principles of FAS106, but it has been clarified that unlike the American standard, the actuarial basis and methodology will be at the discretion of the actuary, subject to suitable disclosure requirements.' (Dutkiewicz, 1996, pp 6). As a result, actuaries will be far more involved in the accounting for postretirement benefits in South Africa than they are in the United States.

' It must be recognised that a valuation for the setting up of a pool of assets for the funding of postretirement healthcare benefits (an actuarial funding valuation) may have a different focus to a valuation for the inclusion of postretirement healthcare costs in the employer's accounts (an accounting valuation). Both share the objective of a quantification of future costs, but the funding valuation is concerned primarily with the long term solvency of the fund of assets built up, while the accounting valuation is aimed at a systematic recognition in the accounts of accruing postretirement costs, and the comparability of such costs between companies.' (Dutkiewicz, 1996, pp 6).

Therefore, in terms of AC 305, the quantification of an OPEB liability will be based on the gross liability value as determined by the actuary, using actuarial assumptions, whereas the American standard prescribes that the liability is quantified on a 'best estimate' or 'market related' basis. This could mean that for South African subsidiaries of US companies (who have to adhere to FAS106), the quantification of the OPEB liability may not be comparable with that of SA companies accounting in terms of AC305.

To further complicate matters, the actuary is responsible for making appropriate assumptions relating to the variation in medical claim costs due to age and gender. Standard tables for this purpose are not available in South Africa and the actuary will need to identify appropriate data sources.

' Most local defined benefit pension fund valuers seem to use the UK a55 or PA90 tables (these tables detail actuarial assumptions used for pensions and OPEB based on statistical information on a country's population), with a few using the newer PML series. These tables are all inappropriate for the South African environment, but lack of local statistics means that there is little better. The PML tables may tend to overstate the longevity of South African pensioners in the next twenty years as South Africa lags far behind the western European ageing population trend even in the more affluent 'assured' population. (Dutkiewicz, 1995, pp 19).

8.7. CURRENT PRACTICE

As AC 305 was only issued in July 1995, the 1995 financial year was the first time that OPEB had been accounted for on the accrual basis for the majority of companies. A review of practices highlights the varying treatments and disclosures that are still occurring, although it is hoped that some degree of consistency will be achieved when a new exposure draft (based on the IASC's E54) is issued in 1998.

Johannesburg Consolidated Investments (JCI) made a provision for future medical aid costs of pensioners in their financial statements for the year ended 30 June 1994. This provision took the form of an extraordinary item 'as it is considered to be closely linked to the unbundling and rationalisation of the group' (JCI, 1994, pp 56). The accounting policy merely states that 'the Group provides for pension and medical aid costs of pensioners over the service lives of employees by contributions to various funds.

Previously, only benefit payments incurred were expensed.' (JCI, 1994, pp 49). It is submitted that this

treatment is no longer acceptable in terms of the new AC 103 statement 'Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policy', as extraordinary items are now extremely rare.

Anglo American Corporation of South Africa have also disclosed their provision for other postretirement benefits since the issue of their 1994 annual financial statements. The accounting policy stated that 'the expected costs of postretirement benefits under defined benefit arrangements are charged to income to spread the costs over the service lives of employees entitled to those benefits. Previously, only benefit payments incurred were expensed. Costs are assessed in accordance with the advice of qualified actuaries. Experience adjustments and prior service costs resulting from plan amendments are amortised over the expected average remaining service lives of relevant current employees.' (Anglo American, 1994, pp 60). The notes then go on to quantify the difference between the costs of benefits charged to the income statement on the cash basis and on the accrual basis, being R30 million in 1994 alone. 'The unfunded accumulated medical aid benefit obligation at 31 March 1997, after deducting tax and minority interests, was R252million (1996: R225million)' (Anglo American, 1997, pp 15).

Otis Limited changed its accounting policy with respect to postretirement medical benefits in the 1996 financial year. 'These have now been accrued for, rather than charged on the previous pay-as-you-go method. The effect of this has been to reduce shareholders' funds by R28,4million as at the end of the year, and an after tax reduction of 14,8 cents in the current year's EPS.' (Otis, 1996, pp 6).

The liability for OPEB has been recognised in the capital employed section of the balance sheet and full disclosure of the change in accounting policy has been made, and disclosures are in terms of the new AC 116, previously, ED 104.

The Rembrandt Group have recognised OPEB in terms of SFAS 106 and have undertaken extensive funding programmes. Note disclosure is as follows:

'In respect of members that retired prior to 1 April 1993, the liabilities as at 31 March 1996 amounted to R1million (1995: R7million). These liabilities have been fully provided for. In respect of all other members the liabilities are being funded uniformly over the service period of each active member. The

past service liabilities at 1 April 1993 are being amortised from that date over twenty years by annual contributions to a separate benefit fund. In respect of service after 1 April 1993 annual contributions are made to the same benefit fund equal to the value of the liabilities arising in respect of that year. As at 31 March 1996 the net liabilities in respect of accumulated past services amounted to R4million (1995: R22million), after taking into account contributions made to the benefit fund.' (Rembrandt, 1996, pp 29).

In general, the disclosure requirements of AC 116 have been modified and applied to OPEB.

It is expected that more consistent and comparable treatment of OPEB will arise in future accounting periods, as AC 305 takes full effect and some clarification on the applicability of AC 116 to OPEB is given. Chapter 12 deals more comprehensively with the treatment of postretirement benefits other than pensions by preparers of financial statements in South Africa.

8.8 CONCLUSION

Although South Africa is lagging behind the US in the quantification and disclosure of OPEB in the financial statements of enterprises, the first steps toward correcting this have been taken with the issue of AC 305.

Much debate seems to have been created by the opinion since its issue in July 1995, attracting attention from actuaries as well as accountants. Such attention is felt to be necessary as:

- 'Prior to the turbulent years recently experienced by the medical aid industry, medical aid subscriptions were a far smaller proportion of payroll costs and therefore less of a concern to employers.
- greater use was made of State hospitals and therefore there was less pressure to be funded in the private medical sector. This is now changing as State care standards are falling far short of private care standards.
- it was taken for granted that the young and healthy would subsidise the old and sick.

- there was no legislation compelling companies to account for this liability.
- there has been a trend towards lower retirement ages, which increases the cost of these benefits substantially.'

(Pollard. 1995, pp 1).

A limited review of present practice has revealed that current accounting treatments seem to be varied, inconsistent and not comparable, with insufficient note disclosure being made. This is further researched in Chapter 12.

It is hoped that AC 305 is merely the first step, and not the final answer on the accounting treatment of OPEB, and as the IASC's position on this issue becomes clearer, so will the guidelines, exposure drafts and standards released by SAICA dealing in this area.

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CHAPTER 9 : SUMMARY OF INTERNATIONAL TRENDS

9.1. INTRODUCTION

The previous six chapters have reviewed the various standards, guidelines and releases issued by accounting bodies in the United States, the United Kingdom, Canada, Australia, South Africa and by the IASC.

The approach adopted in this review was a comprehensive study of the American standard (SFAS 106) which was then used as a basis for the evaluation of other publications dealing with the treatment of OPEB. It was felt that this approach was superior as :

1. SFAS 106 is widely acknowledged as the most detailed standard on OPEB and the majority of standard setting bodies have used it as a basis for their standards.
2. SFAS No. 106 was published in 1990 and its effect on U S enterprises' financial statements and employee benefit management has been well documented. As no other standard has been implemented for as long, indeed, several are still being promulgated, the effect of the standard once published can only be anticipated based on the U S experience.

The following conclusions can be drawn :

9.2. CONCLUSIONS

- There are some instances (highlighted in the previous chapters) where an issued pronouncement - whether in the form of a standard, exposure draft or guideline - has not been set in accordance with the relevant conceptual framework upon which it is supposed to be based.
- The approach taken by the various standard setting bodies has been diverse. The FASB dealt with the treatment of OPEB completely separately from the pension issue, merely recognising that like pensions, other postretirement benefits constitute a form of deferred compensation. The IASC (and some of the other member countries, being Canada, the UK and South Africa) have based the treatment of OPEB on that required by standards on pensions. Although the general treatment is similar, being an expense in the Income Statement and a corresponding credit, representing a liability in the Balance Sheet, many of the more specific issues have not been dealt with (e.g. plan amendments, plan curtailments and settlements etc.) as the pension standards concentrate on the required disclosures in an effort to enable the user to understand the risks associated with the provision of employee benefits by an enterprise. This makes direct comparisons between the standards difficult due to the diverse approaches taken.
- The standard issued by the FASB (SFAS 106) is often cited by other standard setting bodies as a source of guidance in the measurement of OPEB, although disclosure requirements differ from country to country. Such differences in disclosures may be undesirable for both preparers and users of financial statements as it hampers both consistency and comparability on an international level.
- The IASC and some of its member countries have issued pronouncements which deal with the actuarial valuation method which must be used in measuring the OPEB obligation. The disclosures required by these standards also emphasise the role of the actuary. This is never dealt with in the FASB document. This difference further hampers comparability.
- The most contentious areas in the accounting for OPEB seem to be :

- i. The discount rate that should be applied to determine the present value of the OPEB obligation. Currently, settlement rates, risk-adjusted government bond rates and rates related to the return on plan assets are all being used.
- ii. The treatment of the transitional adjustment, representing the change from the cash to the accrual basis of accounting. Currently, practice ranges from a prior year adjustment, immediate recognition in the current year or amortisation. Even the period of amortisation is grounds for dispute as the average remaining working lives of employees is used (the most theoretically correct treatment) in countries other than the US, where an arbitrary 20 year period has been allowed.
- iii. The level of required disclosures. Should the FASB example of more detailed disclosures emphasising the inherent estimation and measurement difficulties be followed?
- iv. The effects of standards dealing with OPEB will vary depending on the environment. In the United States, a country where substantial employee benefits are offered by corporations, the release of SFAS 106 has had a serious impact. The experiences have been well documented in both the popular and more academic press (detailed in chapter 3). But it is submitted that Canada, Australia, the UK and South Africa, where the provision of other postretirement benefits is not as popular, will not experience as dramatic an effect as in the US.
- v. Although the pronouncements issued to date deal with all forms of postretirement benefits, the focus has been on postretirement medical care. In the case of the FASB standard, illustrative examples and the disclosure requirements deal with health care specifically. As a result, the provision of life insurance, tuition assistance, day care, legal services and housing subsidies provided after retirement have not been investigated, although it is the view of the author that these benefits will rarely constitute material amounts.
- vi. The scope of the pronouncements differs. The FASB standard only applies to benefits paid to employees after retirement, being a reward for the provision of services that have already been rendered (refer chapter 3). Pronouncements issued by the other standard setters concentrate on both 'postemployment' and 'postretirement' benefits, the former being a payment to employees

once they cease employment, but before retirement (i.e. due to retrenchment or disability etc.).

This hampers comparability between pronouncements issued to date.

9.3. RESEARCH PROBLEM

The review conducted so far will now be used as a basis for the empirical research (i.e. the questionnaires). These will be used to recommend an acceptable accounting treatment for OPEB within South Africa.

As South Africa is a member of the IASC, any standard dealing with OPEB should be consistent with the international accounting standard dealing with 'Employee Benefits' (E54). However, the previous chapters have detailed various contentious issues in respect of OPEB that have not as yet been satisfactorily resolved by any of the accounting bodies considered (e.g. which discount rate should be used for OPEB and how should the transitional adjustment be accounted for?). These issues will be included in the questionnaires so as to determine the opinions of South African users and preparers of financial statements. Responses received will also be compared to the IASC's E54, so as to establish whether an international accounting standard addresses the needs of South African preparers and users. Current South African accounting standards and guidelines will also be included in the questionnaires to assess their relative success and the level of acceptance they have achieved within the South African environment.

CHAPTER 10 : RESEARCH METHODOLOGY

10.1. INTRODUCTION

In order to determine what the best practice for accounting for postretirement benefits other than pensions for both preparers and users of financial statements might be and make recommendations thereon, it became necessary to obtain the opinions of both parties.

Although this information could have been gathered in a variety of different ways it was felt that a mailed questionnaire would be the most suitable approach.

This decision was based on the following :

- Questionnaires are a cost-effective way of gathering information from a large number of respondents, as the expense involved with interviewing is avoided.
- Uniformity is assured through the use of a questionnaire, whereas questions may be phrased differently in interviews thereby encouraging different replies.
- Questionnaires are not subject to the same geographical constraints as interviews.
- Questionnaires are more time efficient and allow respondents to answer questions in their own time, allowing for more considered responses.
- The responses to questionnaires cannot be influenced by the opinion of the enquirer, as may happen in interviews.

However, the questionnaire approach has some draw-backs :

- Studies have shown that a mail questionnaire has a low response rate.
“For respondents who have no special interest in the subject matter of the questionnaire, figures of 40 percent to 60 percent are typical; even in studies of interested groups, 80 percent is seldom exceeded.”
(Oppenheim, 1972, pp 34).

The effect of this will be considered in a test for low response bias that will be conducted.

- Interviews may generate more valid information as with questionnaires there can be no guarantee that the actual respondent was the intended respondent.
- A respondent to a questionnaire may read the questionnaire in its entirety before beginning to answer any of the questions. This may affect how questions are answered, thereby hampering item independence.

As previously stated, the content of the questionnaires was based on the research detailed in the first nine chapters of this thesis.

10.2. THE QUESTIONNAIRES

Two separate questionnaires were sent out to individuals representing the preparers and users of financial statements.

The purpose of the questionnaire sent to preparers was to :

- determine how many provide an OPEB benefit to employees,
- ascertain how OPEB are currently being accounted for,
- determine what proportion of preparers account for OPEB in terms of AC305,
- ascertain how many of these preparers disclose more information than that currently required by AC305,
- try to ascertain what preparers are willing to disclose in their financial statements, and
- determine which disclosures preparers themselves consider to be the most important.

The purpose of the questionnaires sent to users was to :

- determine whether the users have any knowledge of OPEB,
- the general level of this knowledge,
- whether the different user groups have different needs regarding the disclosure of OPEB,
- their perception of OPEB in a business environment,
- whether the users consider the requirements of AC305 are currently being met by preparers, and
- what users generally desire in terms of OPEB disclosure.

The questionnaires were based on the research of international trends in the accounting for OPEB as conducted in previous chapters. It therefore aimed to highlight the different practices and opinions available that do not contravene the conceptual framework. The questionnaires also tried to determine whether views on OPEB were materially different in South Africa from those held in other countries - is AC 305 adequate for our needs or is a more comprehensive approach such as that required by SFAS 106 more appropriate? An attempt was also made to determine the current trends in the business environment through the use of the questionnaires.

The questionnaires were field tested among academics and accountants in practice who had some understanding of postretirement benefits and had experience in the formulation of questionnaires.

The recommended minor changes following the field tests were made.

The first mailing took place on 1 May 1997, with replies due by 22 May 1997.

The second mailing took place on 18 June 1997, with replies due by 6 July 1997.

10.3. THE RESPONDENTS

These are divided into two separate groups :

Group 1 - This group represents the preparers of financial statements.

The financial directors of the JSE Top 100 listed companies, as per the Financial Mail at 30 June 1995. This list is not materially different (in its entirety) from the Top 100 companies at 30 June 1996 or that at 30 June 1997.

The larger companies were chosen as it was easier to obtain the postal address of these companies. It is felt that these enterprises are more likely to provide OPEB to their employees.

The amounts involved in OPEB offered by these companies are more likely to be material, and hence have more of an impact once disclosed in the financial statements. Finally, these companies are more likely to comply with AC 305. However, a statistical test to determine whether any bias has been introduced by limiting the study to the Top 100 companies will be conducted.

Group 2 - This group represents the users of financial statements.

It was felt that all categories of users who could be affected by the introduction of accounting for postretirement benefits on an accrual basis should be surveyed.

