Financial Accounting Standards Board

Original Pronouncements

As Amended

Statement of Financial Accounting Standards No. 87

Employers' Accounting for Pensions

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STATUS

Issued: December 1985

Effective Date: For fiscal years beginning after December 15, 1986

Affects: Supersedes APB 8
Amends APB 12, paragraph 6
Amends APB 16, paragraphs 88 and 88(h)
Deletes APB 16, footnote 13
Amends FAS 5, paragraph 7
Supersedes FAS 36
Supersedes FIN 3

Affected by: Paragraph 8 amended by FAS 106, paragraph 14
Paragraphs 16, 20, 25, 26, 29, and 32 through 34 amended by FAS 158, paragraphs C2(a) through C2(d) and C2(f) through C2(i), respectively
Paragraphs 28 and 35 through 38 replaced by FAS 158, paragraphs C2(e) and C2(j) through C2(m), respectively
Paragraph 37 amended by FAS 96, paragraph 204; FAS 109, paragraph 287; and FAS 130, paragraph 31(a)
Paragraph 38 amended by FAS 130, paragraph 31(b)
Paragraph 44A added by FAS 158, paragraph C2(n)
Paragraph 49 amended by FAS 135, paragraph 4(p); FAS 149, paragraph 33; effectively amended by FAS 132(R), paragraph 4; and amended by FAS 157, paragraph E12(a), and FAS 158, paragraph C2(o)
Paragraphs 52 and 55 amended by FAS 158, paragraphs C2(p) and C2(q), respectively
Paragraphs 54, 56, 65, and 69 replaced by FAS 132, paragraphs 12(a), 12(b), 12(c), and 12(e), respectively, and FAS 132(R), paragraph 16
Paragraph 66 amended by FAS 135, paragraph 4(p), and effectively amended by FAS 132(R), paragraph 4
Paragraph 74 amended by FAS 141, paragraph E12, and FAS 158, paragraph C2(r)
Paragraph 74 replaced by FAS 141(R), paragraph E19(a)
Paragraphs 74A through 74D added by FAS 158, paragraph C2(s)
Paragraph 261 amended by FSP FAS 158-1, paragraph 5
Paragraph 261A added by FAS 158, paragraph C2(t), and effectively deleted by FSP FAS 158-1, paragraph 5
Illustrations 1, 2, and 5 (paragraph 261) deleted by FSP FAS 158-1, paragraph 5
Illustration 3 (paragraph 261) amended by FSP FAS 158-1, paragraph 5
Illustration 4 (paragraph 261) amended by FAS 135, paragraph 4(p), and FSP FAS 158-1, paragraph 5
Illustration 6 (paragraph 261) replaced by FAS 132, paragraphs 61 through 64, and FAS 132(R), paragraphs C1 through C5
Illustration 7 (paragraph 261) amended by FAS 141, paragraph E12
Illustration 7 (paragraph 261) deleted by FSP FAS 158-1, paragraph 5
Paragraph 264 amended by FAS 157, paragraph E12(b), and FAS 158, paragraph C2(u)
Paragraphs E1 through E107 added by FSP FAS 158-1, paragraph 8
Paragraphs E1, E3, E23, E25, E30, E34 through E43, E60, E64A, E70 through E72, E74 through E78, and E89 through E106 deleted by FSP FAS 158-1, paragraph 8
Paragraphs E15 and E88 deleted by FAS 141(R), paragraphs E19(b) and E19(c), respectively
Footnote 3 deleted by FAS 106, paragraph 14
Footnotes 5 and 6 amended by FAS 158, paragraphs C2(f) and C2(g), respectively
Footnote 11a added by FAS 149, paragraph 33, and deleted by FAS 157, paragraph E12(a)
Footnote 12 amended by FAS 157, paragraph E12(a)

Footnote 13 deleted by FAS 135, paragraph 4(p)
Footnote 17 added by FAS 158, paragraph C2(t), and effectively deleted by FSP FAS 158-1, paragraph 5

Other Interpretive Pronouncement: FTB 87-1 (Superseded by FAS 106)

Other Interpretive Releases: FASB Special Report, *A Guide to Implementation of Statement 87 on Employers' Accounting for Pensions: Questions and Answers* (Resolves EITF Issue No. 87-13) (Superseded by FSP FAS 158-1) **Note:** This Special Report has been included in FAS 87 as Appendix E by FSP FAS 158-1.
FASB Staff Position FAS 158-1

AICPA Accounting Standards Executive Committee (AcSEC)

Related Pronouncement: SOP 94-6

Issues Discussed by FASB Emerging Issues Task Force (EITF)

Affects: Partially resolves EITF Issue No. 84-35

Interpreted by: Paragraphs 24 through 28 interpreted by EITF Issue No. 91-7
Paragraph 64 interpreted by EITF Issue No. 86-27
Paragraph 68 interpreted by EITF Issue No. 90-3
Paragraph 198 interpreted by EITF Topic No. D-36

Related Issues: EITF Issues No. 88-1, 03-2, and 03-4 and Topic No. D-27

SUMMARY

This Statement supersedes previous standards for employers' accounting for pensions. The most significant changes to past practice affect an employer's accounting for a single-employer defined benefit pension plan, although some provisions also apply to an employer that participates in a multiemployer plan or sponsors a defined contribution plan.

Measuring cost and reporting liabilities resulting from defined benefit pension plans have been sources of accounting controversy for many years. Both the Committee on Accounting Procedure, in 1956, and the Accounting Principles Board (APB), in 1966, concluded that improvements in pension accounting were necessary beyond what was considered practical at those times.

After 1966, the importance of information about pensions grew with increases in the number of plans and amounts of pension assets and obligations. There were significant changes in both the legal environment (for example, the enactment of ERISA) and the economic environment (for example, higher inflation and interest rates). Critics of prior accounting requirements, including users of financial statements, became aware that reported pension cost was not comparable from one company to another and often was not consistent from period to period for the same company. They also became aware that significant pension-related obligations and assets were not recognized in financial statements.

Funding and Accrual Accounting

This Statement reaffirms the usefulness of information based on accrual accounting. Accrual accounting goes beyond cash transactions to provide information about assets, liabilities, and earnings. The Board has concluded, as did the APB in 1966, that net pension cost for a period is not necessarily determined by the amount the employer decides to contribute to the plan for that period. Many factors (including tax considerations and availability of both cash and alternative investment opportunities) that affect funding decisions should not be allowed to dictate accounting results if the accounting is to provide the most useful information.

The conclusion that accounting information on an accrual basis is needed does not mean that accounting information and funding decisions are unrelated. In pensions, as in other areas, managers may use accounting information along with other factors in making financial decisions. Some employers may decide to change their pension funding policies based in part on the new accounting information. Financial statements should

provide information that is useful to those who make economic decisions, and the decision to fund a pension plan to a greater or lesser extent is an economic decision. The Board, however, does not have as an objective either an increase or a decrease in the funding level of any particular plan or plans. Neither does the Board believe that the information required by this Statement is the only information needed to make a funding decision or that net periodic pension cost, as defined, is necessarily the appropriate amount for any particular employer's periodic contribution.

Fundamentals of Pension Accounting

In applying accrual accounting to pensions, this Statement retains three fundamental aspects of past pension accounting: *delaying recognition* of certain events, reporting *net cost,* and *offsetting* liabilities and assets. Those three features of practice have shaped financial reporting for pensions for many years, although they have been neither explicitly addressed nor widely understood, and they conflict in some respects with accounting principles applied elsewhere.

The *delayed recognition* feature means that changes in the pension obligation (including those resulting from plan amendments) and changes in the value of assets set aside to meet those obligations are not recognized as they occur but are recognized systematically and gradually over subsequent periods. All changes are ultimately recognized except to the extent they may be offset by subsequent changes, but at any point changes that have been identified and quantified await subsequent accounting recognition as net cost components and as liabilities or assets.

The *net cost* feature means that the recognized consequences of events and transactions affecting a pension plan are reported as a single net amount in the employer's financial statements. That approach aggregates at least three items that might be reported separately for any other part of an employer's operations: the compensation cost of benefits promised, interest cost resulting from deferred payment of those benefits, and the results of investing what are often significant amounts of assets.

The *offsetting* feature means that recognized values of assets contributed to a plan and liabilities for pensions recognized as net pension cost of past periods are shown net in the employer's statement of financial position, even though the liability has not been settled, the assets may be still largely controlled, and substantial risks and rewards associated with both of those amounts are clearly borne by the employer.

Within those three features of practice that are retained by this Statement, the Board has sought to achieve more useful financial reporting through three changes:

a. This Statement requires a standardized method for measuring net periodic pension cost that is intended to improve comparability and understandability by recognizing the compensation cost of an employee's pension over that employee's approximate service period and by relating that cost more directly to the terms of the plan.
b. This Statement requires immediate recognition of a liability (the minimum liability) when the accumulated benefit obligation exceeds the fair value of plan assets, although it continues to delay recognition of the offsetting amount as an increase in net periodic pension cost.
c. This Statement requires expanded disclosures intended to provide more complete and more current information than can be practically incorporated in financial statements at the present time.

Cost Recognition and Measurement

A fundamental objective of this Statement is to recognize the compensation cost of an employee's pension benefits (including prior service cost) over that employee's approximate service period. Many respondents to *Preliminary Views* and the Exposure Draft on employers' accounting for pensions agreed with that objective, which conflicts with some aspects of past practice under APB Opinion No. 8, *Accounting for the Cost of Pension Plans.*

The Board believes that the understandability, comparability, and usefulness of pension information will be improved by narrowing the past range of methods for allocating or attributing the cost of an employee's pension to individual periods of service. The Board was unable to identify differences in circumstances that would make it appropriate for different employers to use fundamentally different accounting methods or for a single employer to use different methods for different plans.

The Board believes that the terms of the plan that define the benefits an employee will receive (the plan's benefit formula) provide the most relevant and reliable indication of how pension cost and pension obligations are incurred. In the absence of convincing evidence that the substance of an exchange is different from that indicated by the agreement between the parties, accounting has traditionally looked to the terms of the agreement as a basis for recording the exchange. Unlike some other methods previously used for pension accounting, the method required by this Statement focuses more directly on the plan's benefit formula as the basis for determining the benefit earned, and therefore the cost incurred, in each individual period.

Statement of Financial Position

The Board believes that this Statement represents an improvement in past practices for the reporting of financial position in two ways. First, recognition of the cost of pensions over employees' service periods will result in earlier (but still gradual) recognition of significant liabilities that were reflected more slowly in the past financial statements of some employers. Second, the requirement to recognize a minimum liability limits the extent to which the delayed recognition of plan amendments and losses in net periodic pension cost can result in omission of certain liabilities from statements of financial position.

Recognition of a measure of at least the minimum pension obligation as a liability is not a new idea. Accounting Research Bulletin No. 47, *Accounting for Costs of Pension Plans,* published in 1956, stated that "as a minimum, the accounts and financial statements should reflect accruals which equal the present worth, actuarially calculated, of pension commitments to employees to the extent that pension rights have vested in the employees, reduced, in the case of the balance sheet, by any accumulated trusteed funds or annuity contracts purchased." Opinion 8 required that "if the company has a legal obligation for pension cost in excess of amounts paid or accrued, the excess should be shown in the balance sheet as both a liability and a deferred charge."

The Board believes that an employer with an unfunded pension obligation has a liability and an employer with an overfunded pension obligation has an asset. The most relevant and reliable information available about that liability or asset is based on the fair value of plan assets and a measure of the present value of the obligation using current, explicit assumptions. The Board concluded, however, that recognition in financial statements of those amounts in their entirety would be too great a change from past practice. Some Board members were also influenced by concerns about the reliability of measures of the obligation.

The delayed recognition included in this Statement results in excluding the most current and most relevant information from the statement of financial position. That information, however, is included in the required disclosures.

Information Needed

The Board believes that users of financial reports need information beyond that previously disclosed to be able to assess the status of an employer's pension arrangements and their effects on the employer's financial position and results of operations. Most respondents agreed, and this Statement requires certain disclosures not previously required.

This Statement requires disclosure of the components of net pension cost and of the projected benefit obligation. One of the factors that has made pension information difficult to understand is that past practice and terminology combined elements that are different in substance and effect into net amounts. Although the Board agreed to retain from past pension accounting practice the basic features of reporting net cost and offsetting liabilities and assets, the Board believes that disclosure of the components will significantly assist users in understanding the economic events that have occurred. Those disclosures also make it easier to understand why reported amounts change from period to period, especially when a large cost or asset is offset by a large revenue or liability to produce a relatively small net reported amount.

* * *

After considering the range of comments on *Preliminary Views* and the Exposure Draft, the Board concluded that this Statement represents a worthwhile improvement in financial reporting. Opinion 8 noted in 1966 that "accounting for pension cost is in a transitional stage." The Board believes that is still true in 1985. FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises,* paragraph 2, indicates that "the Board intends future change [in practice] to occur in the gradual, evolutionary way that has characterized past change."

Statement of Financial Accounting Standards No. 87

Employers' Accounting for Pensions

CONTENTS

INTRODUCTION

1. This Statement establishes standards of financial reporting and accounting for an employer that offers **pension benefits**[1] to its employees. The FASB added two pension projects to its agenda in 1974: (a) accounting and reporting by employee benefit plans and (b) employers' accounting for pensions. The first of those projects led to the issuance in 1980 of FASB Statement No. 35, *Accounting and Reporting by Defined Benefit Pension Plans;* this Statement is a result of the second project.

2. Measurement of cost and reporting of liabilities resulting from **defined benefit pension plans** have been a source of accounting controversy for many years. In 1956, the Committee on Accounting Procedure in Accounting Research Bulletin (ARB) No. 47, *Accounting for Costs of Pension Plans,* expressed a preference for accounting in which cost would be "systematically accrued during the expected period of active **service** of the covered employees . . ." (paragraph 5). The committee went on to state:

> However, the committee believes that opinion as to the accounting for pension costs

[1]Words that appear in the glossary are set in **boldface type** the first time that they appear.

has not yet crystallized sufficiently to make it possible at this time to assure agreement on any one method, and that differences in accounting for pension costs are likely to continue for a time. Accordingly, for the present, the committee believes that, as a minimum, the accounts and financial statements should reflect accruals which equal the present worth, actuarially calculated, of pension commitments to employees to the extent that pension rights have vested in the employees, reduced, in the case of the balance sheet, by any accumulated trusteed **funds** or **annuity contracts** purchased. [paragraph 7]

3. The Accounting Principles Board (APB) issued Opinion No. 8, *Accounting for the Cost of Pension Plans,* in 1966. Opinion 8 described several views of pension cost supported by members of the APB. It concluded that "in the light of such differences in views and of the fact that accounting for pension cost is in a transitional stage, . . . the range of practices would be significantly narrowed if pension cost were accounted for at the present time within limits . . ." (paragraph 17).

4. After 1966, the importance of information about pensions grew with increases in the number of plans and the amounts of pension assets and obligations. There were significant changes in both the legal environment (for example, the enactment of **ERISA**) and the economic environment (for example, higher inflation and **interest rates**). Critics of past accounting, including users of financial statements, became aware that reported pension cost was not comparable from one company to another and often was not consistent from period to period for the same company. They also became aware that significant pension-related obligations and assets were not recognized in financial statements.

5. This Statement continues the evolutionary search for more meaningful and more useful pension accounting. The FASB believes that the conclusions it has reached are a worthwhile and significant step in that direction, but it also believes that those conclusions are not likely to be the final step in that evolution. Pension accounting in 1985 is still in a transitional stage. It has not yet fully crystallized, but the Board believes this Statement represents significant progress, especially in the measurement of **net periodic pension cost** and in the disclosure of useful information.

6. The Board's objectives for this Statement, in broad terms, are as follows:

a. To provide a measure of net periodic pension cost[2] that is more representationally faithful than those used in past practice because it reflects the terms of the underlying plan and because it better approximates the recognition of the cost of an employee's pension over that employee's service period
b. To provide a measure of net periodic pension cost that is more understandable and comparable and is, therefore, more useful than those in past practice
c. To provide disclosures that will allow users to understand better the extent and effect of an employer's undertaking to provide employee pensions and related financial arrangements
d. To improve reporting of financial position.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Scope

7. This Statement establishes standards of financial accounting and reporting for an employer that offers pension benefits to its employees. Ordinarily, such benefits are periodic pension payments to retired employees or their survivors, but they may also include benefits payable as a single lump sum and, except as noted in the following paragraph, other types of benefits such as death benefits provided through a pension plan. An employer's arrangement to provide pension benefits may take a variety of forms and may be financed in different ways. This Statement applies to any arrangement that is similar in substance to a pension plan regardless of the form or means of financing. This Statement applies to a written plan and to a plan whose existence may be implied from a well-defined, although perhaps unwritten, practice of paying postretirement benefits.

8. This Statement does not apply to life insurance benefits provided outside a pension plan or to other

[2]This Statement uses the term *net periodic pension cost* rather than *net pension expense* because part of the cost recognized in a period may be capitalized along with other costs as part of an asset such as inventory.

postretirement health and welfare benefits. The accounting for those benefits is set forth in FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions.* This Statement does not change or supersede any of the requirements set forth in Statement 35 for the financial statements of a pension plan.

9. This Statement supersedes Opinion 8, as amended; FASB Statement No. 36, *Disclosure of Pension Information;* and FASB Interpretation No. 3, *Accounting for the Cost of Pension Plans Subject to the Employee Retirement Income Security Act of 1974.* Paragraphs 70 and 75 of this Statement amend FASB Statement No. 5, *Accounting for Contingencies,* and APB Opinion No. 16, *Business Combinations.*

Use of Reasonable Approximations

10. This Statement is intended to specify accounting objectives and results rather than specific computational means of obtaining those results. If estimates, averages, or computational shortcuts can reduce the cost of applying this Statement, their use is appropriate, provided the results are reasonably expected not to be materially different from the results of a detailed application.

Single-Employer Defined Benefit Pension Plans

11. The most significant parts of this Statement involve an employer's accounting for a single-employer defined benefit pension plan. For purposes of this Statement, a defined benefit pension plan is one that defines an amount of pension benefit to be provided, usually as a function of one or more factors such as age, years of service, or compensation.

12. A pension benefit is part of the compensation paid to an employee for services. In a defined benefit pension plan, the employer promises to provide, in addition to current wages, retirement income payments in future years after the employee retires or terminates service. Generally, the amount of benefit to be paid depends on a number of future events that are incorporated in the **plan's benefit formula,** often including how long the employee and any survivors live, how many years of service the employee renders, and the employee's compensation in the years immediately before retirement or termination. In most cases, services are rendered over a number of years before an employee retires and begins collecting the pension. Even though the services rendered by an employee are complete and the employee has retired, the total amount of benefit that the employer has promised and the cost to the employer of the services rendered are not precisely determinable but can only be estimated using the **benefit formula** and estimates of the relevant future events, many of which the employer cannot control.

13. Any method of pension accounting that recognizes cost before the payment of benefits to retirees must deal with two problems stemming from the nature of the defined benefit pension contract. First, estimates or **assumptions** must be made concerning the future events that will determine the amount and timing of the benefit payments. Second, some approach to attributing the cost of pension benefits to individual years of service must be selected.

14. This Statement requires use of explicit assumptions, each of which individually represents the best estimate of a particular future event. This Statement also requires use of the terms of the pension plan itself, specifically the plan's benefit formula, as a basis for attributing benefits earned and their cost to periods of employee service.

Basic Elements of Pension Accounting

15. The assumptions and the **attribution** of cost to periods of employee service are fundamental to the measurements of net periodic pension cost and pension obligations required by this Statement. The basic elements of pension accounting are described in paragraphs 16–19; they are the foundation of the accounting and reporting requirements set forth in this Statement.

