



December 10, 2004

STATEMENT FROM THE ACCOUNTING AND AUDITING COMMITTEES

Pension insurance with Alecta

A large number of companies in Sweden have their pension accounts as per the ITP insured with Alecta. The introduction of the Swedish Financial Accounting Standards Council's recommendation RR 29 *Ersättningar till anställda (Employee Benefits)* has given rise to various questions as to how companies should report a pension plan insured with Alecta. RR 29 corresponds to the international accounting standard IAS 19 *Employee Benefits*. The coming annual accounts for 2004, along with the requirement that listed companies as of 2005 prepare their consolidated accounts in accordance with IFRS, has also placed these issues on the agenda. In 2004 IASB and its Urgent Issues Task Force IFRIC has dealt with the question of how multi-employer plans should be reported according to IAS 19.

FAR believes that the auditors, prior to the coming annual accounts, should have access to an authoritative statement as to how the pensions managed as per the ITP and which are insured with Alecta should be reported. Thus, FAR's accounting and auditing committees have drawn up this statement to provide guidelines for FAR members in this important accounting matter. Since RR 29 is based on IAS 19, the statement applies to both the Swedish accounting and accounting according to IFRS.

Accounting

In the 2004 annual accounts¹, companies should report a pension plan with Alecta as a defined contribution plan and provide the information required by RR 29/IAS 19 in such a case. The following is an example² of how this information can be formulated:

Commitments regarding retirement pension and family pension for employees in Sweden are secured through an insurance policy with Alecta. According to a statement made by the Financial Accounting Standards Council's Emerging Issues Task Force, URA 42, this is a defined benefit plan that includes several employers. For the 2004 financial year, the company has not had access to information which makes it possible to report this plan as a defined benefit plan. The pension plan according to ITP, which is secured by insurance policies with Alecta, is thus reported as a defined contribution plan. This year's fees for pension insurance policies taken out with Alecta amount to SEK XXm (2003: SEK YYm). Alecta's surplus can be distributed to the policyholders and/or the insured parties. By the end of 2004 Alecta's surplus in the form of the collective funding level³ was xx percent (2003: yy percent). The collective funding level consists of the market value of Alecta's assets as a percentage of the

¹ It's still too early to decide whether the same type of information can be used for reporting in the 2005 interim reports.

² The example should be adapted when a reference is made to IAS 19.

³ Each month Alecta publishes information about its funding ratio on its website.



insurance commitments calculated according to Alecta's projected actuarial calculations, which do not correspond to the specifications in RR 29.

Audit

If a company reports pensions as per ITP which are insured with Alecta in some other way, or does not provide information in accordance with the above, it thereby does not comply with the requirements in RR 29 (clarified in IAS 19 item 32A), which leads to the auditor having to consider how to formulate the auditor's report.

Background

Pension insurance with Alecta

In the URA 42 statement, the Swedish Financial Accounting Standards Council has established that a pension plan within the framework of ITP which is financed by insurance with Alecta should be classified as a defined benefit plan. As this type of pension plan is a defined benefit plan involving several employers, the principal rule is that it should be reported according to item 29 in RR 29.

Reporting of a multi-employer plan⁴ according to RR 29/IAS 19

According to the principal rule, a defined benefit plan involving several employers must be reported according to item 29 in RR 29:

The company must classify a plan involving several employers as a defined contribution plan or as a defined benefit plan), based on the plan's regulations, including any informal obligations that exist in addition to the formal regulations. In cases where a plan involving several employers is a defined benefit plan, the company must a) report its proportional share of the defined benefit obligation and of the plan assets and costs connected with the plan in the same way as for any other defined benefit plan and b) supply the information required in item 125.

This means that the company must report its proportional share of the defined benefit obligation and of the plan assets and costs connected with the plan in the same way as for any other defined benefit plan. The company must also supply the information required for this type of pension plan. When there isn't sufficient information for this type of reporting, the company must report this fact in accordance with item 30 in RR 29. In such a case, it must report the plan as if it were a defined contribution plan and provide the information as stated in item 30:

⁴ Multi-employer plan is the international term for a plan which involves several employers.



When there isn't sufficient information to report a plan involving several employers as a defined benefit plan, the company must a) report the plan according to items 44—46 as if it were a defined contribution plan and b) provide information about I. the fact that the plan is a defined benefit plan and II. the reason why there isn't sufficient information to enable the company to report the plan as a defined benefit plan and c) to the extent that a surplus or a deficit in the plan may affect the size of future policy fees, also provide information about I. the size of this surplus or deficit, if such information is available, II. the manner in which this surplus or deficit has been established and III. any consequences for the company.

Alecta's options to produce information per company

Until now, in Sweden, an ITP plan, which is insured with Alecta, has been reported in the same way as a defined contribution plan. The reason for this is that no requirements for defined benefit reporting have existed previously, and that the construction with ITP secured by insurance policies and negotiated by the parties, does not, according to Alecta, make defined benefit reporting feasible at present. Also, only a limited number of all companies which have their pensions according to ITP insured with Alecta, apply the Financial Accounting Standards Council's recommendations and have to apply IFRS in their consolidated accounts.

During past year, Alecta has endeavoured to produce information according to IAS 19 by calculating the pension commitment for each company and allotting plan assets according to a standardised method. However, due to the construction of the ITP secured by insurance policies, Alecta has not been able to make the definitions required for the calculations to comply with the requirements in RR 29 and IAS 19.