TABLE G : DETAILS OF THE USER GROUP

Number Surveyed:

Source:

15	Investment Analysts selected from the Financial Mail's list of Top Analysts of March 1996.
8	Auditing firms, these included the 'Big Six'. Of the auditors surveyed, most of them were members of the Medical Interest Group of SAICA, and they collectively represented 82% of the auditors of the Top 100 Companies surveyed (i.e. the preparer group)
12	Members of the Shareholders' Association were surveyed. These were randomly selected to participate in this study.
35	Total users surveyed

The auditing firms and the investment analysts represent the more sophisticated users of financial statements. Although the Labour Research Service was approached they did not feel that they could add value to the study.

It was felt that auditors represented users and not preparers as they would be exposed to various postretirement benefits and accounting treatments thereof. Whereas the preparers' questionnaire focused on the policies and practices of a single company, the user questionnaire looked at the current trends and practices within the South African business environment and users' perceptions thereof.

It should be noted that these users were only used to determine whether suggestions and recommendations made in this thesis on how to account for and disclose postretirement benefits other than pensions in financial statements would be acceptable to users.

10.4. THE RESPONSES

Response rates from the mailing of the questionnaires were as follows:

TABLE H : RESPONSE RATES FOR QUESTIONNAIRES

<i>GROUP</i>	<i>TOTAL</i>	<i>FIRST MAILING</i>	<i>SECOND MAILING</i>	<i>TOTAL (%AGE)</i>
Preparers	100 Companies	20	19	39
Users	8 Auditors	5	2	
	15 Analysts	2	1	
	12 Shareholders	3	-	37

Note that of the 39 responses received from the preparers group, only 25 indicated that they did in fact provide OPEB to their employees and as a result only these responses were useable.

Unfortunately, the 14 replies received from preparers that did not provide OPEB to their employees only indicated the number of employees, current retirees and future retirees relevant to the company. The replies did not contain any information relating to disclosure. As a result, no conclusions can be drawn from these responses.

10.5. ANALYSIS AND INTERPRETATION

The responses to the questionnaires are considered in chapters 11 (preparers' responses) and chapter 12 (users' responses).

10.6. STATISTICAL TESTS ON PREPARER QUESTIONNAIRES

In order to validate the responses from the preparers, statistical tests should be conducted on the replies received. Due to the fact that it could not be assumed that a normal distribution existed, non-parametric statistical tests were performed. As Castellan et al states: 'Somewhat more recently, we have seen the development of a large number of techniques of inference which do not make numerous or stringent assumptions about the population from which we have sampled the data. These distribution-free or non-parametric techniques result in conclusions which require fewer qualifications. Having used one of them, we might be able to say that, "Regardless of the shape of the population we may conclude that...."' (1988, pp 3). This means that although the assumptions made on the populations from which the responses have been drawn have been limited, the responses have still been validated for generalisation by using non-parametric statistics.

As only a 39% response rate has been achieved it becomes necessary to test for non-response bias. This means that a test is performed to determine whether the views and opinions of the respondents differ from those that did not respond to the questionnaire. This has to be tested for before it can be assumed that the respondents views are representative of the population as a whole. The approach used to conduct this test

TABLE L : DIFFERENCES BETWEEN AUDITORS AND SHAREHOLDERS

Question No.	Description of Question	Test	P	Accept / Reject
1	Focus of evaluating a company	not tested	-	n/a
2.1	Importance of sources of financial information	Median	0.46	Accept
2.2	Importance of sources of financial information	Median	0.467	Accept
2.3	Importance of sources of financial information	Median	0.083	Reject
2.4	Importance of sources of financial information	Median	0.525	Accept
2.5	Importance of sources of financial information	Median	0.417	Accept
2.6	Importance of sources of financial information	Median	0.417	Accept
2.7	Importance of sources of financial information	Median	0.5	Accept
3	Popularity of OPEB with employers	not tested	-	n/a
4.1	Popularity of types of OPEB	Median	0.4167	Accept
4.2	Popularity of types of OPEB	Median	0.525	Accept
4.3	Popularity of types of OPEB	Median	0.5	Accept
4.4	Popularity of types of OPEB	Median	1	Accept
5	Adequacy of disclosures made	Fischer	1	Accept
6.1	Usefulness of disclosure	Median	0.47	Accept
6.2	Usefulness of disclosure	Median	0.47	Accept
6.3	Usefulness of disclosure	Median	0.5	Accept
6.4	Usefulness of disclosure	Median	0.3	Accept
6.5	Usefulness of disclosure	Median	0.417	Accept
6.6	Usefulness of disclosure	Median	0.175	Accept
6.7	Usefulness of disclosure	Median	0.4167	Accept
6.8	Usefulness of disclosure	Median	0.525	Accept
6.9	Usefulness of disclosure	Median	0.2917	Accept
6.10	Usefulness of disclosure	Median	0.2917	Accept
6.11	Usefulness of disclosure	Median	0.175	Accept
6.12	Usefulness of disclosure	Median	0.5	Accept
6.13	Usefulness of disclosure	Median	0.417	Accept
6.14	Usefulness of disclosure	Median	0.525	Accept
7	Cost vs. benefits constraints	Fischer	0.47	Accept
8	Companies prejudiced by disclosure	Fischer	0.7	Accept
9	Use of OPEB information	not answered	-	n/a
10	Accounting for a transitional adjustment	not tested	-	n/a
11	Split of expense item	Fischer	0.525	Accept
12	Disclosure of liability on balance sheet	not tested	-	n/a

13	Funding of liabilities	Fischer	0.78	Accept
14	Discount rate	not tested	-	n/a
15	Respondent's level of knowledge	not tested	-	n/a
16	Academic qualification	not tested	-	n/a

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TABLE M : DIFFERENCES BETWEEN ANALYSTS AND SHAREHOLDERS

Question No.	Description of Question	Test	P	Accept / Reject
1	Focus of evaluating a company	not tested	-	n/a
2.1	Importance of sources of financial information	Median	0.5	Accept
2.2	Importance of sources of financial information	Median	0.6	Accept
2.3	Importance of sources of financial information	Median	0.05	Reject
2.4	Importance of sources of financial information	Median	0.6	Accept
2.5	Importance of sources of financial information	Median	0.45	Accept
2.6	Importance of sources of financial information	Median	0.2	Accept
2.7	Importance of sources of financial information	Median	0.45	Accept
3	Popularity of OPEB with employers	not tested	-	n/a
4.1	Popularity of types of OPEB	Median	0.6	Accept
4.2	Popularity of types of OPEB	Median	0.6	Accept
4.3	Popularity of types of OPEB	Median	0.45	Accept
4.4	Popularity of types of OPEB	Median	1	Accept
5	Adequacy of disclosures made	Fischer	1	Accept
6.1	Usefulness of disclosure	Median	0.45	Accept
6.2	Usefulness of disclosure	Median	0.45	Accept
6.3	Usefulness of disclosure	Median	0.167	Accept
6.4	Usefulness of disclosure	Median	0.45	Accept
6.5	Usefulness of disclosure	Median	0.46	Accept
6.6	Usefulness of disclosure	Median	0.5	Accept
6.7	Usefulness of disclosure	Median	0.6	Accept
6.8	Usefulness of disclosure	Median	0.45	Accept
6.9	Usefulness of disclosure	Median	0.2	Accept
6.10	Usefulness of disclosure	Median	0.5	Accept
6.11	Usefulness of disclosure	Median	0.45	Accept
6.12	Usefulness of disclosure	Median	0.6	Accept
6.13	Usefulness of disclosure	Median	0.45	Accept
6.14	Usefulness of disclosure	Median	0.17	Accept
7	Cost vs. benefits constraints	Fischer	0.45	Accept
8	Companies prejudiced by disclosures made	Fischer	1	Accept
9	Use of OPEB information	not answered	-	n/a
10	Accounting for a transitional adjustment	not tested	-	n/a
11	Split of expense item	Fischer	0.45	Accept
12	Disclosure of liability on balance sheet	not tested	-	n/a

13	Funding of liabilities	Fischer	1	Accept
14	Discount rate	not tested	-	n/a
15	Respondent's level of knowledge	not tested	-	n/a
16	Academic qualification	not tested	-	n/a

University of Cape Town

TABLE N : DIFFERENCES BETWEEN ANALYSTS AND AUDITORS

Question No.	Description of Question	Test	P.	Accept / Reject
1	Focus of evaluating a company	not tested	-	n/a
2.1	Importance of sources of financial information	Median	0.525	Accept
2.2	Importance of sources of financial information	Median	0.467	Accept
2.3	Importance of sources of financial information	Median	0.525	Accept
2.4	Importance of sources of financial information	Median	0.525	Accept
2.5	Importance of sources of financial information	Median	0.5	Accept
2.6	Importance of sources of financial information	Median	0.292	Accept
2.7	Importance of sources of financial information	Median	0.4167	Accept
3	Popularity of OPEB with companies	not tested	-	n/a
4.1	Popularity of types of OPEB	Median	0.4167	Accept
4.2	Popularity of types of OPEB	Median	0.525	Accept
4.3	Popularity of types of OPEB	Median	0.5	Accept
4.4	Popularity of types of OPEB	Median	0.47	Accept
5	Adequacy of disclosures made	Fischer	1	Accept
6.1	Usefulness of disclosure	Median	0.175	Accept
6.2	Usefulness of disclosure	Median	0.525	Accept
6.3	Usefulness of disclosure	Median	1	Accept
6.4	Usefulness of disclosure	Median	0.3	Accept
6.5	Usefulness of disclosure	Median	0.5	Accept
6.6	Usefulness of disclosure	Median	0.175	Accept
6.7	Usefulness of disclosure	Median	0.4167	Accept
6.8	Usefulness of disclosure	Median	0.47	Accept
6.9	Usefulness of disclosure	Median	0.417	Accept
6.10	Usefulness of disclosure	Median	0.5	Accept
6.11	Usefulness of disclosure	Median	0.47	Accept
6.12	Usefulness of disclosure	Median	0.5	Accept
6.13	Usefulness of disclosure	Median	0.5	Accept
6.14	Usefulness of disclosure	Median	0.47	Accept
7	Cost vs. benefits constraints	Fischer	0.175	Accept
8	Companies prejudiced by disclosure	Fischer	0.7	Accept
9	Use of OPEB information	not answered	-	n/a
10	Accounting for a transitional adjustment	not tested	-	n/a
11	Split of expense item	Fischer	0.3	Accept
12	Disclosure of liability on balance sheet	not tested	-	n/a

13	Funding of liabilities	Fischer	0.7	Accept
14	Discount rate	not tested	-	n/a
15	Respondent's level of knowledge	not tested	-	n/a
16	Academic qualification	not tested	-	n/a

In all cases, except the one mentioned above, there were no instances in which the null hypothesis could be rejected at the ten percent level of significance, and therefore the results of the user questionnaire can be generalised, i.e. the opinions of the various users did not differ significantly and the user group can be considered as a whole.

10.8 CONCLUSION

This chapter has explained the methods used to acquire information regarding OPEB from both user and preparer groups, and the statistical tests conducted to validate the responses received. Detailed analysis of the responses have been considered in chapters 11 and 12.

CHAPTER 11 : ANALYSIS OF PREPARERS' RESPONSES

11.1. INTRODUCTION

Questionnaires were sent to the Top 100 companies as per the Financial Mail's list dated June 1995.

Due to the fact that the responses have already been tested for non-response bias, the answers received from both first and second mailings have been combined.

The format of this chapter follows the structure of the questionnaire, with details of the responses following the questions.

11.2. EMPLOYEE INFORMATION

The first three questions asked respondents for details of the number of employees, current retirees and the estimated number of employees who will retire within the next five years. These questions were asked in order to gain some insight into the average age of employees and the general 'maturity' levels of the companies that responded, and therefore establish what the effect of the adoption of the accrual method of accounting instead of the cash basis would have.

The replies received from companies that provide post retirement benefits other than pensions covered over 260 000 employees and over 33 000 current retirees. Respondents estimate that over 10 000 employees will retire within the next five years. Generally, the responses indicate that South Africa has an ageing work force, as on average the percentage of current retirees to current employees for respondents was 22.66%, with the average expected increase in the number of retirees over the next five years being 44.11%. This means that in five years the estimated percentage of retirees to employees will have increased to 28.63%. The marked increase in the estimated number of retirees means that the service cost of providing health care to retirees will increase within the next five years and into the future, regardless of whether the cash or accrual basis is being used to account for OPEB. However, the costs relating to current retirees will form a transition adjustment and an interest cost component will have to be introduced, both of which will impact the income statement if the accrual basis is adopted.

11.3. NATURE OF BENEFITS

In an effort to determine whether there was any difference between South African OPEB and those OPEB provided in other countries, enquiries were made as to which postretirement benefits were offered by South African firms. One hundred percent of the respondents who provide OPEB made contributions to medical aid funds on behalf of retirees, 8% of respondents also paid medical costs of retirees (i.e. no medical aid fund involved), 12% of respondents made contributions to retirees' life insurance (provided outside a pension fund), 4% offered housing subsidies to retirees and 16% provided special discounts to retirees.

For all of the respondents except one, contributions made to medical aid funds on behalf of retirees are the most financially material OPEB. The remaining respondent indicated that direct payments made to cover retirees' medical expenses were the most material to the company. These results are consistent with the OPEB experiences in other countries where medical costs are also the most material.

An attempt was made to determine the extent to which OPEB are offered to employees, i.e. what percentage of the work force are provided with the various postretirement benefits. The results were as follows:

TABLE O : POSTRETIREMENT BENEFITS OFFERED TO EMPLOYEES

<u>Percentage of workforce</u>	NUMBER OF RESPONDENTS = 25		
	<u>0-33%</u>	<u>34 -66%</u>	<u>67-100%</u>
	Percentage of Respondents		
Contributions made to medical aid funds on behalf of retirees	29.2%	37.5%	33.3%
Payment of retirees medical costs (no medical aid fund)	4%	-	4%
Life Insurance outside a pension plan	8%	-	4%
Housing subsidies after retirement	4%	-	-
Special discounts on products for retirees	8%	-	12%

The results reveal that OPEB are not provided to all employees and as a result the effects of accounting for postretirement benefits other than pensions will in all likelihood not be as material as those experienced in the US. Even in the case of the most expensive OPEB, being payments to medical aid funds, only a third of the respondents provide this benefit to their full work force.

TABLE P : MINIMUM SERVICE PERIOD BEFORE ENTITLED TO BENEFITS

Number of respondents = 24

<u>Response</u>	<u>%</u>	<u>>10 years</u>	<u>5-10 years</u>	<u><5 years</u>
Minimum service period	41.7%	30%	20%	50%
No minimum service period	58.3%			

The table above indicates that the majority of respondents do not require a minimum service period before employees become entitled to OPEB. This means that in terms of the accrual basis, a liability for OPEB should be recognised from the first day of employment. Three respondents indicated sliding scales whereby longer periods of service entitle employees to a greater postretirement benefit.

Respondents all indicated that they had been offering postretirement benefits other than pensions for a number of years, the average period being 25.94 years. Replies ranged from 2 to 60 years.

20.83% of respondents indicated that they have already withdrawn the offer of OPEB to employees who commenced service after a specified date (all dates are 1996 and 1997). Of the remaining respondents, 73.91% responded that there was a plan to reduce the benefits in the future, thereby indicating that attention has been drawn to OPEB and the size of the associated liability through the release of AC 305 and various international standards.

11.4. ADMINISTRATION

Only 28% of the respondents who provide OPEB actually prefund them at the moment, however, of the 72% who did not prefund the benefits provided to their retirees, 83.3% indicated that they did have plans to begin prefunding.

56% of respondents have written agreements to evidence the OPEB they provide to their employees.

The fact that written agreements exist may mean that problems will be encountered in the attempts to reduce the benefits provided as indicated in questions discussed above.

TABLE Q : ACTUARIAL VALUATION

Number of Respondents = 25

Response	%	Annually	Every 2nd Year	Every 3rd Year
No actuarial valuation	8%	-	-	-
Actuarial valuation	92%	39.13%	8.69%	52.18%

This indicates that South Africa, unlike the US, is dependent on the opinion of an actuary to value their OPEB, this should be borne in mind when setting an accounting standard.