16. Net periodic pension cost has often been viewed as a single homogeneous amount, but in fact it is made up of several *components* that reflect different aspects of the employer's financial arrangements as well as the cost of benefits earned by employees. The cost of a benefit can be determined without regard to how the employer decides to finance the plan. The **service cost component** of net periodic pension cost is the **actuarial present value** of benefits attributed by the plan's benefit formula to services rendered by employees during the period. The service cost component is conceptually the same for an unfunded

[3][This footnote has been deleted. See Status page.]

plan, a plan with minimal funding, and a well-funded plan. The other components of net periodic pension cost are **interest cost**[4] (interest on the **projected benefit obligation,** which is a discounted amount), **actual return on plan assets, amortization** of any **prior service cost** or credit included in accumulated other comprehensive income, and **gain or loss,** which includes, to the extent recognized, amortization of the net gain or loss included in accumulated other comprehensive income. Both the return on plan assets and interest cost components are in substance financial items rather than employee compensation costs.

17. The projected benefit obligation as of a date is the actuarial present value of all benefits attributed by the plan's benefit formula to employee service rendered prior to that date. The projected benefit obligation is measured using an assumption as to future compensation levels if the **pension benefit formula** is based on those future compensation levels. Plans for which the pension benefit formula is based on future compensation are sometimes called pay-related, **final-pay,** final-average-pay, or **career-average-pay** plans. Plans for which the pension benefit formula is not based on future compensation levels are called non-pay-related or **flat-benefit plans.** The projected benefit obligation is a measure of benefits attributed to service to date assuming that the plan continues in effect and that estimated future events (including compensation increases, **turnover,** and **mortality**) occur.

18. The **accumulated benefit obligation** as of a date is the actuarial present value of benefits attributed by the pension benefit formula to employee service rendered prior to that date and based on current and past compensation levels. The accumulated benefit obligation differs from the projected benefit obligation in that it includes no assumption about future compensation levels. For plans with flat-benefit or non-pay-related pension benefit formulas, the accumulated benefit obligation and the projected benefit obligation are the same. The accumulated benefit obligation and the **vested benefit obligation** provide information about the obligation the employer would have if the plan were discontinued.

19. Plan assets are assets—usually stocks, bonds, and other investments—that have been segregated and restricted (usually in a trust) to provide for pension benefits. The amount of plan assets includes amounts contributed by the employer (and by employees for a **contributory plan**) and amounts earned from investing the contributions, less benefits paid. 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 for purposes of this Statement even though it may be intended that such assets be used to provide pensions. Amounts accrued by the employer but not yet paid to the plan are not plan assets for purposes of this Statement. Securities of the employer held by the plan are includable in plan assets provided they are transferable.

Recognition of Net Periodic Pension Cost

20. The following components shall be included in the net pension cost recognized for a period by an employer **sponsoring** a defined benefit pension plan:

a. Service cost
b. Interest cost
c. Actual return on plan assets, if any
d. Amortization of any prior service cost or credit included in accumulated other comprehensive income
e. Gain or loss (including the effects of changes in assumptions) to the extent recognized (paragraph 34)
f. Amortization of any net transition asset or obligation existing at the date of initial application of this Statement and remaining in accumulated other comprehensive income (paragraph 77).

Service cost

21. The service cost component recognized in a period shall be determined as the actuarial present value of benefits attributed by the pension benefit formula to employee service during that period. The measurement of the service cost component requires use of an attribution method and assumptions. That measurement is discussed in paragraphs 39–48 of this Statement.

[4]The interest cost component of net periodic pension cost shall not be considered to be interest for purposes of applying FASB Statement No. 34, *Capitalization of Interest Cost.*

Interest cost

22. The interest cost component recognized in a period shall be determined as the increase in the projected benefit obligation due to the passage of time. Measuring the projected benefit obligation as a present value requires accrual of an interest cost at rates equal to the assumed discount rates.

Actual return on plan assets

23. For a funded plan, the actual return on plan assets shall be determined based on the fair value of plan assets at the beginning and the end of the period, adjusted for contributions and benefit payments.

Prior service cost

24. **Plan amendments** (including initiation of a plan) often include provisions that grant increased benefits based on services rendered in prior periods. Because plan amendments are granted with the expectation that the employer will realize economic benefits in future periods, this Statement does not require the cost of providing such **retroactive benefits** (that is, prior service cost) to be included in net periodic pension cost entirely in the year of the amendment but provides for recognition during the future service periods of those employees active at the date of the amendment who are expected to receive benefits under the plan.

25. A plan amendment that retroactively increases benefits (including benefits that are granted to retirees) increases the projected benefit obligation. The cost of the benefit improvement shall be recognized as a charge to other comprehensive income at the date of the amendment. Except as specified in paragraphs 26 and 27, that prior service cost shall be amortized as a component of net periodic pension cost by assigning an equal amount to each future period of service of each employee active at the date of the amendment who is expected to receive benefits under the plan. If all or almost all of a plan's **participants** are inactive, the cost of retroactive plan amendments affecting benefits of inactive participants shall be amortized based on the remaining life expectancy of those participants instead of based on the remaining service period. Other comprehensive income is adjusted each period as prior service cost is amortized.

26. To reduce the complexity and detail of the computations required, consistent use of an alternative approach that more rapidly amortizes the cost of retroactive amendments is acceptable. For example, a straight-line amortization of the cost over the average remaining service period of employees expected to receive benefits under the plan is acceptable. The alternative method used shall be disclosed.

27. In some situations a history of regular plan amendments and other evidence may indicate that the period during which the employer expects to realize economic benefits from an amendment granting retroactive benefits is shorter than the entire remaining service period of the active employees. Identification of such situations requires an assessment of the individual circumstances and the substance of the particular plan situation. In those circumstances, the amortization of prior service cost shall be accelerated to reflect the more rapid expiration of the employer's economic benefits and to recognize the cost in the periods benefited.

28. A plan amendment that retroactively reduces, rather than increases, benefits decreases the projected benefit obligation. The reduction in benefits shall be recognized as a credit (prior service credit) to other comprehensive income that shall be used first to reduce any remaining prior service cost included in accumulated other comprehensive income. Any remaining prior service credit shall be amortized as a component of net periodic pension cost on the same basis as the cost of a benefit increase.

Gains and losses

29. **Gains and losses** are changes in the amount of either the projected benefit obligation or plan assets resulting from experience different from that assumed and from changes in assumptions. This Statement does not distinguish between those sources of gains and losses. Gains and losses include amounts that have been realized, for example by sale of a security, as well as amounts that are unrealized. Because gains and losses may reflect refinements in estimates as well as real changes in economic values and because some gains in one period may be offset by losses in another or vice versa, this Statement does not require recognition of gains and losses as components of net pension cost of the period in which they

arise.[5] Gains and losses that are not recognized immediately as a component of net periodic pension cost shall be recognized as increases or decreases in other comprehensive income as they arise.

30. The **expected return on plan assets** shall be determined based on the **expected long-term rate of return on plan assets** and the **market-related value of plan assets.** The market-related value of plan assets shall 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 ways of calculating market-related value may be used for different classes of assets (for example, an employer might use fair value for bonds and a five-year-moving-average value for equities), but the manner of determining market-related value shall be applied consistently from year to year for each asset class.

31. Asset gains and losses are differences between the actual return on assets during a period and the expected return on assets for that period. Asset gains and losses include both (a) changes reflected in the market-related value of assets and (b) changes not yet reflected in the market-related value (that is, the difference between the fair value of assets and the market-related value). Asset gains and losses not yet reflected in market-related value are not required to be amortized under paragraphs 32 and 33.

32. As a minimum, amortization of a net gain or loss included in accumulated other comprehensive income (excluding asset gains and losses not yet reflected in market-related value) shall be included as a component of net pension cost for a year if, as of the beginning of the year, that net gain or loss exceeds 10 percent of the greater of the projected benefit obligation or the market-related value of plan assets. If amortization is required, the minimum amortization[6] shall be that excess divided by the average remaining service period of active employees expected to receive benefits under the plan. If all or almost all of a plan's participants are inactive, the average remaining life expectancy of the inactive participants shall be used instead of average remaining service.

33. Any systematic method of amortizing gains or losses may be used in lieu of the minimum specified in the previous paragraph provided that (a) the minimum is used in any period in which the minimum amortization is greater (reduces the net balance included in accumulated other comprehensive income by more), (b) the method is applied consistently, (c) the method is applied similarly to both gains and losses, and (d) the method used is disclosed.

34. The **gain or loss component** of net periodic pension cost shall consist of (a) the difference between the actual return on plan assets and the expected return on plan assets and (b) amortization of the net gain or loss included in accumulated other comprehensive income.

Recognition of Liabilities and Assets

35. If the projected benefit obligation exceeds the fair value of plan assets, the employer shall recognize in its statement of financial position a liability that equals the **unfunded projected benefit obligation.** If the fair value of plan assets exceeds the projected benefit obligation, the employer shall recognize in its statement of financial position an asset that equals the overfunded projected benefit obligation.

36. The employer shall aggregate the statuses of all overfunded plans and recognize that amount as an asset in its statement of financial position. It also shall aggregate the statuses of all underfunded plans and recognize that amount as a liability in its statement of financial position. An employer that presents a classified statement of financial position shall classify the liability for an underfunded plan as a current liability, a noncurrent liability, or a combination of both. The current portion (determined on a plan-by-plan basis) is the amount by which the actuarial present value of benefits included in the benefit obligation payable in the next 12 months, or operating cycle if longer, exceeds the fair value of plan assets. The asset for an overfunded plan shall be classified as a noncurrent asset in a classified statement of financial position.

37. The asset or liability that is recognized pursuant to paragraph 35 may result in a temporary difference, as defined in FASB Statement No. 109, *Accounting for Income Taxes.* The deferred tax effects of any temporary differences shall be recognized in income

[5]Accounting for **plan terminations** and **curtailments** and other circumstances in which recognition of gains and losses as a component of net periodic pension cost might not be delayed is addressed in FASB Statement No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits.*

[6]The amortization must always reduce the beginning-of-the-year balance. Amortization of a net gain results in a decrease in net periodic pension cost; amortization of a net loss results in an increase in net periodic pension cost.

tax expense or benefit for the year and shall be allocated to various financial statement components, including other comprehensive income, pursuant to paragraphs 35–39 of Statement 109.

38. If a new determination of the funded status of a plan to be recognized as an asset or a liability in the employer's statement of financial position is made (paragraph 52), or when net gains or losses, prior service costs or credits, or the net transition asset or obligation existing at the date of initial application of this Statement are amortized as components of net periodic pension cost, the related balances for those net gains or losses, prior service costs or credits, and transition asset or obligation in accumulated other comprehensive income shall be adjusted as necessary and reported in other comprehensive income.

Measurement of Cost and Obligations

39. The service component of net periodic pension cost, the projected benefit obligation, and the accumulated benefit obligation are based on an attribution of pension benefits to periods of employee service and on the use of actuarial assumptions to calculate the actuarial present value of those benefits. Actuarial assumptions reflect the time value of money (**discount rate**) and the probability of payment (assumptions as to mortality, turnover, early retirement, and so forth).

Attribution

40. For purposes of this Statement, pension benefits ordinarily shall be attributed to periods of employee service based on the plan's benefit formula to the extent that the formula states or implies an attribution. For example, if a plan's formula provides for a pension benefit of $10 per month for life for each year of service, the benefit attributed to each year of an employee's service is $10 times the number of months of life expectancy after retirement, and the cost attributable to each year is the actuarial present value of that benefit. For plan benefit formulas that define benefits similarly for all years of service, that attribution is a **"benefit/years-of-service" approach** because it attributes the same amount of the pension benefit to each year of service.[8] For final-pay and career-average-pay plans, that attribution is also the same as the "projected unit credit" or "unit credit with service prorate" actuarial cost method. For a flat-benefit plan, it is the same as the "unit credit" actuarial cost method.

41. In some situations a history of regular increases in non-pay-related benefits or benefits under a career-average-pay plan and other evidence may indicate that an employer has a present commitment to make future amendments and that the substance of the plan is to provide benefits attributable to prior service that are greater than the benefits defined by the written terms of the plan. In those situations, the substantive commitment shall be the basis for the accounting, and the existence and nature of the commitment to make future amendments shall be disclosed.

42. Some plans may have benefit formulas that attribute all or a disproportionate share of the total benefits provided to later years of service, thereby achieving in substance a delayed vesting of benefits. For example, a plan that provides no benefits for the first 19 years of service and a vested benefit of $10,000 for the 20th year is substantively the same as a plan that provides $500 per year for each of 20 years and requires 20 years of service before benefits vest. For such plans the total projected benefit shall be considered to accumulate in proportion to the ratio of the number of completed years of service to the number that will have been completed when the benefit is first fully vested. If a plan's benefit formula does not specify how a particular benefit relates to services rendered, the benefit shall be considered to accumulate as follows:

a. For benefits of a type includable in **vested benefits,**[9] in proportion to the ratio of the number of completed years of service to the number that will have been completed when the benefit is first fully vested
b. For benefits of a type not includable in vested benefits,[10] in proportion to the ratio of completed years of service to total projected years of service.

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[7][This footnote has been deleted. See Status page.]

[8]Some plans define different benefits for different years of service. For example, a step-rate plan might provide a benefit of 1 percent of final pay for each year of service up to 20 years and 1½ percent of final pay for years of service in excess of 20. Another plan might provide 1 percent of final pay for each year of service but limit the total benefit to no more than 20 percent of final pay. For such plans the attribution called for by this Statement will not assign the same amount of pension benefit to each year of service.

[9]For example, a supplemental early retirement benefit that is a vested benefit after a stated number of years.

[10]For example, a death or disability benefit that is payable only if death or disability occurs during active service.

Assumptions

43. Each significant 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.

44. Assumed discount rates shall reflect the rates at which the pension benefits could be effectively settled. It is appropriate in estimating those rates to look to available information about rates implicit in current prices of annuity contracts that could be used to effect settlement of the obligation (including information about available annuity rates currently published by the Pension Benefit Guaranty Corporation). In making those estimates, employers may also look to rates of return on high-quality fixed-income investments currently available and expected to be available during the period to maturity of the pension benefits. Assumed discount rates are used in measurements of the projected, accumulated, and vested benefit obligations and the service and interest cost components of net periodic pension cost.

44A. Pursuant to paragraph 44, an employer may look to rates of return on high-quality fixed-income investments in determining assumed discount rates. The objective of selecting assumed discount rates using that method is to measure the single amount that, if invested at the measurement date in a portfolio of high-quality debt instruments, would provide the necessary future cash flows to pay the pension benefits when due. Notionally, that single amount, the projected benefit obligation, would equal the current market value of a portfolio of high-quality zero coupon bonds whose maturity dates and amounts would be the same as the timing and amount of the expected future benefit payments. Because cash inflows would equal cash outflows in timing and amount, there would be no reinvestment risk in the yields to maturity of the portfolio. However, in other than a zero coupon portfolio, such as a portfolio of long-term debt instruments that pay semiannual interest payments or whose maturities do not extend far enough into the future to meet expected benefit payments, the assumed discount rates (the yield to maturity) need to incorporate expected reinvestment rates available in the future. Those rates shall be extrapolated from the existing yield curve at the measurement date. The determination of the assumed discount rate is separate from the determination of the expected rate of return on plan assets whenever the actual portfolio differs from the hypothetical portfolio above. Assumed discount rates shall be reevaluated at each measurement date. If the general level of interest rates rises or declines, the assumed discount rates shall change in a similar manner.

45. The expected long-term rate of return on plan assets shall reflect the average rate of earnings expected on the funds invested or to be invested to provide for the benefits included in the projected benefit obligation. In estimating that rate, appropriate consideration should be given to the returns being earned by the plan assets in the fund and the rates of return expected to be available for reinvestment. The expected long-term rate of return on plan assets is used (with the market-related value of assets) to compute the expected return on assets.

46. The service cost component of net periodic pension cost and the projected benefit obligation shall reflect future compensation levels to the extent that the pension benefit formula defines pension benefits wholly or partially as a function of future compensation levels (that is, for a final-pay plan or a career-average-pay plan). Future increases for which a present commitment exists as described in paragraph 41 shall be similarly considered. Assumed compensation levels shall reflect an estimate of the actual future compensation levels of the individual employees involved, including future changes attributed to general price levels, productivity, seniority, promotion, and other factors. All assumptions shall be consistent to the extent that each reflects expectations of the same future economic conditions, such as future rates of inflation. Measuring service cost and the projected benefit obligation based on estimated future compensation levels entails considering indirect effects, such as changes under existing law in social security benefits or benefit limitations[11] that would affect benefits provided by the plan.

47. The accumulated benefit obligation shall be measured based on employees' *history* of service and *compensation* without an estimate of future compensation levels. Excluding estimated future compensation levels also means excluding indirect effects of future changes such as increases in the social security wage base. In measuring the accumulated benefit obligation, projected years of service shall be a factor

[11]For example, those currently imposed by Section 415 of the Internal Revenue Code.

only in determining employees' expected eligibility for particular benefits, such as:

a. Increased benefits that are granted provided a specified number of years of service are rendered (for example, a pension benefit that is increased from $9 per month to $10 per month for each year of service if 20 or more years of service are rendered)
b. Early retirement benefits
c. Death benefits
d. Disability benefits.

48. Automatic benefit increases specified by the plan (for example, automatic cost-of-living increases) that are expected to occur shall be included in measurements of the projected, accumulated, and vested benefit obligations, and the service cost component required by this Statement. Also, retroactive plan amendments shall be included in the computation of the projected and accumulated benefit obligations once they have been contractually agreed to, even if some provisions take effect only in future periods. For example, if a plan amendment grants a higher benefit level for employees retiring after a future date, the higher benefit level shall be included in current-period measurements for employees expected to retire after that date.

Measurement of Plan Assets

Editor's note: After adoption of FASB Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans,* and prior to adoption of FASB Statement No. 157, *Fair Value Measurements,* paragraph 49 and related footnotes should read as follows:

49. For purposes of applying the provisions of paragraph 35 and for purposes of the disclosures required by paragraphs 5 and 8 of FASB Statement No. 132 (revised 2003), *Employers' Disclosures about Pensions and Other Postretirement Benefits,* plan investments, whether equity or debt securities, real estate, or other, shall be measured at their fair value as of the measurement date. The fair value of an investment is the amount that the plan could reasonably expect to receive for it in a current sale between a willing buyer and a willing seller, that is, other than in a forced or liquidation sale. Fair value shall be measured by the market price if an active market exists for the investment. If no active market exists for an investment but such a market exists for similar investments, selling prices in that market may be helpful in estimating fair value. If a market price is not available, a forecast of expected cash flows[11a] may aid in estimating fair value, provided the expected cash flows are discounted at a current rate commensurate with the risk involved.[12]

[11a]This pronouncement was issued prior to FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements,* and therefore the term *expected cash flows* does not necessarily have the same meaning as that term in Concepts Statement 7.

[12]For an indication of factors to be considered in determining the discount rate, refer to paragraphs 13 and 14 of APB Opinion No. 21, *Interest on Receivables and Payables.* If significant, the fair value of an investment shall reflect the brokerage commissions and other costs normally incurred in a sale.

Editor's note: After adoption of both Statements 158 and 157, paragraph 49 and related footnotes should read as follows:

49. For purposes of applying the provisions of paragraph 35 and for purposes of the disclosures required by paragraphs 5 and 8 of FASB Statement No. 132 (revised 2003), *Employers' Disclosures about Pensions and Other Postretirement Benefits,* plan investments, whether equity or debt securities, real estate, or other, shall be measured at their fair value as of the measurement date.[12]

[11a][This footnote has been deleted. See Status page.]

[12]The fair value of an investment shall be reduced by brokerage commissions and other costs normally incurred in a sale if those costs are significant (similar to fair value less cost to sell).

50. For purposes of determining the expected return on plan assets and accounting for asset gains and losses pursuant to paragraphs 29–34, a market-related asset value, defined in paragraph 30, is used.

51. Plan assets used in plan operations (for example, buildings, equipment, furniture and fixtures, and leasehold improvements) shall be measured at cost less accumulated depreciation or amortization for all purposes.