During the year, IASB has presented a clarification (see below) which delineates how the company should conduct reporting as per IAS 19, where plans involving several employers are concerned.

International developments

The International Financial Reporting Interpretations Committee (IFRIC) has announced that it may discuss general reporting issues concerning plans that involve several employers. The purpose is to provide a more specific guideline than the one in IAS 19. Thus, IFRIC published IFRIC Draft Interpretation D6 *Multi-employer Plans* (D6) referred for consideration until 9 July 2004.

The basis of D6 has been:

For the plan as a whole, pension commitments and fair value of plan assets are calculated according to IAS 19.

Companies must report their proportional share of the plan as a whole, if there is a method of calculation which can be applied in a reliable and consistent manner.

Companies must report their share of the plan's surplus or deficit as a claim or a debt, with any changes directly in the profit and loss account.



After the referral for consideration period, IFRIC has not been able to agree on a decision as to whether the proposed reporting should be introduced or not. If it were not introduced, the idea was for the companies to report as according to US GAAP (reporting as for a defined contribution plan) without any requirement to report the company's share of deficit or surplus. IFRIC's hesitation is partly due to the fact that many bodies, to whom the proposal was referred for consideration, have pointed out that the pertinent information is not always available for a reliable allocation. In its reply to D6 as referred for consideration, Alecta has also drawn this conclusion ⁵.

Because of this, IFRIC has referred the issue to IASB, which simultaneously discussed some other proposed changes (Exposure Draft *Actuarial Gains and Losses, Group Plans and Disclosures* referred for consideration until 31 July 2004), including the issue about reporting a plan involving several companies in the same group.

IASB is expected to publish these proposed changes shortly, where item 32 about rendering accounts for multi-employer plans is also clarified. A new item 32A will be included where IASB clarifies that companies reporting a defined benefit multi-employer plan as a defined contribution plan, must report their share of the plan's surplus or deficit as an asset or a debt in the balance sheet. This presupposes a contractual relationship regulating the treatment of the plan's surplus or deficit (item 32 is included to show the connection):

32. When there is sufficient information available about a plan including several employers and which is a defined benefit plan, the company reports its proportional share of the defined benefit commitment, and the plan assets and costs connected with the plan, in the same way as for any other defined benefit plan. In certain cases the company may, however, be unable to establish its share of the plan's financial position and return in a manner sufficiently reliable for the reporting to be based on it. This may be the case if

a) the company does not have access to information about the plan which complies with the requirements in this recommendation or

b) the plan exposes the involved companies to actuarial risks connected to present or previous employees at other companies, and due to which there is no consistent and reliable basis for the allocation of obligations, plan assets and costs between the individual companies involved in the plan.

In cases like this, the company reports the plan as if it were a defined benefit plan and provides the additional information required in item 30.

32A There may be a contractual agreement between the multi-employer plan and its participants that determines how a surplus in the plan would be distributed to the participants or a deficit funded. A participant in a multi-employer plan with such an agreement that accounts for the plan as a defined contribution plan in accordance with paragraph 30 shall recognise the asset or the liability that arises from the contractual agreement.

⁵ From Alecta's reply to D6 as referred for consideration : "The design of the ITP Plan insured with Alecta would result in accounts that are both inconsistent and very volatile if the plan would be reported as a defined benefit plan"...



Example illustrating paragraph 32A

An entity participates in a multi-employer defined benefit plan that does not prepare plan valuations on an IAS 19 basis. It therefore accounts for the plan as if it were a defined contribution plan. A non-IAS 19 funding valuation shows a deficit of 100 million in the plan. The plan has agreed under contract a schedule of contributions with the participating employers in the plan that will eliminate the deficit over the next five years. The present value of the entity's contribution under the contract is 8 million.

The entity recognises a liability of 8 million.

Application with regard to Alecta

A pension plan within the framework of ITP which is financed through an insurance policy with Alecta, should be classified as a defined benefit plan. But due to the construction with ITP secured by insurance policies and negotiated by the parties, the companies cannot, according to Alecta, currently report their proportional share of the defined benefit commitment and of the plan assets and costs connected with the plan in the same manner as for any other defined benefit plan. Neither can they supply the information required for this type of pension plan. This would require that leavers and pensioners are also related to individual companies and that consideration is taken to informal commitments. The structure of the ITP system implies that the company's actuarial result is composite, which affects the possibility of finding the information required for the individual company.

According to RR 29/IAS 19, the company should thus conduct their reporting as per items 44—46, as if the pension plan were a defined benefit plan. The company should supply information about the plan being a defined benefit plan, while pointing out that the actual construction with an ITP secured by insurance policies does not make it possible for the company to report the plan as a defined benefit plan.

Moreover, it's unclear whether a surplus or a deficit in the plan may affect the size of future fees for the individual company and for the plan as a whole. Alecta is a mutual company which is, on the one hand, governed by the Insurance Operations Act and, on the other hand, by what is decided by the parties involved in collective agreements.

As seen above, defined benefit plans are in certain cases reported as if the pension plans were defined contribution plans. The upcoming clarification in IAS 19, item 32A, requires that a contractual relationship exists between Alecta and the individual companies in these particular cases, in order for their share of Alecta's deficit or surplus to be reported as a debt or an asset. There is no such relationship regarding ITP secured by insurance policies.