91.30% of the respondents who employ an actuary use some of the same actuarial assumptions and data that are used for the pension scheme. This means that the cost of an actuarial valuation is reduced as much of the information needed to make the valuation is already available and being used.

11.5. ACCOUNTING TREATMENT

The most interesting results of the preparers' questionnaire concerned the accounting treatment of postretirement benefits other than pensions. Although AC 305 was issued some time ago (1995), 78.26% of preparers are still accounting for OPEB on the cash basis and only 21.74% have moved to the accrual basis.

A reason for the non-compliance with the statement may be that as yet it has only been awarded 'guideline status', meaning that although SAICA recommend it be complied with, this is not compulsory.

The fact that the majority of preparers are planning to reduce the benefits provided to retirees could be as a result of the fact that the release of AC 305 has focused attention on OPEB and the various risks

associated therewith. The continued use of the cash basis is not necessarily an indication of ignorance, but rather an attempt to avoid the accrual basis and the effects thereof for as long as possible.

TABLE R : ACCOUNTING TREATMENT OF OPEB

Number of Respondents = 23

Response	%	Plan to Change Basis	No Change Planned	Not Answered
Cash Basis	78.26%	44%	50%	6%
Accrual Basis	21.74%	-	-	-

Responses revealed that there is still some uncertainty as to how the change of accounting from the cash to the accrual basis will be accounted for. Two respondents replied that a prior year adjustment (PYA) will be used to effect the change, two specified an amortisation period over which an adjustment would be charged to the income statement. Single respondents each suggested that the charge would be separately disclosed in the income statement, charged to the income statement but not separately disclosed and disclosure made in the directors' report and notes to the annual financial statements. The remaining respondent did not specify how the transition from the cash to the accrual basis would be accounted for.

From the responses received it has become evident that two respondents are considering utilising pension fund surpluses and pension fund holidays to fund any postretirement benefits that the company may offer. Most disturbing is the fact that one respondent is considering shifting from a defined benefit pension scheme to a defined contribution scheme, the excess funds representing the difference in the schemes could then be utilised to fund any OPEB provided to retirees. Such a move would shift some of the responsibility of providing for retirement from the employer to the employee.

Three preparers currently using the accrual basis indicated that they had made a move to this accounting basis in the past two to three years, the move being caused by the release of AC 305 (one respondent), the

issue of various international standards on the subject of OPEB (one respondent), and one responded that it was due to internal requirements (unbundling). One respondent indicated that the accrual basis of accounting for OPEB had always been used and cited the conceptual framework as the reason for the use of this basis. The fifth did not answer the question.

One respondent had accounted for the change from the cash to the accrual basis (i.e. a transitional adjustment) as a 'material' item and as such disclosed separately in the income statement. The other three respondents did not reply to that particular question, and the fifth respondent had always made use of the accrual method.

There does not appear to be any uniformity in the disclosure of a liability relating to OPEB in the balance sheet of preparers. Practices include disclosing a separate long term liability, including the OPEB liability with other long term liabilities and therefore not separately disclosing it and including it with other short term liabilities. There also does not appear to be any agreement on the discount rate that should be used to present value the liability relating to OPEB. Respondents used an expected rate of return on plan assets and an estimated inflation rate. The differing practices make comparisons difficult and indicate that some form of guidance is needed from SAICA on how the actual mechanics of the calculations should best be performed. There does however appear to be agreement between respondents that only a single charge be made to the income statement and not split it into the various components (i.e. service and interest cost components) as required by SFAS 106.

11.6. OBJECTIVES AND DISCLOSURE

The objective of preparers in disclosing information about postretirement benefits other than pensions are mainly to comply with generally accepted accounting practice (55%), give meaningful disclosures (25%), disclose any unfunded liabilities (15%), and to please the auditors (5%).

Actual disclosures made in the annual financial statements seem to be similar. The results are as follows, percentages indicate percentage of respondents making these disclosures:

TABLE 5 : CURRENT DISCLOSURES BEING MADE IN RESPECT OF OPEB

Number of respondents = 25

<u>DISCLOSURES</u>	<u>% RESPONDENTS</u>
• A description of the accounting policy.	60%
• The types of benefits provided.	44%
• Details of the groups of employees covered.	40%
• Details of the date of the last actuarial valuation.	40%
• A description of the funding policy.	32%
• The date of the next valuation.	28%
• The opinion of the actuary.	24%
• No disclosures made	20%
• A description of the nature of the plan assets held.	8%
• In respect of health care, the health care cost trend rate.	4%
• Details of any amortisation period used.	4%
• The discount rate(s) used to measure the liability.	0%
• Quantification of the effect a 1% change in the assumed rates would have on the liability.	0%
• Details of any settlement or curtailment that may have occurred during the financial year.	0%

As can be seen from the above, many companies in South Africa are not as yet making any disclosures in their annual financial statements regarding the postretirement b

enefits other than pensions that they may offer to their employees. In cases where disclosures have been made, they are normally based on those made for pensions and the disclosures specific to OPEB, being the health care cost trend rate and a discount rate, which are required by SFAS 106 are not being made in South Africa.

11.7. IDENTITY OF RESPONDENTS

Although the questionnaires were originally sent to financial directors, there were cases where they had been completed by other employees. Fourteen responses were completed by financial directors, and eleven by pension fund administrators. The identity of the actual respondent will only have affected the questions relating to the accounting of OPEB, as pension fund administrators may not have the necessary accounting knowledge.

Of the 25 responses received, 23 gave details of their accounting basis in respect of OPEB. Of the two respondents that did not reply, one questionnaire had been completed by a financial director and the other by a pension fund administrator. The latter may not have had any knowledge in respect of the accounting policy relating to OPEB. Of the 18 respondents making use of the cash basis, 8 indicated that they were planning to change to the accrual basis, 9 replied that had no such intention to change. The respondent who did not reply to the question was a financial director.

Of the five respondents making use of the accrual basis, one reply did not give any answers for question 16 (i.e. the question dealing with the disclosure of the liability, discount rate and income statement charge), this questionnaire had been completed by a pension fund administrator who may not have had the knowledge necessary to answer the question. Similarly, five respondents did not provide any details of their company's note disclosure for OPEB. Three of these were financial directors, and their non-response was taken to mean that no such disclosure was currently being made in the annual financial

was adopted by Oppenheim (1972), in which the first eight responses received are compared to the last eight responses received as these had to be requested for a second time and therefore represent non-respondents. Different statistical tests are designed to be performed on the various question types - nominal questions (with yes / no replies) were tested by using the Fischer exact probability test. When nominal data had more than two possible replies, the Chi-squared two sample test was used. For all questions except two, in no instances could the null hypothesis (i.e. that the two samples are from the same population) be rejected at the 10% significance level. The exceptions were the questions dealing with information relating to OPEB disclosed in the annual financial statements of preparers (question 18) and that dealing with cost versus benefits (question 19). This means that it does not appear from the statistical tests performed that the opinions of those that did not respond to the question would have been very different from those that did respond.

It was not possible to perform statistical tests on all the questions as they could not be classified as nominal and did not involve ranking or rating procedures. The questions which were not statistically tested were for interest purposes only (e.g. the number of employees, retirees and expected retirees).

A summary is supplied below.

TABLE I : TEST FOR NON-RESPONSE BIAS: PREPARERS

Question No.	Description of Question	Test	P or X2	Accept / Reject
1	Number of employees	not tested	-	n/a
2	Number of current retirees	not tested	-	n/a
3	Employees expected to retire in 5 years	not tested	-	n/a
4	Benefits provided by employer	Chi squared	5	Accept
5	Costliest benefit provided	not tested	-	n/a
6	Percentage of workforce covered by benefit	not tested	-	n/a
7	Minimum service period before qualify for benefit	Fischer	0.233	Accept
8	Length of time providing benefit	not tested	-	n/a
9	Plan to change benefits	Fischer	0.315	Accept
10	Prefunding of benefits	Fischer	0.327	Accept
11	Written agreement with employee detailing benefits	Fischer	0.305	Accept

12	Actuarial valuation performed	Fischer	0.22	Accept
13	Actuarial assumptions used	Fischer	0.308	Accept
14	Accounting treatment used	Chi squared	0.66	Accept
15	Change from the use of the Cash or Terminal Funding Method	Fischer	0.363	Accept
16	Use of the Accrual Basis	Fischer	0.536	Accept
17	Objective of disclosure in financial statements	not tested	-	n/a
18	Current disclosures made	Chi squared	9.95	Reject
19	Cost vs benefits constraints	Fischer	0.075	Reject
20	Respondent had different opinion to that of their company	not tested	-	n/a
21	Position within company	not tested	-	n/a

As only the Top 100 companies had been surveyed, there was a chance that the results could have been biased as the opinions and views of these respondents could differ significantly from the smaller companies not surveyed. To test for this bias, the respondents were divided into two separate groups, being the Top 30 companies and the remaining seventy companies making up the Top 100. Nine respondents fell into the first category and 16 into the second. The same statistical tests were applied as in the test for non-response bias and the null hypothesis could only be rejected for the question on disclosure (question 18) at the 10% significance level, in all other cases it could not be rejected. This means in all cases but one, the responses from the first group did not differ significantly from the second group and hence the preparer group as a whole could be considered.

A summary is supplied below.

TABLE J : LARGE COMPANY BIAS: PREPARERS

Question No.	Description of question	Test	P or X2	Accept / Reject
1	Number of employees	not tested	-	n/a
2	Number of current retirees	not tested	-	n/a
3	Number of employees expected to retire in 5 years	not tested	-	n/a
4	Benefits provided to employees	Chi squared	2	Accept
5	Costliest benefit provided	not tested	-	n/a
6	Percentage of workforce covered by benefit	not tested	-	n/a
7	Minimum service period before qualify for benefit	Fischer	0.32	Accept
8	Length of time providing benefit	not tested	-	n/a
9	Plan to change benefits provided	Fischer	0.365	Accept

10	Prefunding of benefits provided	Fischer	0.318	Accept
11	Written agreement of benefits with employee	Fischer	0.277	Accept
12	Actuarial valuation of benefits	Fischer	0.4	Accept
13	Actuarial assumptions made	Fischer	0.359	Accept
14	Accounting treatment of OPEB	Chi squared	4.018	Accept
15	Planned change from Cash or Terminal Funding Method	Fischer	0.294	Accept
16	Accrual basis of accounting	Fischer	0.571	Accept
17	Objective of disclosures made	not tested	-	n/a
18	Current disclosures made	Chi squared	7.91	Reject
19	Cost vs benefits constraints	Fischer	0.380	Accept
20	Whether respondent has different opinion to that of company	not tested	-	n/a
21	Position within company	not tested	-	n/a

The statistical tests applied to the preparers responses revealed that with the exception of question 18 dealing with disclosure for both non-response and large company bias, and question 19 dealing with the issue of costs versus benefits for non-response bias, the results could be generalised. In all other cases, neither non-response nor large company bias was significant.

10.7. STATISTICAL TESTS PERFORMED ON THE USER QUESTIONNAIRES

As with the preparer group, non-parametric tests were used to test for non-response bias. Once again, the questions were divided into various types and statistical tests were done accordingly. Note that the Median test was performed on ordinal data as these questions called for respondents to rate and not rank certain alternatives, this meant that ranking tests, for example the Mann-Whitney U test was not applicable.

Unfortunately, some questions could not be tested as they were nominal with more than two possible replies. The relevant statistical test, the Chi-Squared two sample test can only be applied to larger sample sizes (Castellan et al, 1988, pp 123). Details are presented below. Note that there were no instances in which the null hypothesis could be rejected for non-response bias for users. These results can therefore be

generalised as based on the statistical tests performed it seems that the opinions of those who did not reply to the questionnaire are not materially different from those who did reply.

TABLE K : NON RESPONSE BIAS - USERS

Question No.	Description of Question	Test	P	Accept / Reject
1	Focus of evaluation when evaluating a company	not tested	-	n/a
2.1	Important sources of financial information	Median	0.419	Accept
2.2	Important sources of financial information	Median	0.419	Accept
2.3	Important sources of financial information	Median	0.122	Accept
2.4	Important sources of financial information	Median	0.2937	Accept
2.5	Important sources of financial information	Median	0.44	Accept
2.6	Important sources of financial information	Median	0.195	Accept
2.7	Important sources of financial information	Median	0.122	Accept
3	Popularity of OPEB with South African companies	not tested	-	n/a
4.1	Popularity of types of OPEB	Median	0.44	Accept
4.2	Popularity of types of OPEB	Median	0.293	Accept
4.3	Popularity of types of OPEB	Median	0.367	Accept
4.4	Popularity of types of OPEB	Median	1	Accept
5	Adequacy of disclosures currently being made	Fischer	0.769	Accept
6.1	Usefulness of disclosure	Median	0.503	Accept
6.2	Usefulness of disclosure	Median	0.472	Accept
6.3	Usefulness of disclosure	Median	0.367	Accept
6.4	Usefulness of disclosure	Median	0.367	Accept
6.5	Usefulness of disclosure	Median	0.44	Accept
6.6	Usefulness of disclosure	Median	0.197	Accept
6.7	Usefulness of disclosure	Median	0.367	Accept
6.8	Usefulness of disclosure	Median	0.419	Accept
6.9	Usefulness of disclosure	Median	0.441	Accept
6.10	Usefulness of disclosure	Median	0.188	Accept
6.11	Usefulness of disclosure	Median	0.503	Accept
6.12	Usefulness of disclosure	Median	0.489	Accept
6.13	Usefulness of disclosure	Median	0.367	Accept
6.14	Usefulness of disclosure	Median	0.472	Accept
7	Cost vs. benefits constraints	Fischer	0.189	Accept
8	Companies prejudiced by disclosure	Fischer	0.769	Accept
9	Use of OPEB information	not answered	-	n/a
10	Accounting for a transitional	not tested	-	n/a

	adjustment			
11	Split of expense item	Fischer	0.196	Accept
12	Disclosure of liability on balance sheet	not tested	-	n/a
13	Funding of liabilities	Fischer	0.25	Accept
14	Discount rate	not tested	-	n/a
15	Respondent's level of knowledge	not tested	-	n/a
16	Academic qualification	not tested	-	n/a

Tests were also conducted on the three different user groups, namely analysts, auditors and shareholders, to determine whether there were any statistically significant differences in the responses of each group. In only one case, the question dealing with the importance of the various sources of information (question 2.3), did statistically significant differences exist between analysts and shareholders and auditors and shareholders.

Details are presented below.

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statements. The other two respondents were pension fund administrators who may not have been aware of the disclosures their company is currently making.

11.8. CONCLUSION

Based on the questionnaires sent to the Top 100 companies, the following conclusions can be drawn :

1. Although a response rate of 39% was achieved, 14 of the 39 respondents replied that they did not offer postretirement benefits other than pensions. The questionnaires revealed that OPEB are often offered to portions of the workforce only. As a result the release of any standard calling for accrual accounting for OPEB in South Africa will not affect all companies and it does not appear that it would have as drastic an impact as that experienced in the U S, even though South African companies are relatively 'immature', meaning that the current charges to the income statement on the cash basis are much lower than they would be on the accrual basis. Of the OPEB provided by South African companies, contributions to retirees' medical aid funds are the most popular and the costliest.
2. The replies indicated that although AC 305 had drawn attention to the possible implications of failing to prefund OPEB and respondents are planning to reduce benefits and/or fund them in the future, most companies are still accounting for these benefits on the cash basis and are not making adequate disclosures. This indicated that there is an urgent need for a South African standard.
3. The level of the respondents' knowledge regarding OPEB was generally low. There was little consensus as to how disclosure should be made in the annual financial statements, or what discount rate should be used. A reason for this may be the fact that often the questionnaires were completed by pension fund administrators who have limited knowledge of accounting concepts, or that companies are still in the process of deciding what the company's policy for OPEB should be.