Measurement Dates

52. The measurements of plan assets and benefit obligations required by this Statement shall be as of the date of the employer's fiscal year-end statement of financial position unless (a) the plan is sponsored by a subsidiary that is consolidated using a fiscal period that differs from its parent's, as permitted by ARB No. 51, *Consolidated Financial Statements,* or (b) the plan is sponsored by an investee that is accounted for using the equity method of accounting under

APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock,* using financial statements of the investee for a fiscal period that is different from the investor's, as permitted by Opinion 18. In those cases, the employer shall measure the subsidiary's plan assets and benefit obligations as of the date used to consolidate the subsidiary's statement of financial position and shall measure the investee's plan assets and benefit obligations as of the date of the investee's financial statements used to apply the equity method. Requiring that the pension measurements be as of a particular date is not intended to require that all procedures be performed after that date. As with other financial statement items requiring estimates, much of the information can be prepared as of an earlier date and projected forward to account for subsequent events (for example, employee service). Unless a business entity remeasures both its plan assets and benefit obligations during the fiscal year, the funded status it reports in its interim-period statement of financial position shall be the same asset or liability recognized in the previous year-end statement of financial position adjusted for (1) subsequent accruals of net periodic pension cost that exclude the amortization of amounts previously recognized in other comprehensive income (for example, subsequent accruals of service cost, interest cost, and return on plan assets) and (2) contributions to a funded plan, or benefit payments. Sometimes, a business entity remeasures both plan assets and benefit obligations during the fiscal year. That is the case, for example, when a significant event such as a plan amendment, settlement, or curtailment occurs that calls for a remeasurement. Upon remeasurement, a business entity shall adjust its statement of financial position in a subsequent interim period (on a delayed basis if the measurement date provisions of FASB Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans,* have not yet been implemented) to reflect the overfunded or underfunded status of the plan consistent with that measurement date.

53. Measurements of net periodic pension cost for both interim and annual financial statements shall be based on the assumptions used for the previous year-end measurements unless more recent measurements of both plan assets and obligations are available or a significant event occurs, such as a plan amendment, that would ordinarily call for such measurements.

Disclosures

54. Refer to paragraphs 5 and 8 of Statement 132(R).

Employers with Two or More Plans

55. An employer that sponsors two or more separate defined benefit pension plans shall determine net periodic pension cost, liabilities, and assets by separately applying the provisions of this Statement to each plan. In particular, unless an employer clearly has a right to use the assets of one plan to pay benefits of another, a liability required to be recognized pursuant to paragraph 35 for one plan shall not be reduced or eliminated because the employer has recognized an asset for another plan that has assets in excess of its projected benefit obligation.

56. Refer to paragraphs 6 and 7 of Statement 132(R).

Annuity Contracts

57. An annuity contract is a contract in which an insurance company[14] unconditionally undertakes a legal obligation to provide specified benefits to specific individuals in return for a fixed consideration or premium. An annuity contract is irrevocable and involves the transfer of significant risk from the employer to the insurance company. Some annuity contracts (participating annuity contracts) provide that the purchaser (either the plan or the employer) may participate in the experience of the insurance company. Under those contracts, the insurance company ordinarily pays dividends to the purchaser. If the substance of a participating contract is such that the employer remains subject to all or most of the risks and rewards associated with the benefit obligation covered and the assets transferred to the insurance company, that contract is not an annuity contract for purposes of this Statement.

58. To the extent that benefits currently earned are covered by annuity contracts, the cost of those benefits shall be the cost of purchasing the contracts, except as provided in paragraph 61. That is, if all the

[13][This footnote has been deleted. See Status page.]

[14]If the insurance company does business primarily with the employer and related parties (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 annuity contract for purposes of this Statement. Some contracts provide for a refund of premiums if an employee for whom an annuity is purchased does not render sufficient service for the benefit to vest under the terms of the plan. Such a provision shall not by itself preclude a contract from being treated as an annuity contract for purposes of this Statement.

benefits attributed by the plan's benefit formula to service in the current period are covered by **nonparticipating annuity contracts,** the cost of the contracts determines the service cost component of net pension cost for that period.

59. Benefits provided by the pension benefit formula beyond benefits provided by annuity contracts (for example, benefits related to future compensation levels) shall be accounted for according to the provisions of this Statement applicable to plans not involving insurance contracts.

60. Benefits covered by annuity contracts shall be excluded from the projected benefit obligation and the accumulated benefit obligation. Except as provided in paragraph 61, annuity contracts shall be excluded from plan assets.

61. Some annuity contracts provide that the purchaser (either the plan or the employer) may participate in the experience of the insurance company. Under those contracts, the insurance company ordinarily pays dividends to the purchaser, the effect of which is to reduce the cost of the plan. The purchase price of a **participating annuity contract** ordinarily is higher than the price of an equivalent contract without **participation rights.** The difference is the cost of the participation right. The cost of the participation right shall be recognized at the date of purchase as an asset. In subsequent periods, the participation right shall be measured at its fair value if the contract is such that fair value is reasonably estimable. Otherwise, the participation right shall be measured at its amortized cost (not in excess of its net realizable value), and the cost shall be amortized systematically over the expected dividend period under the contract.

Other Contracts with Insurance Companies

62. Insurance contracts that are in substance equivalent to the purchase of annuities shall be accounted for as such. Other contracts with insurance companies shall be accounted for as investments and measured at fair value. For some contracts, the best available evidence of fair value may be contract value. If a contract has a determinable cash surrender value or conversion value, that is presumed to be its fair value

Defined Contribution Plans

63. For purposes of this Statement, a **defined contribution pension plan** is a plan that provides pension benefits in return for services rendered, provides an individual account for each participant, and has terms that specify how contributions to the individual's account are to be determined rather than the amount of pension benefits the individual is to receive. Under a defined contribution plan, the pension benefits a participant will receive depend only on the amount contributed to the participant's account, the returns earned on investments of those contributions, and forfeitures of other participants' benefits that may be allocated to the participant's account.

64. To the extent that a plan's defined contributions to an individual's account are to be made for periods in which that individual renders services, the net pension cost for a period shall be the contribution called for in that period. If a plan calls for contributions for periods after an individual retires or terminates, the estimated cost shall be accrued during the employee's service period.

65. Refer to paragraph 11 of Statement 132(R).

66. A pension plan having characteristics of both a defined benefit plan and a defined contribution plan requires careful analysis. If the *substance* of the plan is to provide a defined benefit, as may be the case with some "target benefit" plans, the accounting requirements shall be determined in accordance with the provisions of this Statement applicable to a defined benefit plan and the disclosure requirements shall be determined in accordance with the provisions of paragraphs 5 and 8 of Statement 132(R).

Multiemployer Plans

67. For purposes of this Statement, a **multiemployer plan** is a pension 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 usually is 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. Some multiemployer plans do not involve

a union. For example, local chapters of a not-for-profit organization may participate in a plan established by the related national organization.

68. An employer participating in a multiemployer plan shall recognize as net pension cost the required contribution for the period and shall recognize as a liability any contributions due and unpaid.

69. Refer to paragraph 12 of Statement 132(R).

70. In some situations, withdrawal from a multiemployer plan may result in an employer's having an obligation to the plan for a portion of its unfunded benefit obligations. If withdrawal under circumstances that would give rise to an obligation is either probable or reasonably possible, the provisions of FASB Statement No. 5, *Accounting for Contingencies,* shall apply. Paragraph 7 of Statement 5 is amended to delete the references to accounting for pension cost and Opinion 8.

Multiple-Employer Plans

71. Some pension plans to which two or more unrelated employers contribute are not multiemployer plans. Rather, they are in substance aggregations of single-employer plans combined to allow participating employers to pool their assets for investment purposes and to reduce the costs of plan administration. Those plans ordinarily do not involve collective-bargaining agreements. They may also 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. Such plans shall be considered single-employer plans rather than multiemployer plans for purposes of this Statement, and each employer's accounting shall be based on its respective interest in the plan.

Non-U.S. Pension Plans

72. Except for its effective date (paragraph 76), this Statement includes no special provisions applicable to pension arrangements outside the United States. To the extent that those arrangements are in substance similar to pension plans in the United States, they are subject to the provisions of this Statement for purposes of preparing financial statements in accordance with accounting principles generally accepted in the United States. The substance of an arrangement is determined by the nature of the obligation and by the terms or conditions that define the amount of benefits to be paid, not by whether (or how) a plan is funded, whether benefits are payable at intervals or as a single amount, or whether the benefits are required by law or custom or are provided under a plan the employer has elected to sponsor.

73. It is customary or required in some countries to provide benefits in the event of a voluntary or involuntary severance of employment (also called termination indemnities). If such an arrangement is in substance a pension plan (for example, if the benefits are paid for virtually all terminations), it is subject to the provisions of this Statement.

Business Combinations

[Note: Prior to the adoption of FASB Statement No. 141 (revised 2007), *Business Combinations* (effective for business combinations with an acquisition date on or after the beginning of the first annual reporting period beginning on or after 12/15/08), paragraph 74 should read as follows:]

74. When an employer is acquired in a business combination and that employer sponsors a single-employer defined benefit pension plan, the assignment of the purchase price to individual assets acquired and liabilities assumed shall include a liability for the projected benefit obligation in excess of plan assets or an asset for plan assets in excess of the projected benefit obligation, thereby eliminating any previously existing net gain or loss, prior service cost or credit, or transition asset or obligation recognized in accumulated other comprehensive income. If it is expected that the plan will be terminated or curtailed, the effects of those actions shall be considered in measuring the projected benefit obligation.

[Note: After the adoption of Statement 141(R) by business entities or the adoption of FASB Statement No. 164, *Not-for-Profit Entities: Mergers and Acquisitions* (effective prospectively in the first set of initial or annual financial statements for a reporting period beginning on or after December 15, 2009) by not-for-profit entities, paragraph 74 should read as follows:]

74. If an acquiree sponsors a single-employer defined benefit plan, the acquirer shall recognize as part of the business combination an asset or a liability representing the funded status of the plan (paragraph 35). In determining that funded status, the acquirer shall exclude the effects of expected plan amendments, terminations, or curtailments that at the

acquisition date it has no obligation to make. The projected benefit obligation assumed shall reflect any other necessary changes in assumptions based on the acquirer's assessment of relevant future events. If an acquiree participates in a multiemployer plan, and it is probable as of the acquisition date that the acquirer will withdraw from that plan, the acquirer shall recognize as part of the business combination a withdrawal liability in accordance with Statement 5.

Not-for-Profit Organizations and Other Entities That Do Not Report Other Comprehensive Income

74A. A not-for-profit employer shall recognize as a separate line item or items within changes in unrestricted net assets, apart from expenses, the gains or losses and the prior service costs or credits that would be recognized in other comprehensive income pursuant to paragraphs 25, 28, and 29 of this Statement. Consistent with the provisions of FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations,* this Statement does not prescribe whether the separate line item or items shall be included within or outside an intermediate measure of operations or performance indicator, if one is presented. The AICPA Audit and Accounting Guide, *Health Care Organizations,* requires a not-for-profit organization within its scope to report items of other comprehensive income outside the performance indicator.

74B. A not-for-profit employer shall reclassify to net periodic pension cost a portion of the net gain or loss and prior service costs or credits previously recognized in a separate line item or items and a portion of the transition asset or obligation remaining from the initial application of this Statement, pursuant to the recognition and amortization provisions of paragraphs 24–34 and 77. The contra adjustment or adjustments shall be reported in the same line item or items within changes in unrestricted net assets, apart from expenses, as the initially recognized amounts. Net periodic pension cost shall be reported by functional classification pursuant to paragraph 26 of Statement 117.

74C. In applying the provisions of this Statement to a not-for-profit employer, the references to accumulated other comprehensive income or a separate component of equity in paragraphs 20(d), 20(f), 28, 32–34, 38, 74, and 264, and the references to amounts previously recognized in other comprehensive income in paragraphs 52 and 264, shall instead be to the gains or losses, the prior service costs or credits, and the transition asset or obligation that have been recognized as changes in unrestricted net assets arising from a defined benefit plan but not yet reclassified as components of net periodic pension cost.

74D. An employer other than a not-for-profit employer that does not report other comprehensive income pursuant to FASB Statement No. 130, *Reporting Comprehensive Income,* shall apply the provisions of paragraphs 74A–74C in an analogous manner that is appropriate for its method of reporting financial performance and financial position.

Amendment to Opinion 16

75. The reference to accruals for pension cost in paragraph 88(h) of Opinion 16 and footnote 13 to that Opinion are deleted. The following footnote is added to the end of the last sentence of paragraph 88 of Opinion 16:

> Paragraph 74 of FASB Statement No. 87, *Employers' Accounting for Pensions,* specifies how the general guidelines of this paragraph shall be applied to assets and liabilities related to pension plans.

Transition and Effective Dates

76. Except as noted in the following sentences of this paragraph, this Statement shall be effective for fiscal years beginning after December 15, 1986. For plans outside the U.S. and for defined benefit plans of employers that (a) are **nonpublic enterprises** and (b) sponsor no defined benefit plan with more than 100 participants, this Statement shall be effective for fiscal years beginning after December 15, 1988. For all plans, the provisions of paragraphs 36–38 shall be effective for fiscal years beginning after December 15, 1988. In all cases, earlier application is encouraged. Restatement of previously issued annual financial statements is not permitted. If a decision to initially apply this Statement is made in other than the first interim period of an employer's fiscal year, previous interim periods of that year shall be restated.

77. For a defined benefit plan, an employer shall determine as of the measurement date (paragraph 52) for the beginning of the fiscal year in which this Statement is first applied, the amounts of (a) the projected benefit obligation and (b) the fair value of plan assets plus previously recognized **unfunded accrued pension cost** or less previously recognized **prepaid pension cost.** The difference between those

two amounts, whether it represents an unrecognized net obligation (and loss or cost) or an unrecognized net asset (and gain), shall be amortized on a straight-line basis over the average remaining service period of employees expected to receive benefits under the plan, except that, (a) if the average remaining service period is less than 15 years, the employer may elect to use a 15-year period, and (b) if all or almost all of a plan's participants are inactive, the employer shall use the inactive participants' average remaining life expectancy period. That same amortization shall also be used to recognize any unrecognized net obligation related to a defined contribution plan.

The provisions of this Statement need not be applied to immaterial items.

This Statement was adopted by the affirmative votes of four members of the Financial Accounting Standards Board. Messrs. Brown, Sprouse, and Wyatt dissented.

Mr. Brown does not support either the pension cost determination or the minimum liability recognition provisions of this Statement. He supports the Board's conclusion that pension costs constitute employee compensation and that pension costs should be recognized over employee service lives. He also agrees that the disclosures called for will be helpful in fostering user understanding of the nature and status of employer pension obligations and of employer progress in providing for these obligations. In his view, however, the evidence available to the Board is insufficient to sustain the argument that a benefit/years-of-service method should be the sole required expense attribution method or that recognition of liabilities and assets beyond unfunded accrued or prepaid pension costs should be required.

Mr. Brown believes that considerations of comparability and understandability argue for a narrowing of accounting methods now used to allocate pension costs to accounting periods but observes that neither the benefit family nor the cost family of attribution methods is inherently and demonstrably superior. He believes, however, that the cost/compensation family of attribution methods has considerable appeal as a solution to the difficult problem of allocating the estimated lifetime cost of an employee's defined benefit pension to years of service. Cost/compensation methods allocate net pension cost to periods based on direct compensation—in his view, a reasonable and understandable allocation method—producing a net pension cost that is a constant percentage of compensation over the years of an employee's career. Mr. Brown also notes that cost/compensation methods are more commonly used for both pension cost determination and for funding in the United States than are benefit methods.

Despite the appeal of cost/compensation methods, Mr. Brown would not specify a single actuarial calculation method to be used for periodic attribution of pension costs. Rather, he would establish an objective that net pension cost be charged over the service lives of the existing work force such that the net pension cost would be a level percentage of current and expected compensation of this work force. (He notes that the aggregate method—a cost/compensation approach—is one practical way to meet that objective.)

He believes that stating the accounting objective rather than specifying a single computational method would be cost beneficial. Comparability and understandability would be improved if methods used aimed at a common objective. Attaining comparability of end result does not require standardization of the calculation method as evidenced by the fact that different actuarial calculation methods can produce very similar cost results and cost patterns for the same plan, depending on plan-specific circumstances. Mr. Brown notes that both the actuarial method and the assumptions used are critical in determining periodic pension costs. Differences in assumptions arise both because of different plan circumstances and because judgments are required in developing assumptions. Thus, standardization in method represents only one step, of undeterminable size, in achieving comparability in end result. Available evidence does not support a conclusion that the comparability achieved by method change alone is worth the costs inevitably involved in making the change.

Permitting flexibility in the specific calculations to be used in achieving the accounting objective would avoid the need for specifying detailed methods for amortizing prior service cost and unrecognized actuarial gains and losses, as is done in this

Statement. Those detailed methods are necessarily arbitrary and produce a complex accounting standard. The detailed methodology and the insistence on using settlement rates to measure the service and interest cost components of net periodic pension cost are both, in his view, examples of the pursuit of a level of precision or exactness that is realistically unattainable in this case. Mr. Brown would leave implementation details to those who are aware of and can consider the circumstances of each plan situation.

Mr. Brown believes that an employer has an obligation under a defined benefit plan and that information about that obligation and the resources accumulated to meet it should be included in financial reports. In his view, however, the nature of point-in-time value measures of plan assets and of plan obligations (whether measured in terms of vested benefits, accumulated benefits, or projected benefit obligations) is such that they do not fall meaningfully and readily within the present structure of financial statements. Delayed recognition of price changes and of actuarial gains and losses is embodied in the methodology of this Statement for pension cost determination. To require balance sheet recognition of selected point-in-time market values and actuarial liability estimates—and this only when liabilities exceed assets—is inconsistent both internally and with expense recognition methodology. It would also, in Mr. Brown's view, be confusing to users. He does not believe that the proposed intangible assets and separate components of equity that would be recorded in tandem with additional liability recognition would add meaningful or understandable information. For these reasons, he believes that plan asset and pension obligation information is better presented in disclosures to financial statements.

Mr. Sprouse believes that, although this Statement provides some improvements in employers' accounting for pensions, those improvements are more than offset by certain important deficiencies. As explained below, he would support the requirements for determining net periodic pension cost and for disclosure, if those deficiencies were eliminated.

He starts from the basic position that only unfunded accumulated benefits qualify for accounting recognition as an employer's liability and that plan assets in excess of accumulated benefits qualify for accounting recognition as an employer's asset.

In Mr. Sprouse's view, an employer cannot have a present obligation for pension benefits related to salary increases that are contingent upon future events—future inflation, future promotions, future improved productivity. He believes that the decision to grant increases in wages and salaries, whatever the reason, is an event that has directly related consequences, including increases in employers' social security taxes and pension costs, as well as the wages and salaries themselves. Accounting should recognize all of those directly related consequences at the time the event occurs—when wages and salaries are increased because inflation has reduced the purchasing power of the dollars being paid, when wages and salaries are increased because the more valuable services recognized by promotion are being received, when wages and salaries are increased because the benefits of improved productivity are being realized. Anticipating the effects of those future events on pension cost in accounting for the current period before dollars have lost their purchasing power and before the more valuable services related to promotion and productivity have been received is no more appropriate than anticipating the future higher wages and salaries themselves in accounting for the current period.

Mr. Sprouse believes that past practices in accounting for employers' pension cost that rely on forecasts of nominal salary levels were largely the product of certain actuarial methods that were designed for funding purposes to conform to the provisions of the Internal Revenue Code; those methods are not appropriate for financial accounting purposes. Nevertheless, he recognizes that those practices are firmly embedded in financial accounting and drastic changes in them could be disruptive. Accordingly, he would support the requirements for determining net periodic pension cost and for disclosure as significant improvements in practice. Considering the practical limits within which practice can be changed without undue disruption, he could also support the alternative approach described in paragraph 155.