4. South Africa is definitely moving towards a commercial fund scenario in respect of medical costs, as the respondents indicated that they made use of external medical aid funds as opposed to paying for a retirees medical costs.

5. Companies are considering the various options that are available to them in respect of funding the OPEB liability or withdrawing the benefits they are currently providing. Responses received revealed that some companies are considering moving from a defined benefit pension fund to a defined contribution fund, using the excess funds resulting from this change to fund their OPEB liability. Another respondent was considering utilising the pension fund surplus to fund the OPEB liability.

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CHAPTER 12 : ANALYSIS OF USERS' RESPONSES

12.1. INTRODUCTION

The format of this chapter follows the structure of the questionnaire, with details of the responses following the questions.

As stated in chapter 10, the user group consisted of investment analysts, auditors and shareholders.

Therefore in analysing their responses to the questionnaire, attention will be drawn to any differences in the answers given by each of the user groups.

Due to the fact that the responses have already been tested for non-response bias, the answers received from both first and second mailings have been combined.

12.2. SOURCES OF FINANCIAL INFORMATION

The first question was asked to determine how users evaluate a company, the purpose of this question was to establish how users would react to a change in accounting for OPEB from the cash to the accrual basis.

Six of the respondents recognised financial performance as the most important factor to be considered when evaluating a company, of these the majority were auditors (71% of auditors indicated financial performance was the most important). This implies that users place some emphasis on the income statement. Therefore any large charge relating to a change from the cash basis to the accrual basis made through the income statement may be negatively perceived by users and may affect a company's share price. Other replies given by the respondents were growth potential (by 3 of the respondents), management ability (by 2 of the respondents), financial position (by 1 respondent) (similarly to financial

performance, a large liability relating to OPEB disclosed in the balance sheet may be negatively perceived) and one respondent replied that accountability was the most important criteria to consider when evaluating a company.

The second question attempted to establish which are the most important sources of financial information as far as users are concerned, and made use of a rating scale. A rating of one represented high importance, 2 moderate importance, 3 average importance, 4 below average importance and 5 low importance.

Consistent with the replies received for the first question, respondents rated the various sources of information as follows :

TABLE T : IMPORTANCE OF SOURCES OF FINANCIAL INFORMATION

Number of respondents = 13

Description	Average rating
Balance Sheet	1.23
Income Statement	1.38
Cash Flow Statement	2.54
Interviews with Management	2.65
Directors' / Chairman's Report	2.80
Industry Reports	3.38
Press Articles	3.92

These responses imply that any accounting standard that would cause companies to recognise large liabilities in the balance sheet and/or large charges in the income statement may affect the users' perception of a company and although the change may be explained and justified in the Chairman's or Directors' reports, there is a danger that this information may be ignored by some users.

It is interesting to note that although individually sources of information were sometimes given a rating of 5, on average these ratings decreased as other respondents rated the same sources of information as being more important. This reveals that different users attach importance to different sources of information.

12.3. TYPES AND EXTENT OF BENEFITS

Questions were asked regarding which OPEB users believe are offered, and the frequency with which they are offered by enterprises. This was done in an attempt to gauge the extent to which the users had been exposed to OPEB, the level of their knowledge in this regard and the popularity of the benefits provided.

Responses as to how often postretirement benefits other than pensions are encountered by users varied.

One respondent replied that firms that offered OPEB were encountered all the time, however this was the response of an auditor who specialised in this area, other responses were 'often' (4 respondents), 'occasionally' (4) and 'rarely' (4).

The differing responses can be attributed to the various user groups, with auditors (those auditors selected are experts on dealing with accounting issues relating to pensions, health care and OPEB) being exposed to more OPEB benefits than shareholders and investment analysts.

Users indicated that employers paying employees' medical costs were the most popular type of benefit (on average rated 1.85 on a scale of 1 to 5, with 1 representing very popular, 2 popular, 3 average, 4 below average and 5 unpopular). Table U, below, provides details of the perceived popularity of the various types of postretirement benefits that employers are providing to employees.

TABLE U : TYPES OF BENEFITS PROVIDED

Number of respondents = 13

Type of Benefit	Average Rating Awarded
Employer pays retiree's medical costs	1.85
Employer pays a portion (or all) of retiree's medical aid costs	2.38
Employer gives discounts on their products to retirees	3.15
Employers provide housing subsidies to retirees	3.31

(Note that the other benefits were not ranked by respondents)

The fact that none of the benefits were given a rating of one implies that there is a perception among users that OPEB are not as popular within South Africa as they are in the US, for example. Although this may be attributable to some degree to the fact that these benefits have not previously been disclosed. It is also interesting to note that users believe that most companies providing OPEB do so by paying their retirees' medical costs and fewer make use of an external medical aid fund, into which they pay the retirees' contributions.

12.4. DISCLOSURES

Twelve of the thirteen respondents indicated that disclosures relating to OPEB are inadequate, one shareholder indicated that they were considered adequate.

Such a response reveals that users recognise the need for an official accounting standard dealing with OPEB in South Africa.

As regards disclosure of a charge made for OPEB in the income statement, five respondents feel that it is more meaningful to split the charge into the various components (as specified by SFAS 106) of current service charge and interest cost components. Interestingly, the other eight users surveyed felt that this split could be misleading and may not add value.

There was little consensus regarding the disclosure of a liability in the balance sheet:

Three respondents felt that the OPEB liability should be described as long term in nature and separately disclosed as such. Seven felt that the liability should be split into long and short term categories and separately disclosed, two said that it should be split into long term and short term categories but not separately disclosed in the balance sheet and one did not reply to the question.

The response to the question of useful disclosures regarding OPEB differed among user groups.

Generally the auditors favoured disclosures which were more in line with those currently used for pensions. One auditor responded that all disclosures detailed in the question were needed.

Generally, the following disclosures were recognised as essential by the auditors surveyed :

- disclosure of accounting policy,
- funding policy,
- the opinion of the actuary and
- details of unfunded benefits.

Auditors were undecided (approximately 50:50 split) as to whether the health care cost trend rate and present value details were needed for disclosure purposes.

Analysts rated the disclosure of unfunded benefits and the opinion of the actuary as being necessary disclosures, the remaining disclosures were not highly rated. However this may cause problems as the area of OPEB is a complex one and extensive disclosures often need to be made to obtain an understanding of the concept and benefits offered. Minimum disclosures therefore may be misleading and cause confusion.

The opinions of the shareholders differed, one specified that pension-type disclosures were desirable, one shareholder indicated that almost all disclosures were necessary and the third specified the unfunded benefits should be disclosed, as well as the accounting and funding policies and the opinion of the actuary.

The diverse nature of the needs of the various users indicate that extensive disclosures may be necessary to satisfy the majority of user groups. The respondents, as a whole, rated the disclosures as follows (from most to least important):

**TABLE V : DISCLOSURES RELATING TO OPEB RATED FROM MOST IMPORTANT TO
LEAST IMPORTANT**

1. A description of the accounting policy for postretirement benefits.
2. The opinion of the actuary as to the state of the fund.
3. Details of any unfunded benefits the entity may be held liable for.
4. A description of the funding policy.
5. The date of the last actuarial valuation.
6. Details of any settlement or curtailment that may have occurred during the financial year.
7. The types of benefits provided.
8. Details of the employee group provided with these benefits.
9. A description of the nature of the plan assets held.
10. Details of any amortisation periods used.
11. The date of the next actuarial valuation.
12. For postretirement health care, the assumed health care cost trend rate.
13. The discount rate(s) used to present value the liability.
14. Quantification of the estimated effect a 1% change in the assumed rates would have on the liability.

Nine of the users surveyed felt that the benefits of extensive disclosures (as listed above) outweigh the cost of making such disclosures due to the fact that the information is necessary to assess the potential liability and most of that which would be disclosed is available to fund managers anyway. The remaining four respondents answered that costs outweighed the benefits and gave the reasons that sometimes management have to employ consultants to gather the information required and the only really essential piece of information needed is the size of the previously undisclosed liability.

Twelve of the thirteen respondents were of the opinion that companies are not prejudiced by extensive disclosures, one respondent answered that companies are prejudiced. This implies that users would not tolerate fewer disclosures based on the fact that companies may argue that by becoming more 'transparent' (by making extensive disclosures) they may lose their competitive edge.

12.5. USE OF DISCLOSURES

The question dealing with how respondents make use of information dealing with postretirement benefits was only answered by three respondents, all of whom indicated that they used the information to assess the liability and to determine whether there is adequate funding for such liabilities.

12.6. ACCOUNTING TREATMENT

Respondents had differing opinions on how a change from the cash to the accrual basis for accounting for postretirement benefits other than pensions should be accounted for, the results were as follows:

TABLE W: ACCOUNTING FOR A CHANGE FROM THE CASH TO THE ACCRUAL BASIS

Number of respondents = 13

Description	%
Prior year adjustment	38.5%
Material item separately disclosed	38.5%
Amortised over a specified number of years	23%

All of the respondents answered that there was a difference between funded and unfunded liabilities, which means that users may have some knowledge of the implications of an unfunded OPEB liability.

The discount rate also seemed to cause some confusion for the user respondent group.

One responded that the WACC should be used, five favoured the use of a settlement rate, three felt that the expected rate of return on plan assets would be more correct. In cases where the OPEB are not funded, there are no plan assets and hence this return cannot be used. Four did not respond to the question.

12.7. CONCLUSION

From the questionnaire sent to the user group, which included auditors, investment analysts and shareholders, the following conclusions can be drawn :

1. Users recognise that OPEB is a contentious issue and are aware that there is a certain amount of risk to which the provider of such benefits is exposed.
2. However, the level of knowledge in respect of OPEB was generally low. The more technical questions (for example, those relating to the discount rates and the disclosure of OPEB in annual financial statements) had high non response rates.
3. Users perceive the payment of retirees' medical costs to be the most common other postretirement benefit provided to employees.
4. Users have indicated that the disclosures which are currently being made in respect of postretirement benefits other than pensions are inadequate and have expressed a desire for more clarification and transparency in annual financial statements.
5. The various user groups had markedly different perspectives and needs as regards the information disclosed in annual financial statements. This means that extensive disclosures in respect of OPEB will have to be made if all the needs of users are to be addressed.
6. Unfortunately, due to the fact that the users surveyed evaluated companies on their financial performance and position, a change from the cash to the accrual basis may be negatively received and may result in a drop in share prices.

CHAPTER 13 : CONCLUSIONS ON THE USERS AND PREPARERS' QUESTIONNAIRES.

13.1 INTRODUCTION

This chapter aims to draw together some of the issues that arose from both the users and preparers' questionnaires so as to compare and contrast opinions and needs of both parties. Such an exercise is essential if both users and preparers are to be satisfied by an accounting standard dealing with postretirement benefits other than pensions.

In order to make such comparisons, similar questions were asked in both sets of questionnaires. These will now be analysed in detail so as to try and determine what users and preparers actually look for in an accounting standard and how they would react to it.

13.2 PERCEPTIONS OF BENEFITS OFFERED

Preparers indicated that the benefit they offered most frequently to retirees takes the form of postretirement medical care paid to an external medical aid fund, being their share of the retirees' medical aid contributions. Users responded that an enterprise's payment of a retirees medical costs (i.e. no medical aid fund involved) is the most popular benefit provided.

The differences in perceptions between the two respondent groups could possibly be attributed to the lack of disclosures currently being made by the preparers and the lack of knowledge as regards OPEB of the

user groups surveyed. Users should be made aware of the fact that a company is exposed to less risk by contributing to a medical aid fund than if they were paying for retirees medical costs.

The fact that in many cases a medical aid fund is used instead of the employer paying medical costs directly, may reduce the liability of the employers as they are not liable for any possible shortfall in the medical aid funds. An accounting standard should require disclosure of the actual arrangement as regards the provision of postretirement benefits and the extent to which these benefits are provided to employees (in most cases the OPEB were only offered to a portion of the workforce) so that users can assess the true liability and the risk to which the employer is exposed through the provision of such benefits.

13.3 DISCLOSURES

Currently the disclosures made by preparers of financial statements regarding OPEB are poor. This was indicated by both the user group in response to a direct question and by the answers given by the preparers themselves (where it was found that 20% of respondents did not make any disclosures in respect of OPEB).

Responses indicated that both groups take some comfort from the involvement of an actuary in the valuation of both the liability and the financial position of any existing fund, although Table X reveals that users place more importance on the opinion of the actuary (rated as the 2nd most important disclosure) than is currently being disclosed by preparers (only 24% disclosed the opinion of the actuary). This indicates that the US type disclosures, where actuaries are not involved but extensive disclosures are made of how liabilities have been calculated, would not be welcomed in South Africa. Rather, the practices followed by the IASC where actuaries are involved in the valuation process should be included in a South African standard. This means that the actuarial concerns as noted in chapter 8, should be addressed if they are to be involved in the valuation of an OPEB liability.

TABLE X : DISCLOSURES RELATING TO OPEB RATED BY USERS (FROM MOST TO LEAST IMPORTANT) AND PERCENTAGE OF PREPARERS THAT MAKE DISCLOSURE.

DESCRIPTION	USER RATINGS	% OF PREPARERS
A description of the accounting policy for postretirement benefits.	1	60%
The opinion of the actuary as to the state of the fund.	2	24%
Details of any unfunded benefits the entity may be held liable for.	3	-
A description of the funding policy.	4	32%
The date of the last actuarial valuation.	5	40%
Details of any settlement or curtailment that may have occurred during the financial year.	6	0%
The types of benefits provided.	7	44%
Details of the employee group provided with these benefits.	8	40%
A description of the nature of the plan assets held.	9	8%
Details of any amortisation periods used.	10	4%
The date of the next actuarial valuation.	11	28%
For postretirement health care, the assumed health care cost trend rate.	12	4%
The discount rate(s) used to present value the liability.	13	0%
Quantification of the estimated effect a 1% change in the assumed rates would have on the liability.	14	0%

Although users place some importance on the disclosure of the funding policy relating to OPEB, only 32% of preparers have made this disclosure. A reason for this may be the fact that most OPEB are not funded, and as such no plan assets are held (only 8% of preparer respondents made this disclosure). Due

to the fact that the majority of preparers are still accounting for OPEB on the cash basis, no amortisation periods are used. Both users and preparers do not seem to feel that the disclosure of discount rates, the health care cost trend rates and the effects of a 1% change in these rates are particularly useful or necessary.

As regards cost versus benefit constraints, generally both respondent groups believe that the benefits of OPEB disclosure outweigh the costs. This may be due, in part, to the fact that the data used in determining the pension obligations of employers are being used to value OPEB, thereby reducing the costs of making OPEB disclosures.

Preparers indicated that their objective in making disclosures in respect of OPEB is to comply with generally accepted accounting practice. It is therefore important that the disclosures required by a South African standard meet the needs of users of financial statements.

As a result of the fact that South African companies are generally 'immature' (i.e. have a low number of retirees compared to the current workforce) the disclosure of the change from the cash basis to the accrual basis may be material as at present the charges made to the income statement on the cash basis are small. Unfortunately, the users' responses revealed that a change from the cash to the accrual basis that impacts the balance sheet and income statement will, in all likelihood, be negatively perceived by users and may lead to a fall in the company's share price.

Funding arrangements for OPEB should be extensively disclosed. Users realise there is a difference between funded and unfunded liabilities and require clarification on the status of the OPEB liability. Any arrangements that are made to fund the liability, including the move from a defined benefit pension fund to a defined contribution fund and the utilisation of a pension fund surplus should be required disclosure in terms of an accounting standard, if allowed at all.

13.4 ACCOUNTING ISSUES

There is still some doubt in the minds of both users and preparers surrounding the recognition of liabilities, expenses and any transitional adjustments in financial statements. Although both groups indicated that separate disclosure of a liability is desirable, there was some uncertainty over whether it should be split into long term and current categories. Users indicated that an income statement charge should not be split into the various components as this would cause confusion and not add substantial benefit. This should be borne in mind in the development of a South African standard.

As regards the transitional adjustment users were in agreement that it should be separately disclosed. There was indifference as to whether it was treated as a prior year adjustment or written off in full through the income statement. Insufficient preparers responded to provide any meaningful insight into how they would account for such a transitional adjustment.

13.5 CONCLUSION

As discussed in the introduction, it is necessary to analyse both the needs of users and the opinions of preparers before recommending an accounting treatment for OPEB in a South African standard in order for the standard to achieve a level of acceptance and therefore success within the South African environment.

Unfortunately, the responses indicated that the level of knowledge among both users and preparers of financial statements was poor and therefore extensive disclosures should be made in respect of OPEB in

order to ensure that users understand the risks to which the preparers are exposed and the preparers in turn can provide some comfort that large unfunded liabilities do not exist.

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CHAPTER 14 : CONCLUSION AND RECOMMENDATIONS

14.1 CONCLUSION

This aim of this study was to recommend a conceptually sound method of accounting for postretirement benefits other than pensions in the South African environment. To do this it has been necessary to consider the experiences and practices in other countries. The thesis took an in-depth look at the U S due to the fact that their accounting standard has been in issue for seven years and the effects thereof have been well documented. There is a perception that other countries (specifically the UK, Canada, Australia and South Africa) will not experience the effects of an accounting standard dealing with OPEB to the same extent as the US did as the provision of these benefits is not as prevalent. Unfortunately, the UK, Canada, Australia and South Africa have all been slower to issue standards than the U S. This may mean that the effects of standards could still be dramatic although not fully experienced as yet, and hence not fully documented.

It was necessary to ensure that the standards and exposure drafts that had already been issued were in conformity with the relevant conceptual framework so as to check that the standards themselves were conceptually correct.

Several differences were noted between standards and conceptual frameworks and between the conceptual frameworks themselves - this should mean that the standards based upon the conceptual frameworks would differ. To summarise, these differences were as follows,

1. Although the conceptual frameworks mention the substance over form concept, this has not been applied in all aspects of accounting for OPEB. An employee will only become entitled to OPEB on retirement, yet the accounting standards issued to date specify that full accrual for the liability in respect

of OPEB must have taken place by the employee's eligibility date. This could be years before retirement actually takes place.

2. Conceptual frameworks deal with the prudence concept, in which a conservative approach to accounting should be adopted. SFAS 106 contravenes this by allowing the transitional adjustment to be amortised over the longer of the average remaining working lives of employees and twenty years.

3. Differences were found among the conceptual frameworks in respect of the interpretation of 'probability'. This may mean that liabilities could be recognised in some countries and not in others, due to the fact that the probability criterion has not been complied with.

4. In several standards, the transition obligation could be spread over the estimated average remaining working lives of employees. However, any change in the benefits provided have to be recognised and accounted for immediately in respect of retired employees (in terms of the prudence concept). This is inconsistent as the original benefits have not been totally recognised, but changes to these benefits must be recognised immediately.

5. Although estimates are allowed in respect of health care cost trend rates, standards preclude assumptions about future plan amendments which management may have both the power and the intention to implement. This is inconsistent.

Although there is unanimous agreement by the various international accounting bodies that OPEB meet the definition of a liability and should be accounted for on the accrual basis as postretirement benefits other than pensions are a form of deferred compensation, there are differences between the various pronouncements that have been issued by international accounting bodies to date. The standards differ depending on whether they deal with both OPEB and pensions in detail, OPEB separately or were originally pension accounting standards that have subsequently been applied to OPEB. The level of disclosures and the detail with which the standards deal with OPEB are markedly different. This makes direct comparisons difficult. These differences involve the more technical and complicated aspects of accounting for OPEB, namely the treatment of the transitional adjustment that arises on a change from the cash to the accrual basis, accounting for curtailments and settlements and the question of whether a

corridor approach should be adopted. Unfortunately, it is these differences which will hamper comparability and consistency. As mentioned a number of times in the thesis, fundamental differences exist between the US and other countries as regards the role of the actuary in the valuation of OPEB. Although the US standard does not require an actuary to value OPEB, rather making use of extensive disclosures explaining how the valuation was arrived at, other countries (consistent with the treatment of pensions) have required an actuary to give an opinion on the value of the liability and the status of any fund that exists to cover the liability. As such, disclosures differ between the US and IASC member countries hampering comparability.

14.2 RECOMMENDATIONS

Within South Africa the attitude towards health care is changing. More and more attention is being paid to managed health care and many employers are looking at withdrawing the postretirement benefits they currently provide in an effort to reduce costs. The survey undertaken as part of this thesis revealed that the current disclosure and knowledge levels of both users and preparers of financial statements regarding OPEB is of an alarmingly low standard. There is, however awareness of the risk that companies are exposed to by providing OPEB. AC 305 has brought OPEB into the limelight, but it does not provide sufficient guidance as to how to account for it and due to the fact that compliance with the guideline is only recommended, it has not yet been fully implemented by the South African business community.

The fact that the revised AC 116 differs from the IASC's E54 is cause for some concern. E54 is expected to be elevated to standard status early in 1998, at which time it will in all probability become a South African exposure draft which is intended to replace AC 116, from which it differs. This means that AC116, over which there is currently some debate as to whether it actually applies to OPEB, will only

have been in issue in its revised form for a year. This situation may cause confusion amongst both users and preparers of financial statements and hamper comparability and consistency.

The following recommendations can be made regarding the accounting treatment of OPEB in South Africa :

In terms of AC 000, the South African conceptual framework, OPEB are forms of deferred compensation and should be accounted for on the accrual basis. In line with the IASC's harmonisation process, South Africa will adopt an IASC based standard, but the following should be borne in mind;

1. The responses to the questionnaires sent out as part of this research indicated that both user and preparer groups gather some comfort from the involvement of an actuary in the valuation of OPEB (chapters 11.4, 11.6 and 12.4). Unfortunately, as previously mentioned (in chapter 8.6.1) the actuarial tables currently being used in South Africa are those from the UK, where mortality rates etc. could differ. In the interests of relevant and reliable information, South African actuarial tables should be developed as a matter of urgency. Guidance is expected later this year (1998) on the reliance that can be placed on the work of actuaries by auditors for financial statement purposes.

2. As general levels of knowledge in respect of OPEB were found to be low, any accounting standard should specify that enough disclosure be made in financial statements to enable the users to gain an understanding of the benefits offered, the extent to which they are offered, and the risks to which the company is exposed. This may mean that South African disclosures should be simpler than those specified by the IASC. For example, the majority of users did not feel that the disclosure of health care cost trend rates and the effect of a 1% change in any assumptions were helpful, but rather added to their confusion and complicated the issues (chapter 12.4).

3. Respondents to both the user and preparers' questionnaires also indicated that they did not see much benefit being derived from the breakdown of an income statement charge into several components, as specified in E54 (chapter 12.4). Although in the case of users this may be due to that fact that the additional breakdown of an income statement charge was not considered to add much value and indeed,

may have confused some, the information must still be calculated by employers meaning that there would be no cost saving as a result of avoiding this disclosure. Perhaps a compromise should be considered in which the income statement expense is split into its various components in the notes to the income statements in the annual financial statements, as it would be of interest, for example, to compare the current interest cost with that of prior years so as to determine the changes in employee base and OPEB offered.

4. An OPEB liability should be separately disclosed in financial statements and split into long and short term components (chapters 11.5 and 12.4). This was the view of the majority of both the users and preparers surveyed and meets conceptual framework criteria in that the short term components will be disclosed as part of networking capital, thereby revealing any liquidity problems that may exist. It is also more prudent than disclosing a total liability as part of capital employed on the balance sheet .

5. Unfortunately, there seems to be a growing trend towards moving the risks relating to OPEB from the employer to the employee through various schemes, the most common of which seem to be converting the defined benefit pension fund to a defined contribution fund and using pension fund surpluses to fund the OPEB liability. Users should be made aware of these changes and the possible implications for them through extensive disclosures made in the financial statements as specified in an accounting standard (chapter 11.5).

6. A settlement rate should be specified in an accounting standard as the rate at which OPEB should be discounted, if the liability is funded then the rate of return on plan assets could also be used. It is necessary to stipulate such a rate as neither users or preparers are in agreement as to which rate should be used (chapters 11.5 and 12.6) If a rate was not stipulated in a South African accounting standard, various rates would be used, hampering comparability.

7. The accounting treatments for curtailments and settlements should be specified, and be in line with the treatment used in the IASC standard, as if no such guidance were given in an accounting standard, then practices would be diverse and incomparable.

8. The transitional adjustment should be treated as a prior year adjustment. There is less need for the spreading of the transitional adjustment (as is practice in the U S) in South Africa as the provision of OPEB is not as prevalent (chapter 11.2).

9. A corridor approach should not be adopted in South Africa as this would confuse users and complicate the issue of OPEB even further.

10. The need for a South African standard cannot be emphasised enough. Currently companies are aware of their liability in respect of OPEB but this has not yet been disclosed in many cases. In the rare cases where disclosures are currently being made, there is little consistency and direct comparisons are difficult.

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14.3 SCOPE FOR FURTHER RESEARCH

During the course of this research, the following were noted as areas in which further research could be conducted :

- Postretirement benefits other than pensions and health care costs can be investigated further.
- The effects of the new IASC standard dealing with employee benefits which is scheduled for release in early 1998.
- The tax implications of postretirement benefits other than pensions have not been considered in detail.
- The actuarial valuation process of OPEB has not been thoroughly investigated. The effect of using UK tables in South Africa could provide interesting research material.

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Appendix 1

Simple Example Illustrating Implementation of SFAS 106.

Company XYZ adopts FAS106 on 1 January 1993.

The postretirement benefit plan includes a provision that all employees are fully eligible to receive benefits on reaching the age of 55.

Discount rate = 10%

Transition obligation amortised over twenty (20) years.

On 1 January 1993 (i.e. transitional obligation):

Employees	Status	Age Now	Age Hired	Expected Age at Retirement	Expected Post Retirement Benefit Obligation (EPBO)	Accumulated Post Retirement Benefit Obligation (APBO)
Jane	Active	35	25	55	\$ 9 000	\$ 3 000
Joe	Active	55	30	60	\$12 000	\$10 000
Ann	Active	60	35	65	\$14 000	\$14 000
John	Retired	70	30	N/A	\$ 8 000	\$ 8 000
						\$55 000

APBO = Portion of EPBO to eligibility date

i.e. Jane's EPBO accrues from age 25 to age 55 (30 years), of these she has worked 10 years (35-25).

Therefore, APBO = $10/30 * \$ 9 000$.
= \$ 3 000.

EPBO at the end of the year:

Employees	EPBO 1/1/93	Interest	Benefit payment	EPBO 31/12/93
Jane	\$ 9 000	\$ 900	-	\$ 9 900
Joe	\$12 000	\$1 200	-	\$13 200
Ann	\$14 000	\$1 400	-	\$15 400
John	\$ 8 000	\$ 800	(\$ 400)	\$ 8 400

The APBO a 31/12/93 will reflect the impact of the passage of time through the accrual of service cost and interest cost.

Therefore,

Employees	APBO 1/1/93	Service Cost	Interest Cost	Benefit Payment	APBO 31/12/93
Jane	\$ 3 000	\$ 330	\$ 300	-	\$ 3 630
Joe	\$10 000	\$ 550	\$1 000	-	\$11 550
Ann	\$14 000	-	\$1 400	-	\$15 400
John	\$ 8 000	-	\$ 800	(\$400)	\$ 8 400
		\$ 880	\$3 500		

Service cost = (EPBO 31/12/93) / Years of total service to age 55

i.e. for Jane \$ 9900/ 30 = \$ 330

Interest cost = APBO 1/1/93 * 10%

i.e. for Jane \$ 3 000 * 10 % = \$ 300

Therefore, if the liability is not funded, the costs for XYZ as a whole are:

Service Cost	\$ 880
Interest	\$3 500
Actual Return on Plan Assets	-
Amortisation of Transitional Obligation	\$1 750
	\$6 130

Amortisation = (Total APBO at 1/1/93) / 20 years
as allowed in terms of SFAS 106.

Reconciliation of Funded Status Net Periodic Benefit Cost

	Actual 1/1/93	Service Cost	Interest Cost	Amortise Transition Obligation	Benefit Payment	Actual 12/31/93
APBO	(\$35 000)	(\$880)	(\$3 500)	-	\$400	(\$38 980)
Plan Assets	-	-	-	-	-	-
Funded Status	(\$35 000)	(\$880)	(\$3 500)	-	\$400	(\$38 980)
Unrecognised Net Gain	-	-	-	-	-	-
Unrecognised Prior Service Cost	-	-	-	-	-	-
Unamortised Transition Obligation	(\$35 000)	-	-	(\$1 750)	-	(\$33 200)
Accrued Post Retirement Benefit Cost	-	(\$880)	(\$3 500)	(\$1 750)	\$400	(\$5 730)

To calculate the EPBO

Calculate the assumed per capita claims cost and then the EPBO.

Example : Assume participant is 50 years old and expects to retire at 62.

Expects to start receiving benefits at 63.

Life expectancy is 70.

12% Health Care Cost Trend Rate

7% Discount Rate.

Age	Per Capita Claims Cost	HCCTR	Future Health Care Cost	Medicare Reimbursement	Applied Per Capita Claims Cost
63	\$950	13	\$4,145	\$0	\$4,145
64	\$1,000	14	\$4,887	\$0	\$4,887
65	\$1,065	15	\$5,829	\$4,722	\$1,107
66	\$1,204	16	\$7,380	\$5,830	\$1,550
67	\$1,290	17	\$8,857	\$7,047	\$1,810
68	\$1,365	18	\$10,496	\$7,926	\$2,570
69	\$1,442	19	\$12,420	\$9,812	\$2,608
70	\$1,595	20	\$15,380	\$12,463	\$2,923
					\$21,600

EPBO :

Age	Applied Per Capita Claims Cost	Discount Rate	Present Value
63	\$4,145	13	\$1,720
64	\$4,887	14	\$1,895
65	\$1,107	15	\$401
66	\$1,550	16	\$525
67	\$1,810	17	\$573
68	\$2,570	18	\$760
69	\$2,608	19	\$721
70	\$2,923	20	\$755
			\$7,350

Therefore, in summary, the APBO is used to calculate the interest cost and the EPBO is used to calculate the service cost. The APBO is based on the EPBO and the EPBO is calculated using the per capita claims cost, health care cost trend rates and discount rates.

(Extracted from Choi, 1994, pp 19.4 - 19.12).

Appendix 2

“IBM 1994 ANNUAL REPORT - FINANCIAL REPORT S

NONPENSION POSTRETIREMENT BENEFITS

The company and its U.S. subsidiaries have defined benefit postretirement plans that provide medical, dental and life insurance for retirees and eligible dependants. In 1993, the company applied plan cost maximums to those who retired prior to January 1, 1992. These maximums will take effect beginning with the year 2001. Plan cost maximums were established in 1990 for those employees retiring after December 31, 1991.

The accumulated postretirement benefit obligation was determined by application of the terms of medical, dental and life insurance plans, including the effects of established maximums on covered costs, together with actuarial assumptions. These actuarial assumptions include health care cost trend rates projected rateably from 12,0% in 1995 to 6 percent in the year 2007.

The effect of a one percent annual increase in these assumed cost trend rates would increase the accumulated postretirement benefit obligation by approximately \$52 million, the annual costs would not be materially affected.

Net periodic postretirement benefit cost for the years ended December 31 included the following components:

	1994	1993	1992
Expected long-term rate of return on plan assets	9.5%	9.5%	9.5%

(Dollars in millions)

Service cost:

Benefits attributed to service during the period	\$ 51	\$ 53	\$ 78
Termination incentive expenses	-	-	71
Interest cost on the accumulated postretirement benefit obligation	512	566	485

Return on plan assets:

Actual	22	(201)	(67)
Deferred	(125)	84	(59)
Net amortisations and other	(38)	29	(61)
Curtailement Loss	-	732	-

Net periodic postretirement benefit cost	\$422	\$1 236	\$447
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In the Consolidated Statement of Operations, the curtailment loss and termination expenses referred to above are included in restructuring charges.