Mr. Sprouse objects, however, to the unique recognition practices this Statement establishes for an "intangible asset." In certain situations, this Statement calls for an employer to recognize an intangible asset to offset the result of a loss on plan assets or to eliminate an intangible asset to offset the result of a gain on plan assets. Similar recognition or elimination of an intangible asset is required to offset the effects of changes in actuarial assumptions related to the accumulated benefit obligation. Those features are unacceptable to him. In his view, those recognition practices can neither be reconciled with the Board's conceptual framework nor readily understood by financial statement users. He believes they seriously diminish the credibility of employers' accounting for pension costs.

Mr. Sprouse also objects to this Statement's accounting for a business combination under the purchase method that calls for recognition of an asset or liability based on the projected benefit obligation as of the date of the combination. For the reasons given above, he holds that the excess of the *projected* benefit obligation over plan assets does not qualify for recognition as an employer's liability, and plan assets in excess of *accumulated* benefits do qualify for recognition as an employer's asset. In his view, the fallacy of the Statement's requirement is demonstrated by the need to recognize a different net pension obligation or asset if the acquirer plans to terminate the plan than is recognized if the acquirer plans to continue it.

Mr. Wyatt believes the projected benefit obligation, as defined in this Statement, should be the measure of the pension obligation reported in the financial statements. He believes that neither the excess of net periodic pension cost over amounts contributed (unfunded accrued cost) nor the accumulated benefit obligation is an appropriate measure of an entity's pension obligation. He also believes that the use of a market-related asset value base for effecting the delayed recognition of actuarial gains and losses unnecessarily perpetuates an unsound measure for plan assets. As a result, this Statement falls short of achieving the degree of improvement in accounting for pension costs that was attainable and that users of financial statements could justifiably expect from this project.

A majority of the Board concluded that the pension liability is not properly measured by the unfunded accrued cost. Mr. Wyatt agrees with that conclusion. He believes, however, that the accumulated benefit obligation cannot be a faithful presentation of the pension obligation because its determination involves a fundamental inconsistency. The scheduled future pension benefits under this notion exclude any estimates of salary progression, whether based on estimated inflation or other factors. As a result, the amounts that provide the basis for the measure of the obligation do not represent the actual estimated cash flows in future periods. The interest rate used to reduce those scheduled future pension benefits to a present value is a rate at which the pension benefits could effectively be settled. Such a rate incorporates an existing anticipation of future inflation. Thus, the discounting process effectively removes an estimated inflation factor from a series of scheduled future payments that have been measured by specifically excluding any estimate for future inflation. The resulting amount has estimated future inflation removed twice and therefore is not a faithful measure of a liability; in fact, it understates the appropriate measure of the liability, grossly so in some cases.

Mr. Wyatt believes that the use of a market-related asset value as a basis for delayed recognition of gains and losses compromises the rationale that supports use of fair value to measure assets for other aspects of this Statement. It perpetuates a notion ("actuarial asset value") that has no basis as an accounting concept. Furthermore, other approaches to implement the delayed recognition of unamortized gains and losses are available that could only be perceived as practical in nature and that would not carry over into future considerations of pension accounting a concept that persists in spite of its conceptual defects.

The use of a market-related asset value and an expected rate of return on assets to measure the amortization of unrecognized gains and losses introduces unnecessary flexibility into a process that could justifiably be made uniform because it is inherently a practical mechanism to mitigate volatility. Such flexibility diminishes the improvements in comparability, as related to practice under Opinion 8, achieved by adoption of a single attribution method and an assumed discount rate that reflects the rates at which pension benefits could effectively be settled.

Mr. Wyatt agrees with the assenters that, on an overall basis, the conclusions in this Statement will lead to improvements in accounting for and understanding of pension costs. He believes, however, that the degree of improvement is modest when related to the improvement that he believes should have been achieved. Thus, in his view the Statement's deficiencies represent a lost opportunity for improvement in financial reporting.

Members of the Financial Accounting Standards Board:

Donald J. Kirk, *Chairman*	Victor H. Brown	Robert T. Sprouse
Frank E. Block	Raymond C. Lauver	Arthur R. Wyatt
	David Mosso	

Appendix A

BASIS FOR CONCLUSIONS

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Appendix A

BASIS FOR CONCLUSIONS

Fundamental Conclusions—Single-Employer Defined Benefit Pension Plans

78. This appendix summarizes considerations that were deemed significant by members of the Board in reaching the conclusions in this Statement. It includes reasons for accepting certain views and rejecting others. Individual Board members gave greater weight to some factors than to others. The most significant changes to past practice resulting from the Board's conclusions in this Statement relate to accounting for a single-employer defined benefit pension plan.

The Exchange

79. The Board's conclusions in this Statement derive from the basic idea that a defined benefit pension is an exchange between the employer and the employee. In exchange for services provided by the employee, the employer promises to provide, in addition to current wages and other benefits, an amount of retirement income. It follows from that basic view that pension benefits are not gratuities but instead are part of an employee's compensation, and since payment is deferred, the pension is a type of deferred compensation. It also follows that the employer's obligation for that compensation is incurred when the services are rendered.

Funding and Accrual Accounting

80. In this Statement the Board reaffirms the usefulness of information based on accrual accounting. That does not negate the importance of information about cash flows or the funding of the plan. Accounting recognition of transactions in which cash is disbursed is not controversial. Accrual accounting, however, goes beyond cash transactions to provide information about assets, liabilities, and earnings.

81. Opinion 8 stated, ". . . it is important to keep in mind that the annual pension cost to be charged to expense . . . is not necessarily the same as the amount to be funded for the year" (paragraph 9). However, Opinion 8 allowed any of a range of funding methods to serve as the basis for determining net periodic pension cost, with the result that annual net pension cost and the amount to be funded for the year were commonly the same. This Statement reaffirms the APB's conclusion that funding decisions should not necessarily be used as the basis for accounting recognition of cost. The amount funded (however determined) is, of course, given accounting recognition as a use of cash, but the Board believes this is one of many areas in which information about cash flows alone is not sufficient, and information on an accrual basis is also needed. The question of when to fund the obligation is not an accounting issue. It is a financing question that is properly influenced by many factors (such as tax considerations and the availability of attractive alternative investments) that are unrelated to how the pension obligation is incurred.

82. Any accrual basis of accounting for a defined benefit pension plan inevitably requires estimates of future events because those events determine the amounts of benefits that will be paid. The Board is convinced that information based on such estimates is useful along with information about cash flows, and notes that similar estimates are required for all presently acceptable funding methods and previously permitted accounting methods.

83. The Board's conclusion that accounting information on an accrual basis is needed does not mean accounting information and funding decisions are unrelated. In pensions, as in other areas, managers may use accounting information along with other factors in making financial decisions. Some employers may decide to change their pension funding policies based in part on the new accounting information. The Board believes that financial statements should provide information that is useful to those who make economic decisions, and the decision to fund a pension plan to a greater or lesser extent is an economic decision. The Board, however, does not have as an objective either an increase or a decrease in the funding level of any particular plan or plans. Neither does the Board believe that the information required by this Statement is the only information needed to make a funding decision or that net periodic pension cost, as defined, is necessarily the appropriate amount for any particular employer's periodic contribution.

Fundamentals of Pension Accounting

84. In applying accrual accounting to pensions, this Statement retains three fundamental aspects of past pension accounting: *delaying recognition* of certain events, reporting *net cost,* and *offsetting* liabilities and assets. Those three features of practice have shaped

financial reporting for pensions for many years even though they have been neither explicitly addressed nor widely understood and they conflict in some respects with accounting principles applied elsewhere.

85. The *delayed recognition* feature means that certain changes in the pension obligation (including those resulting from plan amendments) and changes in the value of assets set aside to meet those obligations are not recognized as they occur but are recognized systematically and gradually over subsequent periods. All changes are ultimately recognized except to the extent that they may be offset by subsequent changes, but at any point changes that have been identified and quantified await subsequent accounting recognition as net cost components and as liabilities or assets.

86. The *net cost* feature means that the recognized consequences of events and transactions affecting a pension plan are reported as a single net amount (net periodic pension cost) in the employer's financial statements. That approach aggregates at least three items that might be reported separately for any other part of an employer's operations: the compensation cost of benefits promised, interest cost resulting from deferred payment of those benefits, and the results of investing what are often significant amounts of assets.

87. The *offsetting* feature means that recognized values of assets contributed to a plan and liabilities for pensions recognized as net pension cost of past periods are shown net in the employer's statement of financial position, even though the liability has not been settled, the assets may be still largely controlled, and substantial risks and rewards associated with both of those amounts are clearly borne by the employer.

88. Within those three features of practice that are retained by this Statement, the Board has sought to achieve more useful financial reporting through three changes:

a. This Statement requires a standardized method for measuring net periodic pension cost that is intended to improve comparability and understandability by recognizing the compensation cost of an employee's pension (including prior service cost) over that employee's approximate service period and by relating cost more directly to the terms of the plan.
b. This Statement requires immediate recognition of a liability (the minimum liability) in certain circumstances when the accumulated benefit obligation exceeds the fair value of plan assets, although it continues to delay recognition of the offsetting amount as an increase in net periodic pension cost.
c. This Statement requires expanded disclosures intended to provide more complete and more current information than can be practically incorporated in financial statements at the present time.

Components of Net Periodic Pension Cost

89. The Board concluded that an understanding of pension accounting is facilitated by considering the components of net periodic pension cost separately. The same components were included in net periodic pension cost in prior practice, but they were seldom explicitly or separately addressed. Those components are service cost, interest cost, actual return on plan assets, amortization of unrecognized prior service cost, and gain or loss. An additional component, temporarily, is the amortization of the unrecognized net obligation or asset existing at the date of initial application of this Statement.

90. A plan with no plan assets, no plan amendments, and no gains or losses would still have two components of cost. First, as employees work during the year and earn added benefits, a *service cost* (or compensation cost) accrues. Measurement of that component is difficult and is discussed below. If the service component and the related obligation are measured on a present value basis, a second component—*interest cost*—must also be accounted for. Measurement of that component is less difficult. The primary issue is the selection of appropriate discount rates.

91. A third component is required for a funded plan. The employer must recognize the *return* (or possibly loss) *on plan assets.* That component ordinarily reduces the net cost of providing a pension. If the amount of assets is relatively great and the return on assets is high, the result can be net pension income for a period instead of net pension cost. The interest cost and return-on-plan-asset components represent financial items rather than employee compensation cost. They can be changed or even eliminated by changes in the employer's financing arrangements. For example, an employer can increase return on assets by adding more assets to the fund and can decrease interest cost (and return on assets) by purchasing annuity contracts to settle part of the obligation.

92. The next two components arise from plan amendments and gains or losses, both of which are to

be recognized as part of net periodic pension cost over a number of periods. The *amortization of unrecognized prior service cost* resulting from plan amendments (including initiation of a plan) ordinarily increases the net cost. This component reflects the compensation cost of pension benefits granted in amendments and attributed by the plan's benefit formula to periods prior to the amendment.

93. The *gain or loss component* may either decrease or increase net periodic pension cost depending on whether the net unrecognized amount is a gain or a loss and whether actual return on assets for a particular period is greater or less than expected return on assets. This component combines gains and losses of various types and therefore includes both compensation and financial items that are not readily separable.

The Principal Issues

94. Among the many issues considered by the Board in this project, three stand out as central to the Board's extensive deliberations and to the public debate. Those issues concern (a) the periods in which net periodic pension cost should be recognized, (b) the method(s) that should be used to allocate or attribute that cost to individual periods, and (c) whether current information about the funded status of a defined benefit pension plan should be included in the employer's statement of financial position.

Cost recognition period

95. The Board concluded that, conceptually, compensation cost should be recognized in the period in which the employee renders services. Although the complexity and uncertainty of the pension arrangement may preclude complete achievement of that goal, a fundamental objective of this Statement is to approximate more closely the recognition of the compensation cost of an employee's pension benefits over that employee's service period. Many of the respondents to previous documents issued as part of this project agreed with that objective, which conflicts with some aspects of past practice under Opinion 8.

Attribution method

96. The Board concluded that the understandability, comparability, and usefulness of pension information could be improved by narrowing the range of different methods for allocating or attributing the cost of an employee's pension to individual periods of service. The Board was significantly aided in its consideration of alternative attribution approaches by the work of several committees of the American Academy of Actuaries and by research conducted by that organization. The Board appreciates the efforts of the individuals and firms involved in those efforts and recognizes that most of them continue to prefer that accounting be based on any of several approaches. However, the Board was unable to identify differences in circumstances that would make it appropriate for different employers to use fundamentally different accounting methods or for a single employer to use different methods for different plans. Many respondents agreed that the number of acceptable methods at least should be reduced.

97. The Board concluded that the terms of the plan that define the benefits an employee will receive (the plan's benefit formula) provide the most relevant and reliable indication of how pension cost and pension obligations are incurred. In the absence of convincing evidence that the substance of an exchange is different from that indicated by the agreement between the parties, accounting has traditionally looked to the terms of the agreement as a basis for recording the exchange. All attribution methods used in the past consider the plan's benefit formula in estimating the benefit an employee will receive at retirement. However, unlike some other methods previously used for pension accounting, the method required by this Statement focuses more directly on the plan's benefit formula as the basis for determining the benefit earned, and therefore the cost incurred, in each individual period.

Statement of financial position

98. The Board believes that an employer with an unfunded pension obligation has a liability and an employer with an overfunded pension obligation has an asset. The most relevant and reliable information available about that liability or asset is based on the fair value of plan assets and a measure of the present value of the obligation using current, explicit assumptions.

99. Many respondents to the Preliminary Views, *Employers' Accounting for Pensions and Other Postemployment Benefits (Preliminary Views),* and the Exposure Draft, *Employers' Accounting for Pensions,* agreed that at least the obligation for unfunded vested benefits, or the obligation for unfunded accumulated benefits, conceptually represents a recognizable liability. Most respondents, however, did not

agree with recognition of any liability in the statement of financial position beyond the amount of accrued but unfunded net periodic pension cost. Most also objected to recognition of any liability based on estimates of future compensation levels. Respondents also objected to recognizing an asset in the case of an overfunded plan, and views differed about how to recognize changes in both the fair value of plan assets and the present value of the obligation.

100. Some argued that the uncertainties inherent in predicting future interest rates and salary levels are sufficiently great that available measures of the projected benefit obligation fail to achieve the level of reliability needed for recognition in financial statements. They would prefer to disclose rather than recognize the obligation. Some Board members were sympathetic to that view.

101. This Statement requires recognition of net periodic pension cost based on the present value of the obligation (with consideration of future compensation levels for pay-related plans). This Statement also requires recognition of a liability or an asset (unfunded accrued or prepaid pension cost) when the amount of that net periodic pension cost is different from the amount of the employer's contribution to the plan. Over time, therefore, this Statement requires recognition of a liability for the employer's unfunded obligation, including that portion based on estimated future compensation levels for plans with pay-related benefit formulas. Most respondents who argued that a present liability could not include amounts based on future compensation nevertheless argued strongly that the measure of net periodic pension cost must not ignore that factor.

102. This Statement provides for delayed recognition, in net periodic pension cost and in the related liability (accrued unfunded pension cost) or asset (prepaid pension cost), of certain changes in the present value of the obligation and the fair value of plan assets. Those changes (that is, gains and losses and the effects of plan amendments) are recognized in net periodic pension cost on a systematic basis over future periods. The Board concluded that it is not practical at this time to require accelerated recognition of those changes in financial statements as they occur, although certain of those changes are recognized in the statement of financial position through the minimum liability requirement of this Statement.

103. This Statement accepts the unfunded accrued or prepaid pension cost as the recognized liability or asset except when the accumulated benefit obligation (measured without considering future compensation levels) exceeds the fair value of plan assets. In that situation, the Board concluded that the recognized liability should be adjusted so that the statement of financial position would reflect at least the unfunded accumulated benefit obligation.

104. The Board acknowledges that the delayed recognition included in this Statement results in excluding the most current and most relevant information from the employer's statement of financial position. That information is, however, included in the disclosures required, and, as noted above, certain liabilities previously omitted will be recognized.

Information Needed

105. The Board concluded that users of financial reports need additional information to be able to assess the status of an employer's pension arrangements and their effect on the employer's financial position and results of operations. Most respondents agreed, and this Statement requires certain disclosures not previously required.

106. The components of net periodic pension cost and the net funded status of the obligation are among the more significant disclosure requirements of this Statement. One of the factors that made pension information difficult to understand was that past practice and terminology combined elements that are different in substance into net amounts (assets with liabilities and revenues and gains with expenses and losses). Although the Board agreed to retain from past practice the basic features of reporting net cost and offsetting liabilities and assets, the Board believes that disclosure of the components will significantly assist users in understanding the economic events that have occurred. Those disclosures also make it easier to understand why reported amounts change from period to period, especially when a large cost or asset is offset by a large revenue or liability to produce a relatively small net reported amount.

Evolutionary Changes in Accounting Principles

107. After considering the range of comments on *Preliminary Views* and the Exposure Draft, the Board concluded that the changes required by this Statement represent a worthwhile improvement in financial reporting. Opinion 8 noted in 1966 that "accounting for pension cost is in a transitional stage" (paragraph 17). The Board believes that is still true in

1985. FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises,* paragraph 2, indicates that "the Board intends future change [in practice] to occur in the gradual, evolutionary way that has characterized past change." The Board realizes that the evolutionary change in some areas may have to be slower than in others. The Board believes that it would be conceptually appropriate and preferable to recognize a net pension liability or asset measured as the difference between the projected benefit obligation and plan assets, either with no delay in recognition of gains and losses, or perhaps with gains and losses reported currently in comprehensive income but not in earnings. However, it concluded that those approaches would be too great a change from past practice to be adopted at the present time. In light of the differences in respondents' views and the practical considerations noted, the Board concluded that the provisions of this Statement as a whole represent an improvement in financial reporting.

Other Conclusions—Single-Employer Defined Benefit Pension Plans

108. This section discusses additional reasons for the Board's conclusions and some of the positions advocated by respondents.

The Nature of the Exchange

109. Some respondents disagreed with the Board's basic view of the nature of the employer's obligation under a defined benefit pension plan. They argued that the employer's only obligation is to make periodic contributions sufficient to support the plan. In this view, it is the plan—as a distinct legal entity—that has an obligation for benefits promised to employees. They concluded that the schedule or budget for making contributions determines the amount of the present obligation and current period cost and that contributions scheduled for future periods, although based upon past events, are future obligations.

110. The Board concluded that viewing the obligation and the cost only in terms of scheduled contributions does not reflect the fundamental difference between the inherent promise and the resulting obligation under a defined benefit plan and the promise and obligation under a defined contribution plan. An employer that has undertaken an obligation to provide defined pension benefits based on service already rendered may view it as an obligation directly to the employees (looking through the funding arrangement) or as an obligation to make future contributions to the plan, but the employer has a present obligation based on the defined benefits either way.

111. The Board believes that creating a separate legal entity to receive and invest contributions and pay benefits does not change the nature of the employer's obligation to pay promised benefits to retirees. Viewing the plan as a truly separate economic entity raises the question of what consideration the plan received for making benefit promises to employees. Although legal requirements are only one factor to be considered in determining accounting standards, the Board also notes that Congress, in enacting ERISA, chose to base the definition of an employee's rights under a defined benefit pension plan on the benefits promised rather than on the amounts the employer has contributed or is scheduled to contribute.

112. Those who subscribe to the separate legal entity idea also argued that plan assets are not the assets of the employer. The Board noted that the employer's future contributions to the plan will be increased or decreased by the performance of the plan assets so that the employer bears the risks and reaps the rewards associated with those assets. The Board also observed that numerous recent situations in which significant amounts of assets have been withdrawn by employers provide compelling evidence that rebuts that argument.

113. Some respondents argued that the pension exchange is between the employer and a collective ongoing work force rather than between the employer and each individual employee. They focus on the open group, including employees to be hired in the future, rather than the closed group of current and past employees. They conclude that the obligation to the work force should be defined in terms of contributions necessary to maintain the plan rather than in terms of the aggregate benefits promised to individuals.