The table below provides information on the status of the plans.

The funded status at December 31 was as follows:

	1994	1993
Assumed discount rate	8.25%	7.25%
(Dollars in millions)		
Accumulated postretirement benefit obligation:		
Retirees	(\$5 411)	(\$5 761)
Fully eligible active plan participants	(567)	(673)
Other active plan participants	(530)	(927)
	-----	-----
Total	(6 508)	(7 361)
Plan assets at fair value	1 028	1 366
	-----	-----
Accumulated postretirement benefit obligation in excess of plan assets	(5 480)	(5 995)
Unrecognised net loss	505	1 431
Unrecognised prior service cost	(744)	(828)
	-----	-----
Accrued postretirement benefit cost recognised in the statement of financial position	(\$5 719)	(\$5 392)

In 1994, the accumulated postretirement benefit obligation decreased \$649 million as a result of the change in the assumed discount rate.

It is the company's practice to fund amounts for postretirement benefits with an independent trustee, as deemed appropriate from time to time. The plan assets include corporate equities and government securities. The accounting for the plan is based on the written plan.

Certain of the company's non-U.S. subsidiaries have similar plans for retirees. However most retirees outside the United States are covered by government-sponsored and administered programs, and the obligations and cost of these programs are not significant to the company."

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EXECUTIVE SUMMARY

Paragraph	Exposure Draft Proposals	Current Canadian Standards	Current US Standards
Scope .002 - .005	<p>Employees' future benefits</p> <ul style="list-style-type: none"> pensions other retirement benefits, such as health care benefits, life insurance and other miscellaneous benefits provided to employees after retirement post employment benefits and compensated absences where the right to the benefit vests or accumulates <p>Post employment benefits and compensated absences where the right to the benefit does not vest or accumulate</p> <ul style="list-style-type: none"> post employment benefits and compensated absences where the level of benefit provided is the same for all employees regardless of years of service. Examples are short-term and long-term disability benefits, self-insured workers' compensation, sabbatical leaves and sick leaves that do not vest <p>Termination benefits</p> <ul style="list-style-type: none"> benefits for voluntary termination benefits for involuntary termination termination benefits required by existing terms of a benefit plan when a specified event occurs 	<p>Section 3480: Pension costs and obligations</p> <p>EIC-1: Pension Surplus Recognition</p> <p>EIC-5: Post Retirement Benefits Other Than Pensions</p> <p>EIC-23: Special Termination Benefits</p> <p>EIC-49: Post Retirement Benefits Other Than Pensions - Transitional Balance</p> <p>Changes to existing Canadian authoritative pronouncements are noted below. If no change is proposed, the column is left blank.</p>	<p>SFAS 87: Employers' Accounting for Pensions</p> <p>SFAS 88: Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits</p> <p>SFAS 106: Employers' Accounting for Postretirement Benefits Other Than Pensions</p> <p>SFAS 112: Employers' Accounting for Postemployment Benefits</p> <p>EITF 94-3: Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)</p> <p>Differences between the Exposure Draft proposals and the US authoritative pronouncements are noted below. If there is no difference between the proposals and US standards, the column is left blank.</p>
Defined Contribution Plans .007 - .015	<p>Cost of benefits for the period is the required contribution in the period.</p>		
Defined Benefit Plans <i>Recognition/Measurement</i> .029	<p>Recognize liability and expense when employee has rendered service in return for benefits.</p>		
.030	<p>Recognize a liability and expense for post employment benefits and compensated absences that do not vest or accumulate when:</p> <ul style="list-style-type: none"> event obligating the entity has occurred payment of benefits is probable amount can be reasonably estimated. 		
.027	<p>Determine amounts separately for each plan. Cannot offset assets of one plan to pay benefits of another unless clear right to do so exists.</p>		
.028	<p>Data from all unfunded plans may be aggregated if plans provide benefits to same group of employees or provide same benefit to different groups of employees. A plan with assets cannot be aggregated with a plan without assets.</p>		

EXECUTIVE SUMMARY

Current US Standards

Current Canadian Standards

Paragaph Exposure Draft Proposals

<p><i>Recognition/Measurement (cont'd)</i> .037 - .038 Should reflect substantive terms and conditions of exchange transaction between entity and the employees.</p> <p><i>Timing of actuarial valuations</i> .046 - .047 Period between valuations would normally not exceed three years.</p> <p><i>Measurement date</i> .048 - .051 Plan assets and obligations - should be date of financial statements or date not more than three months prior to that date. Benefit cost for interim and annual financial statements should be based on assumptions at beginning of year, unless more recent measurements are available.</p> <p><i>Plan assets</i> .067 - .068 Should be measured at fair value.</p> <p><i>Immediate recognition in income</i> <u>Cost of current services</u> .071 - .072 Should be determined using an accrued benefit method. If future salary levels affect amount of future benefit, should use projected benefit method pro rated on services.</p> <p>.043 - .045 Cost should be attributed from date of hire to date at which an employee obtains full eligibility for benefits.</p> <p><u>Interest on benefit obligation</u> .073 Use an interest rate that is determined with reference to market interest rates at the measurement date. In selecting this rate look to: .055 - .058</p> <ul style="list-style-type: none"> • high-quality fixed-income investments with cash flows that match expected benefit payments; • high-quality zero coupon bonds with cash flows that match expected benefit payments; or • settlement rates if settlement with third party insurer is possible. <p><u>Expected return on plan assets</u> .074 - .076 Based on the expected long-term rate of return on plan assets and the market-related value of plan assets. Market-related value of plan assets is either fair value or a calculated value that recognizes changes in fair value over not more than five years.</p>	<p>No guidance</p> <p>3460 - No guidance</p> <p>3460 - market-related values which includes fair value.</p> <p>3460 - attributed over service life of employee.</p> <p>3460 - can use an estimate of a long-term rate or a current rate such as a settlement rate.</p>
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EXECUTIVE SUMMARY

Paragraph	Exposure Draft Proposals	Current Canadian Standards	Current US Standards
<p><u>Effect of temporary deviation from plan</u> .090 - .093</p>	<p>Temporary deviations are deviations from the existing cost-sharing provisions of the plan to increase or decrease the entity's share of benefit costs incurred in the current or past periods.</p>	<p>3460 - No guidance</p>	<p>US standards provide no guidance on issue of recognition of benefit asset when employers' access to surplus is restricted.</p>
<p><u>Valuation allowance for a recognized accrued benefit asset in excess of expected future benefit</u> .113 - .122</p>	<p>When an entity has an accrued benefit asset that will not reverse through the normal application of this Section, the asset that can be recorded is limited to the expected future benefit that can be derived from that asset. Any outstanding unamortized balances are added together. If the total is an unamortized liability, it is deducted from the accrued benefit asset. This new amount is used in the limit test calculation. Calculation of limit assumes current population remains steady.</p>	<p>EIC-1 - Calculation of limit assumes no new entrants to plan. No guidance on deduction of unamortized balances.</p>	<p>US standards provide no guidance on issue of recognition of benefit asset when employers' access to surplus is restricted.</p>
<p><u>Settlement gain or loss</u> .094 - .103</p>	<p>When a plan is settled, the settlement gain or loss includes any remaining unamortized actuarial gain or loss (pro rated if only part of the obligation is settled) and any remaining unamortized transitional asset (again pro rated if only part of the obligation is settled).</p>	<p>3460 - requires recognition of all gains or losses on plan settlements, including all remaining unamortized amounts (pro rated if only part settlement).</p>	<p>US standards provide no guidance on issue of recognition of benefit asset when employers' access to surplus is restricted.</p>
<p><u>Curtailment gain or loss</u> .104 - .110</p>	<p>When a plan is curtailed, the curtailment gain or loss includes all or a pro rata reduction of unamortized past service costs and unamortized transitional obligation.</p>	<p>3460 - requires recognition of all gains or losses on plan curtailments, including all remaining unamortized amounts (pro rated if only part curtailment).</p>	<p>US standards provide no guidance on issue of recognition of benefit asset when employers' access to surplus is restricted.</p>
<p><u>Delayed recognition in income</u> <u>Past service costs</u> .077 - .082</p>	<p>Are amortized on a straight-line basis over expected period to full eligibility of employee group covered.</p>	<p>3460 - amortized in a rational and systematic manner over appropriate period of time (usually expected average remaining service life - "EARSL").</p>	<p>Amortized by assigning equal amount to each future period of service of each employee active at date of amendment. Alternative methods, such as straight-line, are accepted. Improvements granted to retirees are treated differently: if all or almost all of the plan's participants are inactive, cost of amendment is amortized based on the remaining life expectancy of those participants.</p>
<p><u>Actuarial gain (loss)</u> .083 - .089</p>	<p>The minimum amortization required is the excess of the unamortized actuarial gain (loss) at the beginning of the year over.</p>	<p>3460 - amortized in a rational and systematic manner over appropriate period of time (usually expected average remaining service life).</p>	<p>If all or almost all of the plan's participants are inactive, the amortization period is the average remaining life expectancy of those participants.</p>

EXECUTIVE SUMMARY

Current US Standards

Current Canadian Standards

Paragraph Exposure Draft Proposals

Actuarial gain (loss) (cont'd)

- a) 10% of the benefit obligation (at beginning of year); and
 - b) 10% of market-related value of plan assets (at beginning of year);
- amortized over EARSL.

Any other method of amortization is allowed as long as amount so calculated is greater than the minimum required (and is applied consistently, to both gains and losses and method used is disclosed). Gains and losses that fall outside the 10% limits are allowed to be recognized in income immediately. Limits should be calculated separately for each defined benefit plan.

Actuarial gains and losses that occur in the current year are deferred until next year, when they are included in the amortization calculation.

3460 - allowed to recognize in current year or defer until next year.

Transitional amount

- .149 Amortization of transitional amount in a rational and systematic manner over an appropriate period of time (usually the expected average remaining service life of the employee group).

Termination Benefits

Special termination benefits for voluntary terminations

- .123 Recognize liability and expense when employees accept offer and amount can be reasonably estimated.

EIC-23 - accrue when management commits the entity to a staff reduction plan.

Special termination benefits for involuntary terminations

- .124 Recognize liability and expense in period management approves plan of termination if following conditions are met:
 - a) appropriate level of management approves plan and establishes benefits
 - b) arrangement is communicated to employees in detail sufficient to determine amount and type of benefits to be received
 - c) plan specifies number of employees to be terminated, job classifications or functions and locations; and
 - d) period of time to complete plan indicates that significant changes to plan are not likely.

EIC-23 - accrue when management commits the entity to a staff reduction plan.

No guidance

No guidance

EXECUTIVE SUMMARY

Current US Standards

Current Canadian Standards

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Paragraph

<p><i>Termination benefits that are part of an existing plan</i> .125 Recognize liability and expense when it is probable that employees will be entitled to benefits and amount can be reasonably estimated.</p> <p>Disclosures .129 - .147 Separate balance sheet presentation of pension plans and other benefit plans. Separate disclosure for pension plans and other benefit plans. Description of plan that is basis for accounting. Disclosure of choices made (see paragraph .135). Total plan obligation determined by actuarial valuation. Fair value of plan assets. Resulting plan surplus/deficit. Balance of unamortized amounts (show past service costs, net actuarial gain or loss, and transitional balance). Amount recognized in balance sheet as accrued benefit liability or asset. Expense for period. Employer contributions for period. Weighted average of assumed discount rates used for obligation. Weighted average of expected long-term rate of return on plan assets. Weighted average of rates of compensation increase used for obligation. Weighted average of assumed health care cost trend rate for health care obligation. Disclose fact that obligation for post employment benefits and compensated absences is not accrued because amount cannot be reasonably estimated. Disclose amount of gain or loss recognized during period for settlement or curtailment and description of nature of related events. Disclose cost of providing termination benefits recognized during period and nature of related event(s) that resulted in these benefits being provided.</p>	<p>No guidance</p> <p>No guidance</p> <p>No guidance</p>	<p>US disclosures are more extensive. See relevant standards for details.</p> <p>EIC-23 and EIC-60 - description of activities to be exited, major actions remaining to be performed, type and amount of exit costs recognized as liability and classification of costs recognized in income statement, amount of any adjustments to the liability.</p>
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EXECUTIVE SUMMARY

Current US Standards

Current Canadian Standards

Exposure Draft Proposals

Paragraph

Transitional Provisions

.148 - .151 Can apply prospectively; amortize difference between obligation and assets in rational and systematic manner over appropriate period of time (usually EARSL). Early implementers do not have to revise the earlier implementation date.

Can apply retroactively; restate financial statements of all prior periods presented for comparative purposes (adjust opening retained earnings balance if restatement cannot be made because effect cannot be reasonably determined).

3460 - prospective application with amortization over EARSL.

EIC-49 - prospective application with amortization over EARSL or retroactive application with restatement of prior periods.

US standards do not allow restatement of prior year's financial statements. When retroactive application is chosen, the adjustment is taken through income in the year of the change, not adjusted through the opening balance of retained earnings.

The amortization period for SFAS 87 is EARSL, unless EARSL is less than 15 years, in which case 15 years should be used. SFAS 106 has the same provisions but uses 20 years as the minimum amortization period.

SFAS 112 - treat as a change in accounting standard. No amortization of transitional balance.

Business Combinations - Section 1580

45 (g)

Use same rate for calculating fair value as will be used on going forward basis for plan.

Can reduce net benefit asset when acquiring company expects limitations on its ability to access a plan surplus.

Minimum Liability

No guidance

No guidance

No guidance

No guidance

SFAS 87 ONLY - pension costs

If the plan is underfunded, a minimum liability has to be recognized equal to the unfunded amount if:

- a) an asset has been recognized as prepaid pension cost
- b) liability recognized is less than the unfunded obligation, or
- c) no accrued or prepaid pension cost has been recognized.

If an additional minimum liability is recognized, an equal amount shall be recognized as an intangible asset, provided asset does not exceed amount of unrecognized prior service cost. If it does exceed, excess is reported as a separate component of equity, net of tax benefits.

GLOSSARY

518. This appendix contains definitions of certain terms used in accounting for postretirement benefits.

Accumulated postretirement benefit obligation

The actuarial present value of benefits attributed to employee service rendered to a particular date. Prior to an employee's full eligibility date, the accumulated postretirement benefit obligation as of a particular date for an employee is the portion of the expected postretirement benefit obligation attributed to that employee's service rendered to that date; on and after the full eligibility date, the accumulated and expected postretirement benefit obligations for an employee are the same.

Active plan participant

Any active employee who has rendered service during the credited service period and is expected to receive benefits, including benefits to or for any beneficiaries and covered dependents, under the postretirement benefit plan. Also refer to Plan participant.

Actual return on plan assets (component of net periodic postretirement benefit cost)

The change in the fair value of the plan's assets for a period including the decrease due to expenses incurred during the period (such as income tax expense incurred by the fund, if applicable), adjusted for contributions and benefit payments during the period.

Actuarial present value

The value, as of a specified date, of an amount or series of amounts payable or receivable thereafter, with each amount adjusted to reflect (a) the time value of money (through discounts for interest) and (b) the probability of payment (for example, by means of decrements for events such as death, disability, or withdrawal) between the specified date and the expected date of payment.

Amortization

Usually refers to the process of reducing a recognized liability systematically by recognizing revenues or of reducing a recognized asset systematically by recognizing expenses or costs. In accounting for postretirement benefits,

amortization is also used to refer to the systematic recognition in net periodic postretirement benefit cost over several periods of previously *unrecognized* amounts, including unrecognized prior service cost, unrecognized net gain or loss, and any unrecognized transition obligation or asset.

Assumed per capita claims cost (by age)

The annual per capita cost, for periods after the measurement date, of providing the postretirement health care benefits covered by the plan from the earliest age at which an individual could begin to receive benefits under the plan through the remainder of the individual's life or the covered period, if shorter. To determine the assumed per capita claims cost, the per capita claims cost by age based on historical claims costs is adjusted for assumed health care cost trend rates. The resulting assumed per capita claims cost by age reflects expected future costs and is applied with the plan demographics to determine the amount and timing of future gross eligible charges. Also refer to *Gross eligible charges* and *Per capita claims cost by age*.

Assumptions

Estimates of the occurrence of future events affecting postretirement benefit costs, such as turnover, retirement age, mortality, dependency status, per capita claims costs by age, health care cost trend rates, levels of Medicare and other health care providers' reimbursements, and discount rates to reflect the time value of money.

Attribution

The process of assigning postretirement benefit cost to periods of employee service.

Attribution period

The period of an employee's service to which the expected postretirement benefit obligation for that employee is assigned. The beginning of the attribution period is the employee's date of hire unless the plan's benefit formula grants credit only for service from a later date, in which case the beginning of the attribution period is generally the beginning of that credited service period. The end of the attribution period is the full eligibility date. Within the attribution period, an equal amount of the expected postretirement benefit obligation is attributed to each year of service unless the plan's benefit formula attributes a disproportionate share of the expected postretirement benefit obligation to employees' early years of service. In that case, benefits are attributed in accordance with the plan's benefit formula. Also refer to *Credited service period*.

Benefit formula

The basis for determining benefits to which participants may be entitled under a postretirement benefit plan. A plan's benefit formula specifies the years of service to be rendered, age to be attained while in service, or a combination of both that must be met for an employee to be eligible to receive benefits under the plan. A plan's benefit formula may also define the beginning of the credited service period and the benefits earned for specific periods of service.

Benefits

The monetary or in-kind benefits or benefit coverage to which participants may be entitled under a postretirement benefit plan, including health care benefits, life insurance not provided through a pension plan, and legal, educational, and advisory services.

Captive insurer

An insurance company that does business primarily with related entities.

Contributory plan

A plan under which retirees or active employees contribute part of the cost. In some contributory plans, retirees or active employees wishing to be covered must contribute; in other contributory plans, participants' contributions result in increased benefits.

Cost-sharing (provisions of the plan)

The provisions of the postretirement benefit plan that describe how the costs of the covered benefits are to be shared between the employer and the plan participants. Cost-sharing provisions describe retired and active plan participants' contributions toward their postretirement health care benefits, deductibles, coinsurance, out-of-pocket limitations on participant costs, caps on employer costs, and so forth.

Credited service period

Employee service period for which benefits are earned pursuant to the terms of the plan. The beginning of the credited service period may be the date of hire or a later date. For example, a plan may provide benefits only for service rendered after a specified age. Service beyond the end of the credited service period does not earn any additional benefits under the plan. Also refer to *Attribution period*.

Curtailment (of a postretirement benefit plan)

An event that significantly reduces the expected years of future service of active plan participants or eliminates the accrual of defined benefits for some or all of the future services of a significant number of active plan participants.

Defined benefit postretirement plan

A plan that defines postretirement benefits in terms of monetary amounts (for example, \$100,000 of life insurance) or benefit coverage to be provided (for example, up to \$200 per day for hospitalization, 80 percent of the cost of specified surgical procedures, and so forth). Any postretirement benefit plan that is not a defined contribution postretirement plan is, for purposes of this Statement, a defined benefit postretirement plan.

Defined contribution postretirement plan

A plan that provides postretirement benefits in return for services rendered, provides an individual account for each plan participant, and specifies how contributions to the individual's account are to be determined rather than specifies the amount of benefits the individual is to receive. Under a defined contribution postretirement plan, the benefits a plan participant will receive depend solely on the amount contributed to the plan participant's account, the returns earned on investments of those contributions, and the forfeitures of other plan participants' benefits that may be allocated to that plan participant's account.

Dependency status

The status of a current or former employee having dependents (for example, a spouse or other relatives) who are expected to receive benefits under a postretirement benefit plan that provides dependent coverage.

Discount rates

The rates used to reflect the time value of money. Discount rates are used in determining the present value as of the measurement date of future cash flows currently expected to be required to satisfy the postretirement benefit obligation. Also refer to **Actuarial present value**.

Expected long-term rate of return on plan assets

An assumption about the rate of return on plan assets reflecting the average rate of earnings expected on existing plan assets and expected contributions to the plan during the period.

Expected postretirement benefit obligation

The actuarial present value as of a particular date of the benefits expected to be paid to or for an employee, the employee's beneficiaries, and any covered dependents pursuant to the terms of the postretirement benefit plan.

Expected return on plan assets

An amount calculated as a basis for determining the extent of delayed recognition of the effects of changes in the fair value of plan assets. The expected return on plan assets is determined based on the expected long-term rate of return on plan assets and the market-related value of plan assets.

Explicit (approach to) assumptions

An approach under which each significant assumption used reflects the best estimate of the plan's future experience solely with respect to that assumption.

Fair value

The amount that a plan could reasonably expect to receive for an investment in a current sale between a willing buyer and a willing seller, that is, other than a forced or liquidation sale.

Full eligibility (for benefits)

The status of an employee having reached the employee's full eligibility date. Full eligibility for benefits is achieved by meeting specified age, service, or age and service requirements of the postretirement benefit plan. Also refer to **Full eligibility date**.

Full eligibility date

The date at which an employee has rendered all of the service necessary to have earned the right to receive all of the benefits expected to be received by that employee (including any beneficiaries and dependents expected to receive benefits). Determination of the full eligibility date is affected by plan terms that provide incremental benefits expected to be received by or on behalf of an employee for additional years of service, unless those incremental benefits are trivial. Determination of the full eligibility date is *not* affected by plan terms that define when benefit payments commence or by an employee's current dependency status.

Fully eligible plan participants

Collectively, that group of former employees (including retirees) and active employees who have rendered service to or beyond their full eligibility date and who are expected to receive benefits under the plan, including benefits to their beneficiaries and covered dependents.

Funding policy

The program regarding the amounts and timing of contributions by the employer(s), plan participants, and any other sources to provide the benefits a postretirement benefit plan specifies.

Gain or loss

A change in the value of either the accumulated postretirement benefit obligation or the plan assets resulting from experience different from that assumed or from a change in an actuarial assumption, or the consequence of a decision to temporarily deviate from the substantive plan. Also refer to **Unrecognized net gain or loss**.

Gain or loss component (of net periodic postretirement benefit cost)

The sum of (a) the difference between the actual return on plan assets and the expected return on plan assets, (b) any gain or loss immediately recognized or the amortization of the unrecognized net gain or loss from previous periods, and (c) any amount immediately recognized as a gain or loss pursuant to a decision to temporarily deviate from the substantive plan. The gain or loss component is generally the net effect of delayed recognition of gains and losses (the net change in the unrecognized net gain or loss) except that it does not include changes in the accumulated postretirement benefit obligation occurring during the period and deferred for later recognition.

Gross eligible charges

The cost of providing the postretirement health care benefits covered by the plan to a plan participant, before adjusting for expected reimbursements from Medicare and other providers of health care benefits and for the effects of the cost-sharing provisions of the plan.

Health care cost trend rates

An assumption about the annual rate(s) of change in the cost of health care benefits currently provided by the postretirement benefit plan, due to factors other than changes in the composition of the plan population by age and dependency status, for each year from the measurement date until the end of the period in which benefits are expected to be paid. The health care cost

trend rates implicitly consider estimates of health care inflation, changes in health care utilization or delivery patterns, technological advances, and changes in the health status of the plan participants. Differing types of services, such as hospital care and dental care, may have different trend rates.

Incurred claims cost (by age)

The cost of providing the postretirement health care benefits covered by the plan to a plan participant, after adjusting for reimbursements from Medicare and other providers of health care benefits and for deductibles, coinsurance provisions, and other specific claims costs borne by the retiree. Also refer to **Net incurred claims cost (by age)**.

Insurance contract

A contract in which an insurance company unconditionally undertakes a legal obligation to provide specified benefits to specific individuals in return for a fixed consideration or premium. An insurance contract is irrevocable and involves the transfer of significant risk from the employer (or the plan) to the insurance company. If the insurance company providing the contract is a captive insurer, or if there is any reasonable doubt that the insurance company will meet its obligations under the contract, the contract is not an insurance contract for purposes of this Statement.

Interest cost (component of net periodic postretirement benefit cost)

The accrual of interest on the accumulated postretirement benefit obligation due to the passage of time.

Market-related value of plan assets

A balance used to calculate the expected return on plan assets. Market-related value can be either fair value or a calculated value that recognizes changes in fair value in a systematic and rational manner over not more than five years. Different methods of calculating market-related value may be used for different classes of plan assets, but the manner of determining market-related value shall be applied consistently from year to year for each class of plan asset.

Measurement date

The date of the financial statements or, if used consistently from year to year, a date not more than three months prior to that date, as of which plan assets and obligations are measured.

Medicare reimbursement rates

The health care cost reimbursements expected to be received by retirees through Medicare as mandated by currently enacted legislation. Medicare reimbursement rates vary by the type of benefits provided.

Multiemployer plan

A postretirement benefit plan to which two or more unrelated employers contribute, usually pursuant to one or more collective-bargaining agreements. A characteristic of multiemployer plans is that assets contributed by one participating employer may be used to provide benefits to employees of other participating employers since assets contributed by an employer are not segregated in a separate account or restricted to provide benefits only to employees of that employer. A multiemployer plan is usually administered by a board of trustees composed of management and labor representatives and may also be referred to as a "joint trust" or "union plan." Generally, many employers participate in a multiemployer plan, and an employer may participate in more than one plan. The employers participating in multiemployer plans usually have a common industry bond, but for some plans the employers are in different industries and the labor union may be their only common bond.

Multiple-employer plan

A postretirement benefit plan maintained by more than one employer but not treated as a multiemployer plan. Multiple-employer plans are generally not collectively bargained and are intended to allow participating employers, commonly in the same industry, to pool their plan assets for investment purposes and to reduce the cost of plan administration. A multiple-employer plan maintains separate accounts for each employer so that contributions provide benefits only for employees of the contributing employer. Multiple-employer plans may have features that allow participating employers to have different benefit formulas, with the employer's contributions to the plan based on the benefit formula selected by the employer.

Net incurred claims cost (by age)

The employer's share of the cost of providing the postretirement health care benefits covered by the plan to a plan participant; incurred claims cost net of retiree contributions. Also refer to **Incurred claims cost (by age)**.

Net periodic postretirement benefit cost

The amount recognized in an employer's financial statements as the cost of a postretirement benefit plan for a period. Components of net periodic postre-

tirement benefit cost include service cost, interest cost, actual return on plan assets, gain or loss, amortization of unrecognized prior service cost, and amortization of the unrecognized transition obligation or asset.

Nonparticipating insurance contract

An insurance contract that does not provide for the purchaser to participate in the investment performance or in other experience of the insurance company. Also refer to **Insurance contract**.

Nonpublic enterprise

An enterprise other than one (a) whose debt or equity securities are traded in a public market, either on a stock exchange or in the over-the-counter market (including securities quoted only locally or regionally), or (b) whose financial statements are filed with a regulatory agency in preparation for the sale of any class of securities.

Participating insurance contract

An insurance contract that provides for the purchaser to participate in the investment performance and possibly other experience (for example, morbidity experience) of the insurance company. Also refer to **Insurance contract**.

Participation right

A purchaser's right under a participating insurance contract to receive future dividends or retroactive rate credits from the insurance company.

Pay-related plan

A plan that has a benefit formula that bases benefits or benefit coverage on compensation, such as a final-pay or career-average-pay plan.

Per capita claims cost by age

The current cost of providing postretirement health care benefits for one year at each age from the youngest age to the oldest age at which plan participants are expected to receive benefits under the plan. Also refer to **Assumed per capita claims cost (by age)**.

Plan

An arrangement that is mutually understood by an employer and its employees, whereby an employer undertakes to provide its employees with benefits after they retire in exchange for their services over a specified period of time, upon attaining a specified age while in service, or a combination of both. A plan may

be written or it may be implied by a well-defined, although perhaps unwritten, practice of paying postretirement benefits or from oral representations made to current or former employees. Also refer to **Substantive plan**.

Plan amendment

A change in the existing terms of a plan. A plan amendment may increase or decrease benefits, including those attributed to years of service already rendered.

Plan assets

Assets—usually stocks, bonds, and other investments—that have been segregated and restricted (usually in a trust) to provide for postretirement benefits. The amount of plan assets includes amounts contributed by the employer (and by plan participants for a contributory plan) and amounts earned from investing the contributions, less benefits, income taxes, and other expenses incurred. Plan assets ordinarily cannot be withdrawn by the employer except under certain circumstances when a plan has assets in excess of obligations and the employer has taken certain steps to satisfy existing obligations. Assets not segregated in a trust, or otherwise effectively restricted, so that they cannot be used by the employer for other purposes are not plan assets, even though it may be intended that those assets be used to provide postretirement benefits. Amounts accrued by the employer as net periodic postretirement benefit cost but not yet paid to the plan are not plan assets. Securities of the employer held by the plan are includable in plan assets provided they are transferable. If a plan has liabilities other than for benefits, those nonbenefit obligations are considered as reductions of plan assets.

Plan demographics

The characteristics of the plan population including geographical distribution, age, sex, and marital status.

Plan participant

Any employee or former employee who has rendered service in the credited service period *and is expected to receive employer-provided benefits* under the postretirement benefit plan, including benefits to or for any beneficiaries and covered dependents. Also refer to **Active plan participant**.

Plan termination

An event in which the postretirement benefit plan ceases to exist and all benefits are settled by the purchase of insurance contracts or by other means.

The plan may or may not be replaced by another plan. A plan termination with a replacement plan may or may not be in substance a plan termination for accounting purposes.

Postretirement benefit fund

Assets accumulated in the hands of a funding agency for the sole purpose of paying postretirement benefits when the claims are incurred or benefits are due. Those assets may or may not qualify as plan assets. Also refer to **Plan assets**.

Postretirement benefit plan

Refer to **Plan**.

Postretirement benefits

All forms of benefits, other than retirement income, provided by an employer to retirees. Those benefits may be defined in terms of specified benefits, such as health care, tuition assistance, or legal services, that are provided to retirees as the need for those benefits arises, such as certain health care benefits, or they may be defined in terms of monetary amounts that become payable on the occurrence of a specified event, such as life insurance benefits.

Postretirement benefits other than pensions

Refer to **Postretirement benefits**.

Postretirement health care benefits

A form of postretirement benefit provided by an employer to retirees for defined health care services or coverage of defined health care costs, such as hospital and medical coverage, dental benefits, and eye care.

Prior service cost

The cost of benefit improvements attributable to plan participants' prior service pursuant to a plan amendment or a plan initiation that provides benefits in exchange for plan participants' prior service. Also refer to **Unrecognized prior service cost**.

Retirees

Collectively, that group of plan participants that includes retired employees, their beneficiaries, and covered dependents.

Service cost (component of net periodic postretirement benefit cost)

The portion of the expected postretirement benefit obligation attributed to employee service during a period.

Settlement (of a postretirement benefit plan)

An irrevocable action that relieves the employer (or the plan) of primary responsibility for a postretirement benefit obligation and eliminates significant risks related to the obligation and the assets used to effect the settlement. Examples of transactions that constitute a settlement include (a) making lump-sum cash payments to plan participants in exchange for their rights to receive specified postretirement benefits and (b) purchasing nonparticipating insurance contracts for the accumulated postretirement benefit obligation for some or all of the plan participants.

Single-employer plan

A postretirement benefit plan that is maintained by one employer. The term also may be used to describe a plan that is maintained by related parties such as a parent and its subsidiaries.