114. The Board recognizes that uncertainty in measuring the benefit obligation for a single employee is greater than for a group because the future events that affect the amount of benefits (such as longevity) cannot be as reliably estimated for a single individual. In the Board's view, however, the fact that a more reliable measurement is possible only for a group does not change the nature of the promise. The actuarial computation considers that some existing or future retirees will live longer than others and that some individuals will terminate before vesting or die before

receiving any benefits. Those factors are properly considered in measuring the probable future sacrifice that will result from the presently existing promise of benefits to the employees.

115. The practical effect of the argument that the obligation is to the ongoing employee group is often to defer recognition of part of the cost of an individual's pension to periods after that individual retires. That open-group view provides no basis for recognizing the cost of pension benefits over any particular period. One of the objectives of accrual accounting is to match costs and revenues. The Board believes that application of the matching objective to pension accounting requires that pension cost be recognized in the period in which economic benefits are received (employee services are rendered). The alternative view is no more appropriate than an argument that a machine should be depreciated over years after its retirement because the machine will be replaced and the important thing is the cost of maintaining the ongoing plant. Employee compensation, whether paid currently or deferred, should be recognized as cost when the services are rendered. The Board concluded that, in concept, the employer's obligation to the existing employee group is the sum of its obligations to individual employees, adjusted to reflect the present value of the amount and the probability of payment (the "actuarial present value").

Recognition versus Disclosure

116. Some respondents agreed that better information about net periodic pension cost and the pension obligation is needed but argued that the information would be just as useful if it were disclosed in the footnotes and, therefore, that changes in the basic financial statements (changes which they believed would be costly) were not necessary. The Board is aware that costs are involved for both preparers and users whenever changes are made in accounting principles, but in the Board's view it is important that elements qualifying for recognition be recognized in the basic financial statements. Footnote disclosure is not an adequate substitute for recognition. The argument that the information is equally useful regardless of how it is presented could be applied to any financial statement element, but the usefulness and integrity of financial statements are impaired by each omission of an element that qualifies for recognition. Further, although the "equal usefulness" argument may be valid for some sophisticated users, the Board does not believe it holds for all or even most other users. Finally, if the argument were valid, the consequences of recognition would not be different from those of not recognizing but disclosing the same information; it is obvious from their arguments that many who assert that disclosure would be equally useful believe recognition would have different consequences.

Measurement of Plan Assets

117. The Board concluded that plan investments should be measured at fair value for purposes of this Statement (except as provided in paragraph 30 for purposes of determining the extent of delayed recognition of asset gains and losses). Fair value provides the most relevant information that can be provided for assessing both the plan's ability to pay benefits as they come due without further contributions from the employer and the future contributions necessary to provide for benefits already promised to employees. The same reasons led to a similar decision in Statement 35.

118. The Board recognizes that there may be practical problems in determining the fair value of certain types of assets. Notwithstanding those difficulties, the Board believes that the relevance of fair value of pension assets is so great as to override objections to its use based on difficulty of measurement. In addition, most pension assets are invested in marketable securities and are priced regularly for investment management purposes.

119. The Board considered the use of an actuarial value of assets instead of fair value. A number of different methods of determining actuarial asset values are available, generally based on some kind of average of past market values or on long-range projections of market values intended to eliminate short-term market fluctuations. The Board concluded that those methods produce information about the assets that is less relevant and more difficult to understand than fair value. Specifically, if an actuarial asset value were used to measure the minimum net liability defined in paragraph 36, it would sometimes result in recognition of a liability when the fair value of the assets exceeds the obligation, and at other times it would result in no recognition when a net unfunded obligation exists based on the fair value.

120. The Board understands that measuring investments at fair value could introduce volatility into the financial statements as a result of short-term changes in fair values. Some respondents described that volatility as meaningless or even misleading, particularly

in view of the long-run nature of the pension commitment and the fact that pension investments are often held for long periods, thus providing the opportunity for some gains or losses to reverse. The Board also recognizes that some changes in the fair value of investments are related to some changes in the measurement of the pension liability because they are affected by the same economic factors. For example, a change in the level of interest rates would be expected to affect the liability by changing the discount rates and would also affect the fair value of at least some types of investments (such as bonds). In many cases such fluctuations in the pension benefit obligation and in the fair value of plan investments would tend to offset each other.

121. The Board concluded that the difference between the actual return on assets and the expected return on assets could be recognized in net periodic pension cost on a delayed basis. Those effects include the gains and losses themselves. That conclusion was based on (a) the probability that at least some gains would be offset by subsequent losses and vice versa and (b) respondents' arguments that immediate recognition would produce unacceptable volatility and would be inconsistent with the present accounting model.

122. The Board also considered whether amounts accrued by the employer but not yet contributed or paid to the plan (that is, unfunded accrued pension cost) should be considered plan assets for purposes of this Statement, noting that Statement 35 does consider some such amounts to be plan assets for purposes of the plan's financial reporting. The Board concluded that including accrued pension cost as plan assets for purposes of the disclosure of funded status (paragraph 54(c)) would be inappropriate because that amount has not been funded (contributed), and would unnecessarily complicate the recognition and disclosure requirements of this Statement.

123. The Board discussed whether securities of the employer held by the plan should be eliminated from plan assets and from the employer's financial statements as, in effect, treasury securities. The Board concluded that elimination would be impractical and might be inappropriate absent a decision that the financial statements of the plan should be consolidated with those of the employer, but that disclosure of the amount of such securities held would be appropriate and should be required.

Measurement of Service Cost and the Obligation

124. Measurement of the service cost component has much in common with measurement of the pension obligation. The service cost is essentially the portion of the projected benefit obligation that is attributable to services rendered in a period. The Board concluded that (a) all employers should use a single measurement method and (b) that method should reflect the plan benefit formula to the extent that the formula specifies how employees' benefits accrue.

Single method

125. Some respondents suggested that the Board should not require the use of a single method but should allow a choice among a number of acceptable alternatives. Many noted that choices among accounting methods are allowed in other areas, including accounting for inventory and depreciation. They also suggested that a standardized method would not achieve comparability because of differences in assumptions or would impair comparability because it would obscure different circumstances that call for different approaches.

126. The Board was not convinced by those who made reference to other areas of accounting. The appropriateness of allowing a choice of methods for depreciation and inventory accounting is beyond the scope of this project. The Board also believes that the differences among methods available for pension measurements are significantly more complex and less well understood than other method differences. A knowledgeable user is more likely to understand the approximate difference between straight-line and accelerated depreciation than the difference between two actuarial funding methods.

127. The Board concluded that use of a standardized method would improve comparability. Differences in assumptions are intended, at least conceptually, to reflect real differences in circumstances. The Board noted that comparability is not a characteristic that is either completely present or absent. It concluded that improvements in comparability could be achieved, even though some differences that are not necessarily reflective of real differences will remain because of the exercise of judgment in the selection of assumptions.

128. The Board is not convinced that differences in circumstances among employers require fundamentally different methods for measuring the service

component of net periodic pension cost. Differences such as expected rates of turnover and mortality would continue to be reflected. The Board concluded that use of a single method based on the terms of the plan would improve comparability and understandability of financial reporting by reflecting real differences among plans.

Choice of method

129. The 1981 FASB Discussion Memorandum, *Employers' Accounting for Pensions and Other Postemployment Benefits,* described two families of attribution approaches: the benefit approaches and the cost approaches. Benefit approaches determine an amount of pension benefits attributed to service in a period and then calculate the service cost component for the period as the actuarial present value of those benefits. Cost approaches project an estimated total benefit at retirement and then calculate the level contribution that, together with return on assets expected to accumulate at the assumed rates, would be sufficient to provide that benefit at retirement. (The amount allocated to each year may be level in dollar amount or level as a percentage of compensation.)

130. A number of respondents indicated a preference for the cost family of approaches, usually the approach defined in the 1981 Discussion Memorandum as cost/compensation. That preference was frequently based on the view that a pension is earned only over an employee's full period of employment with the result that measuring the obligation and the cost on an annual basis is less important than the pattern of net cost from period to period. Although all of the commonly used approaches may be described as systematic and rational, the cost/compensation approach is preferred by many because it is thought to produce a net periodic pension cost that is a level percentage of compensation. In fact, however, that desired pattern of net periodic pension cost will result only if amounts recognized as net periodic pension cost are also the amounts funded and if experience does not vary from assumptions.

131. The Board rejected the cost family of approaches because it believes that the terms of the plan provide a more relevant basis for relating benefits promised to services rendered. The benefit approaches are also more consistent with the Board's definition of liabilities. FASB Concepts Statement No. 3, *Elements of Financial Statements of Business Enterprises,* defines liabilities in terms of obligations, and an employer's obligation under a defined benefit plan as of a particular date is for pension benefits promised by the terms of the plan rather than for an accumulation of level costs. The Board believes that, although the "level percentage of compensation" pattern may be desirable for funding or for budgeting contributions, it does not necessarily reflect how cost is incurred or how a liability arises.

132. All attribution approaches measure service cost and the related obligation by discounting amounts payable in future periods to reflect the time value of money. No respondents advocated solutions that would not include such discounting. The way in which discounting is applied, however, is the fundamental difference between the cost approaches and the benefit approaches. The benefit approach adopted by the Board uses the terms of the plan to determine the benefits earned during a period (that is, the future cash flow) and then calculates the actuarial present value of those benefits. Under the cost approaches the amount attributed to a period is not the actuarial present value of a benefit earned in the period. Instead, the total cost of all the expected benefits is discounted and assigned to periods in a single mathematical step so that the net pension cost (the service cost, plus interest cost, less anticipated return on assets in the fund and to be added in future periods) is a constant amount or a constant percentage of salary.

133. In the Board's view, the benefit approaches reflect the promise of a defined benefit, and the present value of a dollar of benefit promised to a 60-year-old is greater than that of a dollar of benefit promised to a 25-year-old, if both are payable at age 65. Under the cost approaches, the cost charged in the early years of an employee's service will provide an amount of benefit at retirement much greater than the benefits earned in those years based on the plan formula. In the last years of an employee's service, the cost is less than the present value of benefits earned. The result is that at any point before retirement, the amount accrued for an individual under a cost approach will exceed the present value of benefits earned to that point based on the plan's benefit formula.

134. The Board concluded that the measurements of net periodic pension cost and the projected benefit obligation should reflect the terms of the plan under which they arose. Because a defined benefit pension plan specifies the employer's promise in terms of how benefits are earned based on service, rather than how contributions can be made to adhere to a desired funding pattern, the benefit approaches were preferred.

135. The Board also considered a benefit approach that would attribute benefits to periods based on compensation paid in those periods (a benefit/compensation approach). Some believe that compensation is the best available indicator of the value of the employee's services and, therefore, it is the most logical basis for allocation of benefits. In the Board's view, however, that approach less faithfully represents how the cost is incurred under the terms of the plan than the approach selected. The Board also noted that the benefit/compensation approach is not among those allowable under Internal Revenue Service regulations for funding purposes for certain types of plans.

Funding considerations

136. For purposes of funding a plan, using a cost approach to assign relatively large amounts to early years may be considered by some to be desirable because it allows more time for tax-free earnings on contributed assets to compound and because it provides additional benefit security. That basic funding approach may be particularly useful in achieving funding objectives if the cost of plan amendments is to be funded over a relatively long period after each amendment occurs. The relatively rapid funding of the obligation arising from service in the current and future periods may compensate for delayed funding of obligations arising from plan amendments.

137. Some respondents asserted that the cost of calculating amounts for accounting purposes on a basis different from that used for funding purposes would be high and would exceed the benefits of improved financial reporting. The Board notes, however, that a large part of the cost involved in an actuarial valuation is incurred in gathering and processing the input data and that the data used are largely the same for any computational approach. The Board concluded that the additional cost attributable to the requirements is unlikely to be excessive.

Future compensation levels

138. In response to the Exposure Draft and earlier documents issued as part of this project, some respondents argued that, based on the definition of a liability, pension benefits dependent on future increases in compensation cannot be a present obligation and, therefore, the liability measurement should be based only on actual compensation experience to date. They also noted that if the plan were terminated or if an employee with vested benefits did not render future services, the employer's obligation would be limited to amounts based on compensation to date.

139. Among those respondents who argued that obligations dependent on future compensation increases are excluded by the definition of a liability, very few were prepared to accept a measure of net periodic pension cost that was based only on compensation to date. The Board notes that under the double entry accounting system, recognition of an accrued cost as a charge against operations requires recognition of a liability for that accrued cost. Thus, excluding future compensation from the liability and including it in net periodic pension cost are conflicting positions.

140. The Board also considered the arguments of respondents who noted that it would be inconsistent (a) to measure pension cost or the obligation ignoring future compensation increases that reflect inflation and (b) to use discount rates that reflect expected inflation rates in making those measurements. In this view, discounting a benefit that does not include the effects of inflation amounts to removing the effect of inflation twice. Those respondents suggested that the effects of inflation should either be considered for both purposes or be eliminated from both. The latter approach would involve use of inflation-free (or "real") discount rates. The Board considered that possibility but concluded that the use of explicit rates observable in actual transactions ("nominal rates") would be more understandable and would present fewer implementation problems, as noted below.

141. The Board notes that at present few private pension plans in the U.S. provide benefits that are increased automatically after an employee retires based on either compensation levels or inflation. If future compensation increases were incorporated *implicitly* by reducing the discount rates used to compute the present value of the benefit obligation, projected benefit increases during the postretirement period would be incorporated automatically at the same time unless different (explicit) discount rates were used for those periods. Using inflation-adjusted (implicit) discount rates would, in effect, anticipate postretirement benefit increases, which would be inconsistent with the Board's decision that future plan amendments should not be anticipated unless there is a present substantive commitment to make such amendments.

142. Other respondents disagreed with the argument that a measurement approach based only on current compensation would be inconsistent with use of

nominal interest rates (paragraph 140). They argued that the assumed discount rates should reflect the rates at which the obligation could be settled—for example, by purchasing annuities or perhaps by dedicating a portfolio of securities. They argued that future interest rates (and therefore forecasts of future inflation) are irrelevant.

143. The Board concluded that the pension obligation created when employees render services is a liability under the definition in Concepts Statement 3. That definition, however, does not resolve the issue of whether the measurement of that liability should consider future compensation levels. After considering respondents' views, both practical and conceptual, the Board concluded that estimated future compensation levels should be considered in measuring the service cost component and the projected benefit obligation if the plan's benefit formula incorporates them. The Board perceives a difference between an employer's promise to pay a benefit of 1 percent of an employee's *final* pay and a promise to pay an employee a fixed amount that happens to equal 1 percent of the employee's *current* pay. Ignoring the future variable (final pay) on which the obligation in the first case is based would result in not recognizing that difference. The Board also concluded that the accumulated benefit obligation, which is measured *without* considering future compensation levels, should continue to be part of the required disclosure and should be the basis on which to decide whether a minimum liability needs to be recognized.

Liabilities

144. *Preliminary Views* proposed requiring recognition of a net pension liability or asset based on the difference between the projected benefit obligation and the fair value of plan assets. However, the net gain or loss not yet included in net periodic pension cost was also unrecognized for purposes of measuring the net pension liability or asset, thereby reducing the volatility of that balance. An intangible asset would have been recognized when a plan was amended, increasing the projected benefit obligation. Respondents objected to the proposal for a number of reasons, both conceptual and pragmatic. Some of those objections, based on doubts about the nature of the employer's obligation, were discussed previously.

145. A number of respondents argued that increased pension benefits granted in a plan amendment are exchanged for employees' *future* services, even when the amount of the benefit is computed based on prior service. In this view, the employer's liability for such benefits arises only as the future services are rendered. Some also argued that a plan amendment is a wholly executory contract and for that reason should not be recognized. The Board agrees that the obligation is undertaken by the employer with the expectation of future economic benefits but believes that does not provide a basis for not recognizing the obligation that arises from the event or for arguing that no obligation exists. The Board does not agree that a plan amendment is a wholly executory contract. To the extent that an amendment increases benefits that will be attributable to future services, neither party has performed. The Board has never proposed to recognize any liability for those benefits. However, to the extent the increased benefits are attributed by the benefit formula to services already rendered, the Board concluded that one party to the contract has performed and the agreement is at most only partially executory.

146. Some respondents argued that the obligation could not be measured with sufficient reliability (or precision) to justify recognition. The Board notes that the measurements of net periodic pension cost and unfunded accrued pension cost, which are based on the same assumptions, are no more or less precise than measurements of the accumulated and projected benefit obligations. In addition, insurance companies often undertake obligations that will be determined in amount by future events (although not by future compensation levels), and those obligations are recognized. When an insurance contract involves obligations similar to pension obligations (for example, an annuity contract), measurement of those obligations involves some of the same assumptions used in pension accounting. The Board concluded that information about pension cost and obligations based on best estimates of the relevant future events is sufficiently reliable to be useful. The Board recognizes that pension (and other postemployment benefit) liabilities are, as some respondents argued, different from the other recognized liabilities of most employers, but that is because most enterprises other than insurance companies do not ordinarily take on obligations of comparable significance that depend on unknown and uncontrollable future events to define the amount of future sacrifice.

147. Those respondents who challenged the reliability of liability measures based on actuarial calculations generally supported recognition of part of that same liability based on unfunded accrued pension

costs. FASB Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information,* defines reliability as a combination of representational faithfulness and verifiability. In the Board's view, the obligation based on the terms of the plan and the unfunded accrued cost are equally difficult to verify, but the former is a more faithful representation of a liability because it is an estimate of a present obligation to make future cash outlays as a result of past transactions and events. The unfunded accrued cost does not purport to be a measure of an obligation; it is a residual resulting from an allocation process and, therefore, it cannot be a faithful representation of a liability.

148. A number of respondents argued that a pension liability must be limited either to the amount that would have to be paid on plan termination or to the amount of vested benefits. Those arguments were based on the view that the employer has discretion to avoid any obligations in excess of those limits. Some who preferred no recognition nevertheless agreed that it is difficult to argue that at least unfunded vested benefits are not a liability.

149. The Board concluded that, in the absence of evidence to the contrary, accounting should be based on a going-concern assumption that, as applied to pensions, assumes that the plan will continue in operation and the benefits defined in the plan will be provided. Under that assumption, the employer's probable future sacrifice is not limited to either the termination liability or amounts already vested. The Board believes that the actuarial measurement of the obligation encompasses the probability that some employees will terminate and forfeit nonvested benefits. Benefits that are expected to vest are probable future sacrifices, and the liability in an ongoing plan situation is not limited to vested benefits. However, the Board was influenced by respondents' views of the nature of vested and accumulated benefit obligations in its decision that a reported liability should not be less than the unfunded accumulated benefit obligation. Some Board members were also influenced by arguments that the accumulated benefit obligation, which requires no estimate of future salary levels, is more reliably measurable than is the projected benefit obligation.

150. Some respondents objected to the accounting proposed in *Preliminary Views* on the grounds that delaying the recognition of gains and losses as part of the measurement of the net pension liability or asset could cause an employer to report a net liability when the fair value of plan assets exceeded the projected benefit obligation, or to report a net asset when the projected benefit obligation exceeded the fair value of plan assets. The Board noted that delayed recognition of the effects of price changes is an inherent part of historical cost accounting and that the problem results from the Board's retention of the delayed recognition and offsetting features of past pension accounting.

151. The Board understands that the recognition of a minimum liability required by this Statement only updates the statement of financial position in some circumstances when plan obligations are not fully funded. Unlike *Preliminary Views,* this Statement does not update the liability for all amendments when they occur. Also, like past practice and *Preliminary Views,* this Statement will result in recognition of liabilities for certain plans with assets in excess of their projected benefit obligations. That will occur because of delayed recognition of gains and of unrecognized net assets existing at the date of initial application of this Statement, if net periodic pension cost is not funded (for example, because it is not currently tax deductible). The provisions of this Statement, however, will result in recognition of some liabilities not currently reflected and, in the Board's view, in more representationally faithful reporting in those situations. This Statement also requires disclosure of the current information about assets and liabilities that is not reflected in the statement of financial position.