Substantive plan

The terms of the postretirement benefit plan as understood by an employer that provides postretirement benefits and the employees who render services in exchange for those benefits. The substantive plan is the basis for the accounting for that exchange transaction. In some situations an employer's cost-sharing policy, as evidenced by past practice or by communication of intended changes to a plan's cost-sharing provisions, or a past practice of regular increases in certain monetary benefits may indicate that the substantive plan differs from the extant written plan.

Termination benefits

Benefits provided by an employer to employees in connection with their termination of employment. They may be either special termination benefits offered only for a short period of time or contractual benefits required by the terms of a plan only if a specified event, such as a plant closing, occurs.

Transition asset

The unrecognized amount, as of the date this Statement is initially applied, of (a) the fair value of plan assets plus any recognized accrued postretirement benefit cost or less any recognized prepaid postretirement benefit cost in excess of (b) the accumulated postretirement benefit obligation.

Transition obligation

The unrecognized amount, as of the date this Statement is initially applied, of (a) the accumulated postretirement benefit obligation in excess of (b) the fair value of plan assets plus any recognized accrued postretirement benefit cost or less any recognized prepaid postretirement benefit cost.

Unfunded accumulated postretirement benefit obligation

The accumulated postretirement benefit obligation in excess of the fair value of plan assets.

Unrecognized net gain or loss

The cumulative net gain or loss that has not been recognized as a part of net periodic postretirement benefit cost or as a part of the accounting for the effects of a settlement or a curtailment. Also refer to Gain or loss.

Unrecognized prior service cost

The portion of prior service cost that has not been recognized as a part of net periodic postretirement benefit cost, as a reduction of the effects of a negative plan amendment, or as a part of the accounting for the effects of a curtailment.

Unrecognized transition asset

The portion of the transition asset that has not been recognized either immediately as the effect of a change in accounting or on a delayed basis as a part of net periodic postretirement benefit cost, as an offset to certain losses, or as a part of accounting for the effects of a settlement or a curtailment.

Unrecognized transition obligation

The portion of the transition obligation that has not been recognized either immediately as the effect of a change in accounting or on a delayed basis as a part of net periodic postretirement benefit cost, as an offset to certain gains, or as a part of accounting for the effects of a settlement or a curtailment.

APPENDIX 5

P O Box 786267
Sandton
2146
082 450 8936 (w/h)
18 June 1997

Dear Sir/Madam

SECOND REQUEST

I am currently researching the issues surrounding the provision of postretirement benefits other than pensions to employees.

These benefits can take several forms including :

1. postretirement health care (where an entity will pay some or all of a retired employee's medical aid contributions or medical costs).
2. life insurance provided outside a pension plan to retirees
3. tuition assistance, legal services, day care or housing subsidies provided to employees after retirement, and,
4. discounts offered on an entity's goods or services to retired employees.

Currently there is no South African accounting standard dealing with the accounting treatment of postretirement benefits. However, several companies are accounting for these benefits in terms of a guideline issued by SAICA (AC305) or following recommendations made by various overseas accounting standards. These foreign standards require the adoption of accrual accounting. Previously, postretirement benefits were recognised as an expense when the payment was made (pay-as-you-go or cash accounting basis), whereas the accrual method specifies that the future cost of providing a postretirement benefit be present-valued and 'matched' to the current benefit being rendered in the form of service by an employee, as in the case of pensions. This means that in changing from the cash to the accrual basis liabilities have to be recognised in the Balance Sheet for the future payment of postretirement benefits and expenses have to be recognised in the Income Statement. A transitional adjustment arises due to the fact that liabilities and expenses that had not been included in the accounts on the cash basis (as not yet paid) now have to be recognised on the accrual basis (as employee has already rendered the service 'earning' these benefits).

The research is toward the degree of Master of Commerce at the University of Cape Town. The thesis addresses the requirements of both preparers and users of financial statements with regard to the measurement and disclosure of other postretirement benefits in an effort to recommend a conceptually correct and practical method of accounting for postretirement benefits.

It would be greatly appreciated if you would complete the enclosed questionnaire and return it in the enclosed envelope before the 6 July 1997.

Naturally the results of the research will be available to you and your confidentiality in this matter is assured.

Your assistance in this matter is greatly appreciated.

Yours faithfully,

Joanne Pollitt.

APPENDIX 6

POSTRETIREMENT BENEFITS USER QUESTIONNAIRE

GENERAL:

1. ***When evaluating a company, what do you consider most important :***

- i. financial performance
- ii. financial position
- iii. stability
- iv. growth potential
- v. management ability ?

2. ***Rate on a scale of 1 to 5 the importance of the following sources of financial information :(1= high, 2=moderate, 3=average, 4=below average, 5= low)***

- i. the Income Statement
- ii. the Balance Sheet
- iii. interviews with management
- iv. press or journal articles
- v. industry reports
- vi. the cash flow statement
- vii. Directors' / Chairman's report
- vi. other (please specify)

.....
.....
.....

3. ***How often have you encountered firms that offer postretirement benefits other than pensions?***

- i. All the time
- ii. Often
- iii. Occasionally
- iv. Rarely
- v. Never

4. **Of these benefits, which seem to be the most popular? Please rate on a scale of 1 to 5. (1=very popular, 2= popular, 3= average, 4=below average,5= unpopular).**

- i. Employer pays retirees medical costs.
- ii. Employer pays a portion (or all) of retirees medical aid contribution.
- iii. Discounts offered to retirees on employer's products or services.
- iii. Housing subsidies provided after retirement.
- iv. Other (please specify).

DISCLOSURES

5. **Do you consider the disclosures relating to postretirement benefits other than pensions are generally adequate?**

Please tick relevant box.

YES

NO

6. **Which disclosures do you consider the most useful? Please rate on a scale of 1 to 5. (1= essential, 2= very useful, 3=useful, 4=of interest, 5= of no use).**

- i. A description of the accounting policy for postretirement benefits.
- ii. Details of the employee group provided with these benefits.
- iii. The types of benefits provided.
- iv. A description of the funding policy.
- v. A description of the nature of the plan assets held.
- vi. For postretirement health care, the assumed health care cost trend rate.
- vii. The discount rate(s) used to present value the liability.
- viii. Quantification of the estimated effect a 1% change in the assumed rates would have on the liability.
- ix. Details of any amortisation periods used.
- x. Details of any settlement or curtailment that may have occurred during the financial year.
- xi. The date of the last actuarial valuation.
- xii. The opinion of the actuary as to the state of the fund.
- xiii. The date of the next actuarial valuation.
- xiv. Details of any unfunded benefits the entity may be held liable for.

7. Do you think that the costs of these extensive disclosures (as in question 6 above) outweigh the benefits?

Why or why not?

8. Do you think that companies are prejudiced by extensive disclosures (as in question 6 above)? Explain.

9. How do you use information about other postretirement benefits?

10. When changing from the cash (pay-as-you-go) basis of accounting to the accrual basis, a transitional adjustment often arises. How do you feel this should be accounted for?

- i. As a prior year adjustment (PYA).
- ii. Written off in full as an 'exceptional' item and separately disclosed in the income statement.
- iii. Written off in full but not separately disclosed in the income statement.
- iv. Amortised over a specified number of years.
- v. Another method. Please specify.

11. Do you think that the income statement charge should be split into separate components?

E.g. into current service cost, interest cost and prior service cost components.

Please tick relevant box.

YES Why? _____

NO Why? _____

12. Should the liability for postretirement benefits other than pensions be disclosed as :

- i. A long term liability separately disclosed.
- ii. A long term liability but not separately disclosed.
- iii. A separate short term liability
- iv. A short term liability but not separately disclosed.
- v. Split into long and short term liabilities and separately disclosed.
- vi. Split into long and short term liabilities but not separately disclosed.
- vii. Part of interest free liabilities.
- viii. Part of creditors

13. Do you consider there to be a difference between funded and unfunded liabilities?

Please tick the relevant box.

YES

NO

If yes, what do you perceive these differences to be?

14. Which do you consider to be the more correct discount rate as regards the present valuing of the postretirement obligation?

- i. The weighted average cost of capital of the entity.
- ii. A rate at which the obligations could be settled (a settlement rate).
- iii. A rate reflecting the expected return on plan assets.
- iv. Another rate. Please specify.

15. Do you consider the level of your accounting knowledge to be,

- i. Excellent
- ii. Good
- iii. Adequate
- iv. Poor

16. What is your highest professional qualification, and when was it achieved?

THANK YOU FOR YOUR TIME

University of Cape Town

APPENDIX 7

P O Box 786267
Sandton
2146
082 450 8936 (w/h)
18 June 1997

Dear Sir/Madam

SECOND REQUEST

I am currently researching the issues surrounding the provision of postretirement benefits other than pensions to employees.

These benefits can take several forms including :

1. postretirement health care (where an entity will pay some or all of a retired employee's medical aid contributions or medical costs).
2. life insurance provided outside a pension plan to retirees
3. tuition assistance, legal services, day care or housing subsidies provided to employees after retirement, and,
4. discounts offered on an entity's goods or services to retired employees.

Currently there is no South African accounting standard dealing with the accounting treatment of postretirement benefits. However, several companies are accounting for these benefits in terms of a guideline issued by SAICA (AC305) or following recommendations made by various overseas accounting standards. These foreign standards require the adoption of accrual accounting. Previously, postretirement benefits were recognised as an expense when the payment was made (known as pay-as-you-go or the cash accounting basis), whereas the accrual method specifies that the future cost of providing a postretirement benefit be present-valued and 'matched' to the current benefit being rendered in the form of service by an employee, as in the case of pensions. This means that in changing from the cash to the accrual basis liabilities have to be recognised in the Balance Sheet for the future payment of postretirement benefits and expenses have to be recognised in the Income Statement before they are actually paid. A transitional adjustment arises due to the fact that liabilities and expenses that had not been included in the accounts on the cash basis (as not yet paid) now have to be recognised on the accrual basis (as employee has already rendered the service 'earning' these benefits).

The research is toward the degree of Master of Commerce at the University of Cape Town. The thesis addresses the requirements of both preparers and users of financial statements with regard to the measurement and disclosure of other postretirement benefits in an effort to recommend a conceptually correct and practical method of accounting for postretirement benefits.

Naturally the results of the research will be available to you and your confidentiality in this matter is assured.

I would be grateful if you would complete the enclosed questionnaire (if it is the policy of your company not to provide post retirement benefits other than pensions, please indicate this on the questionnaire) and return it in the addresses envelope provided before the 6 July 1997. Naturally the results of my study will be available to you and your confidentiality in this matter is assured.

Your assistance in this matter is greatly appreciated.

Yours faithfully,
Joanne Pollitt.

APPENDIX 8

POSTRETIREMENT BENEFITS

PREPARERS' QUESTIONNAIRE

GENERAL

1. *Approximately how many employees does your company have?*

2. *Approximately how many retirees does your company currently have?*

3. *How many employees do you expect to retire within the next five years?*

4. *What postretirement benefits do you provide to your employees?*

- i. Contributions to medical aid funds on behalf of retirees.
- ii. Payment of retirees medical costs (i.e. no medical aid fund involved).
- iii. Life insurance outside a pension plan.
- iv. Tuition assistance after retirement.
- v. Legal services after retirement.
- vi. Day care after retirement.
- vii. Housing subsidies after retirement.
- viii. Special discounts on your products for retirees.
- ix. Other (please specify).

5. *Of the above, which is (are) the most costly to the company?*

6. Approximately what percentage of your workforce is provided with the various postretirement benefits?

Please tick relevant box.

	<u>Type of Benefit (as per question 4)</u>								
	i	ii	iii	iv	v	vi	vii	viii	ix
0 - 33%	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
34 - 66%	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
67 - 100%	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

7. Is there a minimum service period before employees become entitled to these benefits?

Please tick relevant box.

YES NO

If yes, how long is this period?

If yes and entitlement varies between employees, please clarify.

8. How long have you been offering these benefits to your retirees?

9. ***Is there any plan to change these benefits in the future?***

Please tick relevant box.

YES REDUCE INCREASE

NO

ADMINISTRATION

10. ***Are these benefits pre-funded?***

Please tick relevant box.

YES NO

If no, is there any plan to pre-fund these benefits in the future?

Please tick relevant box.

YES NO

11. ***Are the benefits documented by a written agreement between employer and employee?***

Please tick relevant box.

YES NO

12. Are the benefits actuarially valued?

Please tick relevant box.

YES NO

If yes, how often?

13. If valued, are some of the actuarial assumptions used the same as those used for the pension scheme?

E.g. same average number of years of service.

Please tick relevant box.

YES NO

NO PENSION SCHEME PROVIDED

ACCOUNTING TREATMENT

14. How are you currently accounting for postretirement benefits other than pensions?

- i. Cash (pay-as-you-go) basis.
- ii. Accrual basis
- iii. Terminal funding basis (i.e. accrual at retirement).
- iv. Other (please specify).

15. **TO BE COMPLETED BY PREPARERS USING THE CASH BASIS AND
TERMINAL FUNDING BASIS ONLY.**

Are you planning to change your accounting policy?

Please tick relevant box.

YES NO

If yes, to what accounting basis?

If changing from the cash to the accrual basis, will this be dealt with as :

- i. a prior year adjustment
- ii. an 'material' item (i.e. separately disclosed in the Income Statement)
- iii. charged to the Income Statement but not separately disclosed.
- iv. amortised over _____ years
- v. other (please specify).

16. **TO BE COMPLETED BY PREPARERS USING THE ACCRUAL BASIS
ONLY:**

Was the adoption of this basis as a result of:

- i. the issue of AC 305?
- ii. the release of international standards in this area?
- iii. the applicability of the conceptual framework?
- iv. the applicability of AC 116?
- v. another reason (please specify)?

How long have you been accounting for other postretirement benefits on the accrual basis?

Did you ever account for postretirement benefits other than pensions on the cash basis?
Please tick relevant box.

YES NO

If yes, how did you account for the charge relating to the change in accounting basis?

- i. as a prior year adjustment.
- ii. as an 'material' item (separately disclosed).
- iii. charged to the Income Statement but not separately disclosed.
- iv. amortised over _____ years.
- v. other (please specify).

Where is the liability for other postretirement benefits disclosed in the Balance Sheet?

- i. with long term liabilities (not separately disclosed).
- ii. with long term liabilities (separately disclosed).
- iii. as a separate short term liability.
- iv. as a short term liability (not separately disclosed).
- v. with creditors.
- vi. a combination of the above.
- vii. other (please specify).

At what discount rate is the liability discounted to present value?

- i. at a settlement rate.
- ii. at a rate reflecting the expected return on plan assets.
- iii. at the weighted average cost of capital of the company.
- iv. other rate (please specify).

What is disclosed in the Income Statement?

- i. the current service cost.
- ii. the interest cost component.
- iii. the return on plan assets.
- iv. amortisation of any unrecognised prior service cost.
- v. amortisation of the unrecognised obligation or asset when first applying the accrual basis.
- vi. a single figure composed of the above.
- vii. nothing.
- viii. other (please specify).

TO BE COMPLETED BY ALL RESPONDENTS:

17. What is the objective of your company in disclosing information about postretirement benefits other than pensions?

18. Is it the policy of your company to disclose:

- i. a description of the accounting policy.
- ii. details of the groups of employees covered.
- iii. the types of benefits provided.
- iv. a description of the funding policy.
- v. a description of the nature of the plan assets held.
- vi. in respect of health care, the health care cost trend rate.
- vii. the discount rate(s) used to measure the liability.
- viii. quantification of the effect a 1% change in the assumed rates would have on the liability.
- ix. details of any amortisation period used.
- x. details of any settlement or curtailment that may have occurred during the financial year.
- xi. details of the date of the last actuarial valuation.
- xii. the opinion of the actuary.
- xiii. the date of the next valuation.

Do you consider any other disclosures relevant?
If so, what are they?

19. Do you think that the cost of extensive disclosures (as per question 18 above) exceed the benefits? Why?

20. Are any of your own opinions substantially different from those of your company in this area? If so, how?

21. What is your position in the company?

THANK YOU FOR YOUR TIME.