152. The Board believes that this Statement represents an improvement in past practices for the reporting of financial position in two ways. First, recognition of the cost of pensions over employees' service periods will result in earlier (but still gradual) recognition of significant liabilities that were reflected more slowly in the past financial statements of some employers. Second, the requirement to recognize a minimum liability limits the extent to which the delayed recognition of plan amendments and losses can result in omission of liabilities from statements of financial position.

153. Recognition of a measure of at least a minimum pension obligation as a liability is not a new idea. ARB 47, published in 1956, stated that "as a minimum, the accounts and financial statements should reflect accruals which equal the present worth, actuarially calculated, of pension commitments to employees to the extent that pension rights have vested in the employees, reduced, in the case of the balance sheet, by any accumulated trusteed funds

or annuity contracts purchased" (paragraph 7). Paragraph 18 of Opinion 8 required that "if the company has a legal obligation for pension cost in excess of amounts paid or accrued, the excess should be shown in the balance sheet as both a liability and a deferred charge." Opinion 8 did not define the term *legal liability,* and the FASB concluded in Interpretation 3 that, pending completion of this project, ERISA should not be presumed to create a legal liability for purposes of applying paragraph 18.

154. The Board considered a minimum liability based on the vested benefit obligation but concluded that the time at which benefits vest should not be the primary point for recognition of either cost or liabilities.

155. The Board also considered an alternative proposal that would differ from the requirements of this Statement in two ways. First, while it would have recognized the same minimum liability, it would also have recognized a minimum asset when the fair value of plan assets exceeded the projected benefit obligation. Second, it would have recognized an intangible asset only when recognition of a minimum liability resulted directly from a plan amendment. Changes in the minimum liability or the minimum asset not resulting from plan amendments (that is, gains and losses) would have been recognized as a separate component of equity (and thus would have been included in comprehensive income but not in earnings of the current period). The Board rejected that alternative because of the volatility that it would introduce into financial statements and because of its added complexity.

Two or More Plans

156. Some respondents argued that an employer with two or more plans should combine or net all plans and report the funded status only on an overall basis. That would affect the required disclosure and minimum liability recognition provisions of this Statement. They suggested that differences between plans are not substantive because an employer could merge two or more plans. The Board believes that an employer with one well-funded plan and another less well funded or unfunded plan is in a different position than an employer with similar obligations and assets in a single plan. The Board was not convinced that combining plans would be easy or even possible in many cases. For example, the Board believes it would be difficult to combine a qualified plan with an unqualified plan or a flat benefit plan with a final-pay plan. Further, netting all plans would be inconsistent with other standards that preclude offsetting assets and liabilities unless a right of offset exists. The Board concluded that the requirements of this Statement to show separately certain information for plans with assets less than accumulated benefits would provide more useful information than would allowing the netting of all plans.

Recognition of the Cost of Retroactive Plan Amendments

157. When a defined benefit pension plan is initiated or amended to increase benefits, credit is often given for employees' services rendered before the date of the amendment. After such an amendment the projected benefit obligation, based on benefits attributed to past services by the plan's new benefit formula, is greater than before. The Board concluded that the employer's obligation for pension benefits granted in a plan amendment and attributable under the terms of the plan to prior service is not significantly different from the obligation arising year by year in accordance with the plan terms in effect prior to the amendment and that, as a result, the incremental obligation created by a plan amendment should be reflected as an increase in the projected benefit obligation. The increase in obligation is substantive, not simply the result of a computation; for example, vested benefits are increased immediately.

158. A few respondents argued that the retroactive cost of a plan amendment should be recognized as net periodic pension cost in the year of the amendment. They agreed that the obligation for benefits attributed to past service represents a liability and they concluded that, although some intangible future economic benefit may also result, it would not qualify for recognition as an asset. In their view, the retroactive cost of past plan amendments should not be charged to future periods.

159. Most respondents agreed with the rationale in *Preliminary Views* and the Exposure Draft that a plan initiation or amendment is invariably made with a

view to benefiting the employer's operations in future periods rather than in the past or only in the period of the change.[15] The Board believes that a future economic benefit exists, that the cost of acquiring that benefit can be determined, and that amortization of that cost over future periods is consistent with accounting practice in other areas. The Board also believes that a requirement to charge the cost of a retroactive plan amendment immediately to net periodic pension cost would not be representationally faithful and would represent an unacceptably radical change from current practice. The Board concluded that the increase in the projected benefit obligation resulting from a plan change should be recognized as a component of net periodic pension cost over a number of future periods as the anticipated benefit to the employer is expected to be realized.

160. Some respondents argued that the intangible asset proposed in the Exposure Draft does not qualify for recognition. The Board acknowledges the fact that similar future benefits are not recognized as assets in some cases. The Board concluded, however, that the asset should be recognized to the extent that a liability in excess of unfunded accrued pension cost is recognized. The Board also concluded that the asset recognized should be limited to the amount of prior service cost not yet recognized in net periodic pension cost. A plan can have unfunded accumulated benefits in excess of unfunded accrued pension cost only as a result of either retroactive plan amendments or losses. Although the Board agreed to delay recognition of losses in net periodic pension cost, it believes recognition of a loss as an asset would be inappropriate. No respondents argued that unrecognized losses represent future economic benefits.

161. Some respondents suggested that an intangible asset should be recognized but should be grouped with or netted against the pension liability. The Board rejected that approach because the asset cannot be used directly to satisfy the liability. There is no right of offset. That is really an argument against recognizing any liability arising from a plan change. The Board's conclusions on liability recognition were discussed previously.

Amortization of the cost of retroactive plan amendments

162. The Board recognizes that the number of periods benefited by a retroactive plan amendment (or the amount of the benefit remaining at a subsequent date) is difficult to estimate and is not objectively determinable. However, the Board concluded that amortization based on the expected future service of plan participants who are active at the time of the plan amendment or plan adoption and who are expected to receive benefits under the plan provides a reasonable basis for allocating the cost of a plan amendment to the periods benefited. Amortization beyond that period would be inconsistent with the objective of recognizing the cost of an employee's pension over that individual's service period.

163. The Board concluded that, conceptually, amortization of prior service cost should recognize the cost of each individual's added benefits over that individual's remaining service period. In practice, the Board believes that the precision of such a computation on an individual basis is unnecessary and might not be worth the cost. The Board viewed a method that allocates the same amount of prior service cost to each expected future year of each employee's service as a reasonable approximation of the results of an individual computation. Use of the more precise method is, of course, appropriate. The Board also concluded that interest on that part of the obligation arising in an amendment and the anticipated future return on assets contributed (or to be contributed) to provide for that part of the obligation are separate components. Neither of those components should affect the recognition of prior service cost.

164. The individual computation, like the method adopted by the Board, would result in a declining amortization charge for the cost of a particular plan amendment because some of the employees who were granted additional benefits in the plan change normally could be expected to retire or terminate each period. In fact, an amortization of prior service cost for each individual as a level amount over that individual's remaining service period would be somewhat more rapid than the method adopted because the individuals receiving the greatest amount of retroactive benefits will usually be those nearest

[15]The probable future economic benefits in a particular case may include reduced employee turnover, improved productivity, and reduced demands for increases in cash compensation. The cost of the benefits is measured at the date of the plan change by the discounted amount of the incremental obligation resulting from the change.

retirement. The method adopted is also consistent with the idea that the benefits realized by the employer as a result of a retroactive plan change are likely to be greatest in the years immediately after the change. An illustration of the method is included in Appendix B.

165. Some respondents to the Exposure Draft argued that the proposed allocation of the same amount of prior service cost to each future year of service would be unnecessarily complex and would require employers to maintain detailed records for long periods. The Board noted that it intends this Statement, to the extent possible, to define accounting objectives rather than specific computational means of attaining those objectives. The Board agreed to allow alternative methods of amortization (explicitly including a straight-line amortization over the average remaining service period of participants expected to receive benefits) that would simplify computations and record keeping as long as such methods do not have the effect of delaying recognition of prior service cost to a greater extent than the method that was defined in the Exposure Draft.

166. Because the cost of an amendment is measured as a present value (an increase in the projected benefit obligation), an amendment also results in an increase in the interest cost component of net periodic pension cost. Opinion 8 permitted amortization of the cost of retroactive plan amendments between a minimum and maximum range (paragraphs 17(a) and (b)), which, in practice, resulted in amortization periods ranging from 10 to 40 years. The method previously most often used in practice was an "interest method" or "mortgage method," which allocates the prior service cost and interest cost on the unamortized (or unfunded) balance as a level total amount. Because that method considers interest only on a net basis (interest on the unfunded balance), it actually has the effect of delaying recognition of the cost of retroactive benefits in anticipation of future contributions and the return on the fund expected to be accumulated. That method is often described as producing a level total amortization, but the total that is level is the sum of principal amortization and interest cost on the related portion of the obligation, less return on the funds that will be built up, assuming future contributions equal to the level total. Under that method small amounts of the cost of the retroactive benefits are recognized in the years immediately after an amendment when interest on the unamortized cost is high, and the largest amounts of the cost of the benefits are recognized in the last years of the amortization period. The Board concluded that method has the effect of deferring a major portion of the cost of pensions beyond the service period of employees receiving them.

167. Some respondents suggested that some plans (for example, those providing benefits that are not pay-related or are related to career-average-pay) are amended more often than plans with final-pay benefit formulas and that as a result, the cost of each amendment should be recognized more rapidly. The Board concluded that if those or other circumstances indicate that the benefits of a retroactive plan amendment have been impaired or will expire more rapidly than would be reflected by the minimum amortization specified, the cost should be recognized more rapidly.

Future amendments

168. Some respondents suggested that plan amendments should be anticipated or estimated before they are made, in which case increased benefits expected to be granted in the future would be included in determining current period cost. Under that approach plan amendments actually occurring during a period would be treated as changes in estimates to the extent they varied from the assumption. The Board rejected that approach for most situations because of concerns about the ability to make reasonable estimates of future plan amendments and because the Board does not believe that a present obligation ordinarily exists for benefits to be promised in future amendments. Anticipation of future plan amendments also is inconsistent with the basic view that the terms of the present plan provide the best basis for measuring the present obligation.

169. However, respondents to the Exposure Draft argued that in some situations the substance of a plan embodies a present substantive commitment to provide benefits beyond those defined in the written plan formula. One example cited was a career-average-pay plan that produces approximately the same results as a final-pay plan through regular updates. Another example was an unwritten but substantive commitment to increase regularly the benefits paid to retirees to reflect inflation. The Board noted that this Statement retains from Opinion 8 the requirement to account for the substance of an unwritten plan. The Board agreed that employers should account for the substance of such commitments and disclose their existence and nature.

Amendments affecting retirees

170. An amendment sometimes increases benefits for individuals already retired. Since those individuals are not expected to render future services, the cost of those benefits cannot be recognized over the individuals' remaining service periods.

171. Some respondents argued that such an amendment does not give rise to a future economic benefit and that its entire cost should be recognized as an expense in the period of the amendment. The Board sees some merit in that argument but concluded that it is reasonable to assume that a plan amendment is the result of an economic decision and that future economic benefits similar to those expected to result from a benefit increase for active employees are expected to result when retirees' benefits are increased. The Board noted that in at least some cases retirees' benefit increases are part of collective-bargaining agreements and that some may view those benefits as being exchanged for services of active employees. The Board agreed that it would be simpler and more practical to recognize the cost of all plan amendments similarly, that is, on a delayed basis.

Amendments that reduce benefits

172. The Board recognizes that a situation might exist in which a plan amendment reduces benefits attributed to prior service. The Board concluded that accounting for such amendments should be consistent with accounting for benefit increases and that the accounting specified in paragraph 28 would accomplish that objective.

Volatility and Delayed Recognition of Gains and Losses

173. Gains and losses, sometimes called actuarial gains and losses, are changes in either the value of the projected benefit obligation or the fair value of plan assets arising from changes in assumptions and from experience different from that incorporated in the assumptions. Gains and losses include actual returns on assets greater than or less than the expected rate of return.

174. A number of respondents to the Exposure Draft and earlier documents issued as part of this project expressed concern about the volatility of an unfunded or overfunded pension obligation measure and the practical effects of incorporating that volatility into financial statements. The Board does not believe that reporting volatility per se is undesirable. If a financial measure purports to represent a phenomenon that is volatile, the measure must show that volatility or it will not be representationally faithful. The Board also notes that the volatility of the unfunded or overfunded obligation may be less than some expect if the explicit assumptions used in the valuation of the obligation are changed to reflect fully the changes in interest rate structures that affect the fair values of plan assets, because changes in the assets may tend to offset changes in the obligation.

175. However, in the case of pension liabilities, volatility may not be entirely a faithful representation of changes in the status of the obligation (the phenomenon represented). It may also reflect an unavoidable inability to predict accurately the future events that are anticipated in making period-to-period measurements. That is, the difference in periodic measures of the pension liability (and therefore the funded status of the plan) results partly from the inability to predict accurately for a period (or over several periods) compensation levels, length of employee service, mortality, retirement ages, and other pertinent events. As a result, actual experience often differs significantly from that which was estimated and that leads to changes in the estimates themselves. Recognizing the effects of revisions in estimates in full in the period in which they occur may result in volatility of the reported amounts that does not reflect actual changes in the funded status of the plan in that period.

176. Some respondents believe that some of the volatility is representationally faithful, for example, gains and losses that result from measuring investments at fair value. They also believe, however, that recognizing those gains and losses, and especially including them in earnings of the current period, would be inconsistent with the present accounting model applicable to employers' financial statements. They argued that such a major departure from the present model should not be made in this project.

177. The Board considered those views and concluded that it should not require that gains and losses be recognized immediately as a component of net periodic pension cost. Accordingly, this Statement provides for recognition of gains and losses prospectively over future periods to the extent they are not offset by subsequent changes. Based on the concerns expressed by many respondents to the Exposure Draft, the Board also concluded that the effects of changes in the fair value of plan assets, including the

indirect effect of those changes on the return-on-assets component of net periodic pension cost, should be recognized on a basis that reduces the volatility more effectively than that proposed in the Exposure Draft. The Board believes that both the extent of volatility reduction and the mechanism adopted to effect it are essentially practical issues without conceptual basis. The Board does not believe that the market-related value of assets used in this Statement as a device to reduce the volatility of net periodic pension cost is as relevant as the fair value required for other purposes.

178. The Exposure Draft would have required use of the discount rate and the fair value of assets as the basis for calculating the return-on-assets component of net periodic pension cost. Many respondents argued that the return-on-assets component so determined would generate unacceptable volatility even if gains and losses were never amortized. The Board considered several approaches that would have further reduced volatility and concluded that the approach required by this Statement represents the best pragmatic solution.

179. This Statement requires use of an assumption, described as the expected long-term rate of return on plan assets, and of a market-related value of assets to calculate the expected return on plan assets. Actual returns greater than or less than the expected return are afforded delayed recognition. The Board anticipates that the expected return on assets defined in this Statement will be less volatile than either the actual return on assets or the return on assets that would have been recognized based on the Exposure Draft. The Board noted, however, that an expected long-term return-on-assets rate significantly below the rate at which the obligations could be settled implies that settlement would be economically advantageous.

180. The Board believes the approach required in this Statement has several advantages. First, it is very similar mechanically to past practices intended to achieve similar objectives. As a result, it should be easier for those familiar with the details of past practices to understand and apply. Second, it avoids the use of discount rates relevant primarily to the pension obligation as part of a calculation related to plan assets. As a result, it reflects more clearly than did the Exposure Draft the Board's basic conclusion that information about a pension plan is more understandable if asset-related or financial aspects of the arrangement are distinguished from the liability-related and compensation cost aspects.

181. This Statement defines market-related asset value as 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. The Board considered defining a more specific averaging method to be used by all employers, but it concluded that the definition adopted has the advantage of simplicity. It also allows the use of fair value for some classes of assets, and the Board believes that use of fair value for certain assets (for example, bonds) will reduce the volatility of net periodic pension cost. The Board also noted that the definition adopted is similar to (in fact, it was adapted from) that proposed in an Exposure Draft by the Canadian Institute of Chartered Accountants.

182. The Board also considered a number of respondents' suggestions that would have further reduced the volatility of net periodic pension cost by using a discount rate that would change less often and less significantly than the rate described in paragraph 44. Those respondents were primarily concerned that the service component of net cost would be volatile because of changes in the discount rate assumption. The Board concluded that the service component is the cost of benefits attributed to service in the current period and should reflect prices of that period. The Board noted that accounting generally recognizes the current prices rather than past or average prices in recording transactions of the current period. The Board also noted that the service component under the provisions of this Statement is essentially the same as net pension cost determined under the provisions of Opinion 8 for a plan that purchases annuities annually for all benefits attributed to service of that year.

183. The discount rate also has some effect on the interest cost component of net periodic pension cost, but that was less controversial among respondents because as the rate increases (or decreases) the present value of the obligation determined at that rate decreases (or increases) so that the effect on net periodic pension cost (the rate times the present value of the obligation) is less significant.

184. The Board noted that, if assumptions prove to be accurate estimates of experience over a number of years, gains or losses in one year will be offset by losses or gains in subsequent periods. In that situation, all gains and losses would be offset over time, and amortization of unrecognized gains and losses would be unnecessary. The Board was concerned, however, that the uncertainties inherent in assumptions could lead to gains or losses that increase rather

than offset, and concluded that gains and losses should not be ignored completely. Actual experience will determine the final net cost of a pension plan. Therefore, the Board concluded that some amortization, at least when the net unrecognized gain or loss becomes significant, should be required. The Board also noted that amortization of unrecognized gains or losses is part of current funding and past accounting practice.

185. In *Preliminary Views,* the Board proposed a simple amortization based on the average remaining service period of active plan participants. The amount amortized would have been equal to the net unrecognized gain or loss divided by the average remaining service. Many respondents commented that the proposed amortization did not sufficiently reduce the volatility of net periodic pension cost.

186. The Board concluded that once a decision is made to delay recognition of gains and losses, no demonstrably correct period is identifiable over which those items should be amortized. Accordingly, the Board concluded that less rapid amortization could be allowed but that some limit should be retained.

187. The Board was attracted to the "corridor" approach required by this Statement as a minimum amortization approach in part because it allows a reasonable opportunity for gains and losses to offset each other without affecting net periodic pension cost. The Board also noted that the corridor approach is similar in some respects to methods used by some to deal with gains and losses on plan assets for funding purposes.

188. Like the period of amortization of unrecognized gains and losses, a decision about the point at which it becomes necessary to begin amortizing (the width of the corridor) is not conceptually based. The Board believes it is appropriate to relate that requirement to the market-related value of plan assets and the amount of the projected benefit obligation because the gains and losses subject to amortization are changes in those two amounts. The Board concluded that a net gain or loss equal to 10 percent of the greater of those two amounts should not be required to be amortized. The width of the resulting corridor is 20 percent (from 90 percent to 110 percent of the greater balance).

189. The Board considered whether the changes made to the provisions of the Exposure Draft to reduce the volatility of net periodic pension cost obviated the need for the corridor approach to gain or loss amortization, either for all gains and losses or for those related to plan assets. The Board concluded that that approach should be retained as a reasonable way to avoid excessive volatility that might otherwise result from changes in the projected benefit obligation, and that treating asset gains and losses similarly was a simple and reasonable solution to a practical problem.

190. Opinion 8 stated that ". . . actuarial gains and losses should be spread over the current year and future years . . ." (paragraph 30). The Board understands, however, that predominant past practice did not consider gains and losses until after the period in which they arose. *Preliminary Views* would have calculated net periodic pension cost including amortization of the year-end unrecognized net gain or loss. Participants in a field test conducted by the Board and a number of employers associated with the Financial Executives Institute suggested that that approach would unnecessarily complicate the preparation of interim financial statements. The Board agreed, and this Statement requires amortization of unrecognized net gains or losses based on beginning-of-the-year balances.

Assumptions

191. This Statement requires that each significant assumption used in determining the pension information reflect the best estimate of the plan's future experience solely with respect to that assumption. That method of selecting assumptions is referred to as an *explicit approach.* An *implicit approach,* on the other hand, means that two or more assumptions do not individually represent the best estimate of the plan's future experience with respect to those assumptions, but the aggregate effect of their combined use is presumed to be approximately the same as that of an explicit approach. The Board believes that an explicit approach results in more useful information regarding (a) components of the pension benefit obligation and net periodic pension cost, (b) changes in the pension benefit obligation, and (c) the choice of significant assumptions used to determine the pension measurements. The Board also believes that the explicit approach is more understandable. Most respondents who addressed the question agreed.

192. A number of respondents commented that differences in assumptions, especially the discount rates and the assumed compensation levels, would impair comparability. Some of those respondents concluded

that the Board should require all employers to use the same assumptions. Others concluded that the Board could not fix the assumptions and, therefore, any attempt to improve comparability by making other changes in accounting for pensions was futile.

193. The Board concluded that requiring all employers to use the same assumptions is inappropriate. Concepts Statement 2 defines comparability as "the quality of information that enables users to identify similarities in and differences between two sets of economic phenomena." The Board noted that requiring all employers to use the same turnover assumption, for example, would *reduce* comparability to the extent that that assumption would otherwise reflect real differences in expected turnover among employers.

194. This Statement requires use of an assumption described as the expected long-term rate of return on plan assets to calculate the expected return on plan assets. That assumption would not have been required by the Exposure Draft. The Board's reasons for adopting that requirement are discussed in paragraphs 177–181.

195. Most respondents focused their comments on assumed discount rates and compensation levels. Those are generally cited as the assumptions that have the greatest effect on measures of pension cost and benefit obligations, and they are related because both are affected by some of the same economic factors (such as the expected future rates of inflation). Some respondents also believe those assumptions (particularly the discount rates) are less likely than others to reflect real differences among plans.

196. The Board considered a requirement that all employers use common benchmark discount rates, such as those published by the Pension Benefit Guaranty Corporation (PBGC). One reason for that consideration was its concern that rates previously used for disclosure purposes varied among employers over an unreasonable range. In spite of that concern, however, the Board concluded that requiring use of benchmark rates would be inappropriate, in part because no readily available rates seemed fully suitable. Instead, the Board decided that this Statement should describe more clearly the objective of selecting the discount rates with the expectation that a narrower range of rates used would result. Although the Board concluded that it should not require use of PBGC rates, it noted that certain of those rates, as currently determined, are one source of readily available information that might be considered in estimating the discount rates required by this Statement.

197. The Board notes that discount rates are used to measure the current period's service cost component and to determine the interest cost component of net periodic pension cost. Both of those uses relate to the liability side of pension accounting. From an accounting (as opposed to funding) perspective, they have nothing to do with plan assets. The same assumptions are needed for an unfunded plan.

198. The Board concluded that selection of the discount rates should be based on current prices for settling the pension obligation. Under this Statement, the discount rates are used most significantly to calculate the present value of the obligation and the service cost component of net periodic pension cost. Both of those uses are conceptually independent of the plan's assets. If two employers have made the same benefit promise, the Board believes the service cost component and the present value of the obligation should be the same even if one expected to earn an annual return of 15 percent on its plan assets and the other had an unfunded plan. The Board concluded that a current settlement rate best meets that objective and also is consistent with measurement of plan assets at fair value for purposes of disclosing the plan's funded status.

199. Interest rates vary depending on the duration of investments; for example, U.S. Treasury bills, 7-year bonds, and 30-year bonds have different interest rates. Thus, the weighted-average discount rate (interest rate) inherent in the prices of annuities (or a dedicated bond portfolio) will vary depending on the length of time remaining until individual benefit payment dates. A plan covering only retired employees would be expected to have significantly different discount rates from one covering a work force of 30-year-olds. The disclosures required by this Statement regarding components of the pension benefit obligation will be more representationally faithful if individual discount rates applicable to various benefit deferral periods are selected. A properly weighted average rate can be used for aggregate computations such as the interest cost component of net pension cost for the period.

200. An insurance company deciding on the price of an annuity contract will consider the rates of return available to it for investing the premium received and the rates of return expected to be available to it for reinvestment of future cash flows from the initial investment during the period until benefits are payable. That consideration is indicative of a relationship between rates inherent in the prices of annuity contracts

and rates available in investment markets. The Board concluded that it would be appropriate for employers to consider that relationship and information about investment rates in estimating the discount rates required for application of this Statement.

201. Some believe that year-to-year changes in pension information as a result of changes in assumed discount rates should be avoided to the maximum extent possible. In their view, some averaging technique should be used to smooth potential year-to-year changes so that assumed rates are changed only when it is apparent that the long-term trend has changed. The Board recognizes that long-term interest rates must be considered in determining appropriate assumed discount rates. However, it rejects the view that material changes in long-term rates should be ignored solely to avoid adjusting assumed discount rates.

202. The Board also addressed assumed compensation levels and concluded that they should (a) reflect the best estimate of actual future compensation levels for the individuals involved and (b) be consistent with assumed discount rates to the extent that both incorporate expectations of the same future economic conditions.

203. Some respondents argued that only certain components[16] of future compensation increases should be considered. The Board concluded that the terms of the plan do not distinguish between compensation increments from different causes and that accounting should not do so either. The Board also is not convinced that a meaningful breakdown of a change in compensation levels into its components is practical.

Different Accounting for Smaller Employers

204. The 1983 FASB Discussion Memorandum, *Employers' Accounting for Pensions and Other Postemployment Benefits,* raised the question of whether certain smaller employers should have pension accounting requirements different from those for larger companies.

205. Some respondents argued that different requirements were needed because the costs of obtaining information are relatively more burdensome for smaller employers and because there is less benefit from improved accounting for those employers. In their view, the needs and interests of users of smaller employers' financial statements, especially those of employers that are not publicly held, are different from the needs and interests of users of public companies' financial statements.

206. The Board also considered arguments that certain defined benefit plans of small employers are substantively different from those of larger employers. In this view the smaller employer's plan is primarily a means of sheltering the income of key employees or manager-owners from taxation, and as a result, the nature of the obligation is different.

207. The Board concluded that the measurement of net periodic pension cost and the recognition of net pension liabilities or assets should not differ for smaller or nonpublic employers. Evidence from users of the financial statements of smaller employers (in particular, bankers) does not provide support for a different approach. In the Board's view, the existence of a separate set of measurement requirements or a range of alternatives for certain employers would probably not improve the cost-benefit relationship but would add complexity and reduce the comparability and usefulness of financial statements.

208. The Exposure Draft proposed to allow certain smaller and nonpublic employers to elect an alternative set of disclosure requirements less extensive than those proposed for other employers. Because changes to reduce the extent of required disclosure for all employers eliminated most of the items that would not have been required of smaller employers, the Board concluded that the same requirements should apply to all employers.

209. Some respondents argued that smaller employers would have a more difficult time than other employers with the initial application of this Statement, in part because advisors involved with pension accounting may put a higher priority on the needs of larger employers. The Board agreed that the transition provisions of this Statement, which allow an extra two years before application is required for certain smaller employers, would be a practical and appropriate means of facilitating its adoption by those employers.

[16]The components have been defined as increases due to merit, productivity, and inflation. Merit increases are those that an individual employee will receive as that employee progresses through a career and that are theoretically based on the employee's ability to perform at a more competent or responsible level as the individual becomes older and accumulates more experience. The second component is labor's share of productivity gains. The third component attempts to anticipate general compensation increases that result from inflation.

Different Accounting for Certain Industries

210. Some respondents argued that accounting requirements should be different for employers subject to certain types of regulation (rate-regulated enterprises) or for employers that have certain types of government contracts for which reimbursement is a function of costs incurred. In both of those cases it was noted that a change in reported net periodic pension cost might have a direct effect on the revenues of the employer (lower cost would result in reduced revenues), or conversely, that increases in reported net periodic pension cost would not be recoverable. The Board understands the practical concerns of those respondents, but it concluded that the cost of a particular pension benefit is not changed by the circumstances described and that this Statement should include no special provisions relating to such employers. For rate-regulated enterprises, FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation,* may require that the difference between net periodic pension cost as defined in this Statement and amounts of pension cost considered for rate-making purposes be recognized as an asset or a liability created by the actions of the regulator. Those actions of the regulator change the timing of recognition of net pension cost as an expense; they do not otherwise affect the requirements of this Statement.

Disclosure

General considerations

211. Decisions on disclosure requirements involve evaluating and balancing considerations of relevance, reliability, and cost. Relevance and reliability are characteristics that make information useful for making decisions and that make it beneficial to require disclosure of some information. Benefits to users that are expected to result from required disclosures must be compared with the costs of providing and assimilating that information. Evaluating individual disclosures in relation to those criteria is generally a matter of judgment. Cost, for example, is affected by several factors, one of which is the fact that some employers have a large number of different plans and some disclosures are more difficult than others to aggregate or summarize meaningfully. Also, as the total amount of disclosure increases, the incremental cost to both preparers and users of additional disclosure may be greater than the benefit of the additional information.

212. Many respondents supported the basic idea that additional information about defined benefit pension plans was needed by users of financial reports. Respondents suggested a wide range of possible disclosures.

Specific Disclosure Requirements

Descriptive information

213. Respondents generally favored disclosure of information about plan provisions and employee groups. The Board concluded that a brief description of the plan and the type of benefit formula could assist users in understanding the financial statements, particularly in view of the fact that the measurement of net periodic pension cost is based on the benefit formula. Respondents and the Board agreed that financial statements should continue to disclose the nature and effects of significant changes in the factors affecting the computation of the net pension liability (or asset) and net periodic pension cost recognized in the financial statements and other significant or unusual matters necessary to an understanding of the impact of the plan on the employer's financial position and results of operations.

214. Respondents also favored disclosure of the funding policy. They noted that the disclosure required by Opinion 8 and Statement 36 had been helpful in understanding differences between funding a pension plan and accounting for it. Information that highlights changes in funding policies also can be useful in predicting future cash flows.

Pension cost information

215. Most respondents indicated that the disclosure of net periodic pension cost has been useful and favored continuing that disclosure requirement. The Board concurred and also decided to require disclosure of the components of net periodic pension cost. Some respondents argued that it is important to separate return on assets from the other components because they consider that return to be the result of the employer's financing decisions and not really a part of pension cost. The Board also believes that disclosure of the components will, over time, increase the general understanding of the nature of net periodic pension cost, the reasons for changes in that cost, and the relationship of financing activities and employee compensation cost.

216. The Exposure Draft proposed to require disclosure of both the expected return on assets (as a component of net periodic pension cost) and the actual return on assets (as part of a disclosure of changes in the fair value of plan assets). Respondents suggested that disclosure of two different measures of return on assets would be confusing. The Board agreed and concluded that, of the two, the actual return was more relevant and important.

Information about obligations and assets

217. Disclosure of information about the funded status of the plan was favored by most respondents who addressed that issue. The Board concluded that disclosure of certain components of the pension benefit obligation should be required. The Board believes that disclosure of that information is important to an understanding of the economics of the employer's pension plan. For example, disclosure of vested benefits provides important information about the firmness of the obligation (vested benefits are less avoidable than nonvested benefits). In addition, vested benefits may be a reasonable surrogate for a plan termination liability. The Board believes that this information is not particularly difficult or costly to obtain.

218. The Board concluded that users should also be provided general information about the major types of plan assets (and nonbenefit liabilities, if any) and the actual amount of return on plan assets for the period. Management has a stewardship responsibility for efficient use of plan assets just as it does for operating assets. The Board believes that disclosure of that information will be useful in assessing the profitability of investment policies and the degree of risk assumed.

219. The Board believes that a reconciliation of the amounts included in the employer's statement of financial position to the funded status of the plan's projected benefit obligation is essential to understanding the relationship between the accounting and the funded status of the plan. The Board acknowledges that the amount recognized in the financial statements as a net pension liability or asset under this Statement does not fully reflect the underlying funded status of the plan.

Information about assumptions

220. Respondents addressing the question generally favored disclosure of the weighted-average assumed discount rate. They noted that the discount rate is a significant assumption that materially affects the computation of the pension benefit information and the comparability of that information among employers. Respondents were divided on whether other assumptions should be disclosed. Some opposed disclosing other assumptions on the basis that additional information would not be understood by most users. Others suggested that for employers with numerous plans, certain of the disclosures (such as turnover and mortality) would be complex and difficult to aggregate or summarize.

221. The Board agreed that information about certain assumptions is useful and this Statement requires disclosure of the assumed weighted-average discount rate and rate of compensation increase. It noted that those two assumptions have the most significant impact on the amounts of net periodic pension cost and the projected benefit obligation and that those two assumptions are related. It also noted that their effect on reported amounts is relatively easy to understand. The Board concluded that information about those two assumptions is essential if users are to be able to make meaningful comparisons among employers using different assumptions. For the same reasons, when the Board decided to allow the use of an expected long-term rate of return on plan assets different from the discount rate, it concluded that disclosure of that assumption should be required.

222. Some respondents opposed disclosure of assumed future compensation levels because providing that information to employees could affect labor negotiations. The Board concluded that the information is likely to be available to labor negotiators from other sources and that the usefulness of the information to financial statement users justifies its disclosure.

Suggested Disclosures

223. The Exposure Draft would have required the following disclosures in addition to those noted in the preceding paragraphs:

a. The ratio of net periodic pension cost to covered payroll
b. The separate amounts of amortization of unrecognized prior service and amortization of unrecognized net gain or loss
c. Information about the cash flows of the plan separately showing employer contributions, other contributions, and benefits paid during the period
d. The amounts of plan assets classified by major asset category

e. The amounts of the vested benefit obligation owed to retirees and to others
f. The change in the projected benefit obligation that would result from a one-percentage-point change in (1) the assumed discount rate and (2) the assumed rate of compensation increase
g. The change in the service cost and interest cost components of net periodic pension cost that would result from a one-percentage-point change in (1) the assumed discount rate and (2) the assumed rate of compensation increase.

224. Those disclosures had been suggested by respondents to previous documents issued as part of this project and the Board had concluded in the Exposure Draft that they would provide useful information and would not be unduly costly to provide. However, many respondents to the Exposure Draft commented that the volume of the proposed disclosures was too great. The Board agreed and concluded that the disclosures described in the preceding paragraph should not be required. The Board believes those disclosures are relatively less useful or (in the case of the last two items listed) relatively more costly than the disclosures required by this Statement. The Board also believes it would be appropriate for employers to consider disclosing those items if they decide to disclose more information about pension plans than the minimum required by this Statement, for example, because their plans are large relative to their overall operations.

225. The Board also considered an approach that would have allowed reduced disclosures for employers with defined benefit plans not large enough in the aggregate to qualify as a segment of the business under FASB Statement No. 14, *Financial Reporting for Segments of a Business Enterprise.* The Board concluded that that approach would not be cost effective, in part because of the difficulty of defining how the provisions of Statement 14 should be applied to pension plans.

Other Disclosures Considered

226. Other disclosures noted in the following paragraphs were suggested by respondents and considered by the Board. The Board concluded that those suggested disclosures are less important than the disclosures discussed previously and should not be required because, in the Board's judgment, there is not sufficient evidence that the usefulness of that information is great enough to justify the costs involved.

227. Some respondents favored disclosing estimates of future contributions. They suggested that the information would be relevant to assessing near-term cash flows and would provide more timely information about changes in funding policy. That requirement was opposed by others who believed that presentation of forecasts of future funds flows should not be required for any specific activity. Opponents also suggested that the information would be too costly to produce if done properly and that it implies greater certainty than exists. Similar views were expressed for and against disclosure of estimates of future net periodic pension cost.

228. Disclosure of demographic information about the employee population was advocated by several respondents. They suggested that a limited amount of demographic information could be provided at minimal cost and would be useful. For example, disclosure of the number of covered employees, the number of retirees, and the average age of active employees might contribute to understanding the pension situation. Opponents suggested that those disclosures are outside the scope of financial reporting.

229. Others suggested disclosing the obligation for pension benefits that would be used in determining the PBGC or termination liability. The Board concluded that such information could be costly to determine if done properly and might not be substantially different from other disclosed information (vested and accumulated benefit obligations).

230. Information about the plan's actuary was suggested as another possible disclosure. Recommendations were to provide the name and professional qualifications of the actuary and comments of the actuary about any anticipated changes in plan costs or contribution rates. The Board concluded that such information is outside the scope of financial reporting.

Timeliness of Information

231. The 1983 Discussion Memorandum raised the question of whether the accounting measurements of pension obligations and plan assets should be as of the date of the financial statements or as of an earlier date. Measuring pension assets as of the date of the financial statements does not present very significant or unusual problems; the issue relates primarily to the measures of the pension obligations.

232. Although many respondents preferred that the Board allow measurements as of a date earlier than the date of the financial statements, most of the arguments raised related to a perceived requirement to have an actuarial valuation performed after that date and completed before financial statements are issued. The Board concluded that it should be feasible in most situations to provide information as of the date of financial statements based on a valuation performed at an earlier date with adjustments for relevant subsequent events (especially employee service) after that date. The Board noted that a number of employers have used that approach to provide information previously required. The Board also believes that the benefits of having the information on a timely basis and consistent with other financial information provided would usually outweigh the incremental costs involved. However, the Board acknowledges that practical problems may make it costly in some situations to obtain information, especially that concerning obligations and related components of net periodic pension cost, as of the date of the financial statements. Accordingly, the Board concluded that the information required by this Statement should be as of a date not earlier than three months before the date of the financial statements. The Board also noted that ARB No. 51, *Consolidated Financial Statements,* allows consolidation of a subsidiary with an annual fiscal period ending not more than about three months earlier than the parent's.

233. The Board also considered respondents' requests for clarification of how to apply the provisions of the Exposure Draft to quarterly reports and comments on the practical difficulty of basing current period net pension cost on assumptions related to the current period. The Board concluded that the provisions of paragraphs 52 and 53 of this Statement are practical and responsive to those concerns.

Other Situations and Types of Plans

Contracts with Insurance Companies

234. The Board concluded that some contracts with insurance companies are in substance forms of investments and that the use of those funding arrangements should not affect the accounting principles for determining an employer's net periodic pension cost. Some respondents who agreed with that conclusion were concerned that fair value of those investments would be difficult or impossible to determine. They suggested that contract value be used instead of fair value. The Board concluded that fair value should be the measurement basis for all types of investments but agreed that for some contracts the best available estimate of fair value might be contract value.

235. The Board recognized that some contracts with insurance companies are in substance more than investment vehicles. Most respondents noted that some insurance contracts (for example, nonparticipating annuities) effectively transfer the primary obligation for payment of benefits from the employer to the insurance company. They argued that, in those circumstances, the premium paid is an appropriate measure of pension cost. The Board agreed that the purchase of nonparticipating annuities is in substance more like a settlement of the pension obligation than like an investment.

236. Under some annuity contracts, the purchaser (either the plan or the employer) acquires the right to participate in the investment performance or experience of the insurance company (participating annuities). Under those contracts, if the insurance company has favorable experience, the purchaser receives dividends. Participating annuities have some characteristics of an investment. However, the employer is as fully relieved of the obligation as with a nonparticipating annuity, and a separate actuarial computation ordinarily would not be performed. The Board concluded that, except as indicated in the following paragraph, it would be appropriate to treat a participating annuity contract the same as a nonparticipating annuity contract and to exclude the benefits covered from measures of the obligation.

237. The Board was concerned, however, that a contract could be structured in such a way that the premium would be materially in excess of the cost of nonparticipating annuities because of the expectation of future dividends. If the full amount of the premium were recognized as periodic cost in the year paid and dividends were recognized as reductions of cost when received, the resulting measures of net periodic pension cost would be unrelated to benefits earned by employees. If the employer had the ability to influence the timing of dividends, it would then be possible to shift cost among periods without regard to underlying economic events. The Board concluded that part of a participating contract is in substance an investment that should be recognized as an asset.

238. The Board believes that measurement of the participation right asset in periods subsequent to its acquisition should be, consistent with the measurement of other assets, at fair value to the extent that

fair value can be reasonably determined. The Board understands, however, that some participating annuity contracts may not provide a basis for an estimate of fair value better than that provided by amortized cost and concluded that in that situation amortized cost should be used. That conclusion is not intended to permit use of amortized cost if that amount is in excess of net realizable value.

239. The Exposure Draft would have treated annuity contracts purchased from an insurance company affiliated with the employer as investments (that is, it would have included such contracts and covered benefits in plan assets and the accumulated benefit obligation). Respondents argued that information needed to treat such contracts as investments, including the actuarial present value of the obligations covered by the contract, would be neither available nor cost beneficial. The Board agreed and this Statement requires only contracts purchased from a captive insurance subsidiary to be treated as investments. Because an employer remains indirectly at risk if annuities are purchased from an affiliate, however, the Board concluded that disclosure of the approximate amount of annual benefits covered by such contracts should be required.

Defined Contribution Plans

240. Most respondents supported the past accounting and disclosure requirements for defined contribution plans, and the Board concluded that no significant changes to those requirements were needed. The Board believes that in most cases the formula in a defined contribution plan unambiguously assigns contributions to periods of employee service. Accordingly, the employer's present obligation under the terms of the plan is fully satisfied when the contribution for the period is made, subject to the constraint that costs (defined contributions) should not be deferred and recognized in periods after the termination of service of the individual to whose account the contributions are to be made. Most of the questions that have been referred to the Board about defined contribution plans have dealt with the definition of those plans and how to treat plans that have some of the attributes of both defined benefit and defined contribution plans. The definition of a defined contribution plan in this Statement is similar to the definitions presently established by the Internal Revenue Code and ERISA.

241. The Board also concluded that defined contribution plans are sufficiently different from defined benefit plans that disclosures about them should not be combined. Opinion 8 did not specifically address combining disclosures, and practice has varied as some employers disclosed, for example, net periodic pension cost as a single amount including both types of plans.

Multiemployer Plans

242. The 1983 Discussion Memorandum raised the issue of whether an employer participating in a multiemployer pension plan that provides defined benefits should recognize cost or obligations other than those defined by contributions. Respondents' comments indicated substantial uncertainty as to the legal status of employers' obligations to multiemployer plans. Some noted that the obligation to a multiemployer plan can be changed by events affecting other participating employers and their employees. Respondents also expressed concern about the availability of information sufficiently reliable for accounting recognition.

243. Based on respondents' comments, the Board concluded that it was not appropriate to require changes in the accounting for multiemployer plans as part of this Statement. Many respondents also emphasized the substantive differences between a multiemployer plan and a single-employer plan. The Board concluded that those differences are such that separating disclosure for the two types of plans will enhance the understandability and usefulness of the information.

244. The Exposure Draft would have required certain disclosures intended to provide information about the extent of involvement with multiemployer plans, including available information about the withdrawal liability. Many respondents argued that the withdrawal liability is a contingent liability, which suggests that it should be disclosed. Other respondents, however, argued that information about the withdrawal liability would be difficult and expensive to obtain, would be unreliable and, to the extent readily available, out of date, and would be of limited value except in cases in which withdrawal was expected to occur under circumstances that would trigger the liability. The Board agreed and the proposed requirements are not included in this Statement. Instead, the Board concluded that the provisions of Statement 5 should determine when withdrawal liabilities are recognized or disclosed.

245. Several respondents to the Exposure Draft argued that some plans involve more than one employer, are in substance multiemployer plans because

the assets cannot be attributed to particular employers, and do not involve unions. The Board concluded that it should modify the proposed definition of multiemployer plans to include those plans.

246. The 1983 Discussion Memorandum also inquired about other multiple-employer plans not classified as multiemployer plans under ERISA. The few that responded to that issue indicated that those plans are in substance more like single-employer plans than like multiemployer plans. Accordingly, the definition of multiemployer plans in this Statement is similar to that in ERISA as amended by the Multiemployer Pension Plan Amendments Act of 1980.

Non-U.S. Pension Plans

247. Respondents' reactions to accounting issues concerning pension arrangements outside the United States (foreign plans) varied. Almost equal numbers of respondents supported and opposed special accounting provisions for those plans. Those supporting the position that special provisions should be required for foreign plans argued that either (a) the nature of the arrangement or the substance of the obligation is sufficiently different from that of plans in the United States to preclude similar treatment or (b) circumstances in other countries make it impractical or impossible to implement similar accounting principles.

248. The Board concluded that the substance of the arrangement and the nature of the employer's obligation should determine the appropriate accounting. For foreign plans that are in substance similar to plans in the United States, the Board was not convinced that application of the basic requirements of this Statement would be impractical. The Board is not aware of significant problems arising from the application of prior requirements to foreign plans, and those requirements were based on actuarial calculations and the same assumptions needed to apply this Statement.

249. The Board was convinced, however, that practical problems could arise in communicating the requirements and obtaining the information necessary for initial application of this Statement to plans outside the U.S. The Board concluded that allowing an extra two years before application is required would give employers time to make necessary arrangements in an orderly manner and would reduce the cost of transition.

250. Some respondents also argued that combined disclosures for U.S. plans and for plans in other countries with very different economic conditions would be difficult to understand. The Board agreed and concluded that disclosures for such plans should be presented separately.

Business Combinations

251. The Board is aware of diversity in practice relating to recognition of pension-related assets and liabilities in purchase business combinations. The Board has also been asked how the asset or liability, once recognized, should be subsequently reduced.

252. This Statement requires that in a business combination accounted for as a purchase under Opinion 16, the acquiring company should recognize a pension liability (or asset) if the acquired company has a projected benefit obligation in excess of (or less than) plan assets. It also requires that, if it is expected that the purchaser will restructure the plan, the effects of restructuring should be considered in valuing the projected benefit obligation. The Board concluded that those requirements are consistent with purchase accounting as defined by Opinion 16, which specifies a *new basis of accounting* reflecting bargained (fair) value of assets acquired and liabilities assumed whether or not previously reflected in the financial statements. The Board believes that the unfunded or overfunded projected benefit obligation defined by this Statement is a more appropriate measure of the net pension obligation or asset than the measure required by Opinion 16 in view of the other conclusions in this Statement. The Board also noted that Opinion 16 was predicated on pension accounting that involved alternative methods. One result of the accounting required by this Statement is that the effects of plan amendments and gains and losses of the acquired company's plan that occurred before the acquisition are not a part of future net periodic pension cost of the acquirer.

253. The Board also decided to avoid possible ambiguity and future diversity in practice by clarifying how Opinion 16 should apply to a multiemployer plan situation. The Exposure Draft would have required recognition of a withdrawal liability when the employer is acquired in a business combination accounted for as a purchase. Based on respondents' comments, however, the Board concluded that no recognition of withdrawal liabilities should be required unless withdrawal under conditions that would result in a liability is probable. The Board was

led to that conclusion by doubts about the reliability of the measure of the liability in other circumstances. The Board was not convinced that there is an obligation for future contributions to a multiemployer plan or that an estimated withdrawal liability would provide useful information about such an obligation, absent a probable withdrawal.

Transition and Effective Dates

254. In *Preliminary Views* the Board concluded that transition was essentially a practical question and that providing a choice between two specified transition methods (prospective and retroactive) was appropriate. However, the choice of methods was not supported by most respondents principally due to the lack of comparability that would result. Required application of a retroactive approach also had little appeal among respondents because of the practical problems for some employers. In particular, a retroactive determination of the balance of the pension benefit obligation as of a past date would often require a new actuarial valuation as of that date. Many argued that such an approach would have been costly and might have been impracticable in some cases because relevant data no longer existed. Finally, many argued that a retroactive approach would have adverse consequences for some employers because of the materiality of pension amounts and the wide range of practices used under Opinion 8.

255. The Exposure Draft would have required amortization of the unrecognized net obligation or net asset on a declining basis over the service periods of employees active at the date of transition. Respondents argued that a declining basis amortization of that amount created year-to-year changes in net periodic pension cost that would reflect only transition and that for some companies with short average remaining service periods the transition would be unduly severe. The Board agreed and decided that the amortization required by this Statement would mitigate those concerns. That approach has the additional advantage that the transition will be completed somewhat earlier than would have been the case under the approach proposed in the Exposure Draft.

256. The Board continues to believe that transition is a practical matter and that a major objective of transition is to minimize the cost and to mitigate the disruption involved, to the extent that is possible without unduly compromising the objective of enhancing the ability of financial statements to provide useful information. The transition problem in this Statement is different from some others in several respects. The unrecognized net obligation or net asset described in paragraph 77 is the net total of several components: (a) unrecognized costs of past retroactive plan amendments, (b) unrecognized net gain or loss from previous periods, and (c) the cumulative effect of past use of accounting principles different from those in this Statement. If those components could be treated separately, it would be consistent with other provisions of this Statement to treat the last component as the effect of an accounting change (and to recognize it when this Statement is first applied), but prospective accounting (or delayed recognition) of the first two components is continued by this Statement. As a practical matter, the Board is convinced that it is effectively impossible, at least in many cases, to identify those components separately. Accordingly, the Board concluded that the single method of transition required by this Statement should be used.

257. Some respondents suggested that unrecognized amounts existing at transition should continue to be amortized using past methodologies. The Board noted that such a transition approach would result in delaying recognition of significant amounts for as much as 30 years and concluded that a less-extended transition was practical and preferable.

258. The Board also considered respondents' requests to clarify the appropriate procedures for transition to this Statement in other than the first interim period of a fiscal year. The Board agreed to do so and concluded that requiring restatement of previous interim periods would be appropriate and consistent with existing guidance in other areas.

259. The Board decided to allow more than the normal time between issuance of this Statement and its required application to give time for employers and their advisors to assimilate the requirements and to obtain the information required. The Board believes that a one-year delay is adequate for those purposes.

260. The Board also decided to allow an additional two years before employers are required to apply the provisions of this Statement that require recognition of a minimum liability because of concerns expressed by some respondents that some employers would have to arrange to renegotiate or to obtain waivers of provisions of some legal contracts. As noted previously, the Board also decided to allow an additional two years before employers are required to apply the provisions of this Statement to plans outside the U.S. and before certain smaller employers are required to apply those provisions.

Appendix B

ILLUSTRATIONS

261. This appendix contains illustrations of the following requirements of this Statement:

1–2. [These illustrations have been deleted. See Status page.]
3. Amortization of prior service cost as a component of net periodic pension cost
4. Delayed recognition in net periodic pension cost of gains or losses
5. [This illustration has been deleted. See Status page.]
6. Disclosure requirements [Replaced]
7. [This illustration has been deleted. See Status page.]

261A. [This paragraph has been deleted. See Status page.]

Illustration 1 and Illustration 2

[These illustrations have been deleted. See Status page.]

Illustration 3—Amortization of Prior Service Cost as a Component of Net Periodic Pension Cost

Case 1—Assigning Equal Amounts to Future Years of Service

Determination of expected future years of service

The amortization of prior service cost as a component of net periodic pension cost (paragraph 25) is based on the expected future years of service of participants active at the date of the amendment who are expected to receive benefits under the plan. Calculation of the expected future years of service considers population decrements based on the actuarial assumptions and is not weighted for benefits or compensation. Each expected future service year is assigned an equal share of the initially determined prior service cost. The portion of prior service cost to be recognized in net periodic pension cost in each of the future years is determined by the service years rendered in that year.

The following chart illustrates the calculation of the expected future years of service for the defined benefit plan of Company E. At the date of the amendment (January 1, 20X0), the company has 100 employees who are expected to receive benefits under the plan. Five percent of that group (5 employees) are expected to leave (either retire or quit) in each of the next 20 years. Employees hired after that date do not affect the amortization. Initial estimates of expected future years of service related to each amendment are subsequently adjusted only for a curtailment.

[17] [This footnote has been deleted. See Status page.]

Determination of Expected Years of Service
Service Years Rendered in Each Year

Individuals	Future Service Years	Year 1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
A1–A5	5	5																			
B1–B5	10	5	5																		
C1–C5	15	5	5	5																	
D1–D5	20	5	5	5	5																
E1–E5	25	5	5	5	5	5															
F1–F5	30	5	5	5	5	5	5														
G1–G5	35	5	5	5	5	5	5	5													
H1–H5	40	5	5	5	5	5	5	5	5												
I1–I5	45	5	5	5	5	5	5	5	5	5											
J1–J5	50	5	5	5	5	5	5	5	5	5	5										
K1–K5	55	5	5	5	5	5	5	5	5	5	5	5									
L1–L5	60	5	5	5	5	5	5	5	5	5	5	5	5								
M1–M5	65	5	5	5	5	5	5	5	5	5	5	5	5	5							
N1–N5	70	5	5	5	5	5	5	5	5	5	5	5	5	5	5						
O1–O5	75	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5					
P1–P5	80	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5				
Q1–Q5	85	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5			
R1–R5	90	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5		
S1–S5	95	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	
T1–T5	100	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5
	1,050																				
Service Years Rendered		100	95	90	85	80	75	70	65	60	55	50	45	40	35	30	25	20	15	10	5
		100	95	90	85	80	75	70	65	60	55	50	45	40	35	30	25	20	15	10	5
Amortization Fraction		1,050	1,050	1,050	1,050	1,050	1,050	1,050	1,050	1,050	1,050	1,050	1,050	1,050	1,050	1,050	1,050	1,050	1,050	1,050	1,050

Amortization of prior service cost

On January 1, 20X0, Company E grants retroactive credit for prior service pursuant to a plan amendment. The amendment generates prior service cost of $750,000 that is recognized as an increase in the pension liability and a corresponding charge to other comprehensive income. The prior service cost resulting from the plan amendment is subsequently amortized as a component of net periodic pension cost based on the expected future years of service of active participants as discussed in the previous paragraph. Other comprehensive income is adjusted each period as prior service cost is amortized.

Amortization of Prior Service Cost

Year	Beginning-of-Year Balance	Amortization Rate	Amortization	End-of-Year Balance
20X0	750,000	100/1050	71,429	678,571
20X1	678,571	95/1050	67,857	610,714
20X2	610,714	90/1050	64,286	546,428
20X3	546,428	85/1050	60,714	485,714
20X4	485,714	80/1050	57,143	428,571
20X5	428,571	75/1050	53,571	375,000
20X6	375,000	70/1050	50,000	325,000
20X7	325,000	65/1050	46,429	278,571
20X8	278,571	60/1050	42,857	235,714
20X9	235,714	55/1050	39,286	196,428
20Y0	196,428	50/1050	35,714	160,714
20Y1	160,714	45/1050	32,143	128,571
20Y2	128,571	40/1050	28,571	100,000
20Y3	100,000	35/1050	25,000	75,000
20Y4	75,000	30/1050	21,429	53,571
20Y5	53,571	25/1050	17,857	35,714
20Y6	35,714	20/1050	14,286	21,428
20Y7	21,428	15/1050	10,714	10,714
20Y8	10,714	10/1050	7,143	3,571
20Y9	3,571	5/1050	3,571	0

Case 2—Using Straight-Line Amortization over Average Remaining Service Period

Determination of expected future years of service

To reduce the complexity and detail of the computations shown in Illustration 3, Case 1, alternative amortization approaches that recognize the cost of retroactive amendments as a component of net periodic pension cost more quickly may be consistently used (paragraph 26). For example, a straight-line amortization of the cost over the average remaining service period of employees expected to receive benefits under the plan is acceptable.

If Company E (Case 1) elects to use straight-line amortization over the average remaining service period of employees expected to receive benefits (1,050 future service years/100 employees = 10.5 years), the amortization is as follows:

Amortization of Prior Service Cost

Year	Beginning-of-Year Balance	Amortization[a]	End-of-Year Balance
20X0	750,000	71,429	678,571
20X1	678,571	71,429	607,142
20X2	607,142	71,429	535,713
20X3	535,713	71,429	464,284
20X4	464,284	71,429	392,855
20X5	392,855	71,429	321,426
20X6	321,426	71,429	249,997
20X7	249,997	71,429	178,568
20X8	178,568	71,429	107,139
20X9	107,139	71,429	35,710
20Y0	35,710	35,710	0

[a]750,000 ÷ 10.5 = 71,429.

Illustration 4—Delayed Recognition in Net Periodic Pension Cost of Gains or Losses

This Statement provides for delayed recognition in net periodic pension cost of the effects of a number of types of events that change the measures of the projected benefit obligation and the fair value of plan assets. Those events include retroactive plan amendments and gains and losses. Gains and losses as defined in this Statement include the effects of changes in assumptions.

The following examples start with an assumed beginning-of-the-year funded status and show how a series of events change the projected benefit obligation or the plan assets and how the effects of those events are recognized in the financial statements. Any change in the projected benefit obligation or the plan assets (other than contributions and benefit payments) either is initially recognized in other comprehensive income or is included in net periodic pension cost for the period. Employer contributions to a funded plan decrease a recognized pension liability or increase a recognized pension asset. Benefit payments from a funded plan reduce the pension obligation and the plan assets equally, with no effect on the employer's statement of financial position. For simplicity, all illustrations ignore the effects of income taxes, and all contributions and benefit payments are assumed to occur on the last day of the year. Also, assumed discount rates and expected long-term rates of return are included for illustrative purposes only and are not meant to represent assumptions that would be appropriate at any given time.

20X1—LIABILITY LOSS

When Company I's plan assets and obligations were measured at December 31, 20X1, the amount of the projected benefit obligation was not equal to the expected amount. Because the discount rate had declined to 9 percent and for various other reasons not specifically identified, the projected benefit obligation was higher than had been projected (a loss had occurred). The results were as follows:

	Projected for 20X1	Actual for 20X1 and Projected for 20X2
Assumptions:		
Discount rate	10.00%	9.00%
Expected long-term rate of return on plan assets	10.00%	10.00%
Average remaining service	10 years	10 years

	Actual 12/31/X0	For 20X1	Projected 12/31/X1	Actual 12/31/X1	For 20X2	Projected 12/31/X2
			(Amounts in thousands)			
Projected benefit obligation	$(1,000)		$(1,060)	$(1,200)		$ (1,266)[b]
Plan assets at fair value	800		880	880		968[c]
Funded status and recognized liability	$ (200)		$ (180)	$ (320)		$ (298)
Amounts recognized in accumulated other comprehensive income:						
Transition obligation	$ 200		$ 180	$ 180		$ 160
Prior service cost	0		0	0		0
Net (gain) or loss	0		0	140		138
	$ 200		$ 180	$ 320		$ 298

Service cost component		$ 60[a]		$ 72
Interest cost component		100		108
Expected return on assets		(80)		(88)
Market-related value of assets	$800		$880	
Actual return on assets—(increase)/decrease			(80)	
Amortization of:				
Transition obligation		20		20
Prior service cost		0		0
Net (gain) or loss		0[d]		2[d]
Net periodic pension cost		$100		$114
Contribution		$100		$114
Benefits paid		$100		$114

[a]Throughout this illustration, the service cost component is assumed as an input rather than calculated as part of the illustration.

[b](Actual projected benefit obligation at 12/31/X1) + (service component) + (interest component) – (benefits paid).

[c](Actual plan assets at 12/31/X1) + (expected return on assets) + (contributions) – (benefits paid).

[d]The minimum amortization of the net gain or loss included in beginning accumulated other comprehensive income (paragraph 32) is calculated as follows:

	20X1	20X2
Net (gain) or loss included in beginning accumulated other comprehensive income	$ 0	$ 140
Plus asset gain or less asset loss not yet in market-related value of assets at 1/1—(fair value of plan assets) – (market-related value of plan assets)	0	0
Net (gain) or loss included in beginning accumulated other comprehensive income subject to amortization	0	140
Corridor = 10% of the greater of projected benefit obligation or market-related value of assets at 1/1	100	120
Net (gain) or loss included in beginning accumulated other comprehensive income outside corridor	0	20
× 1/average remaining service	0.10	0.10
Amortization recognized in net periodic pension cost	$ 0	$ 2

20X2—ASSET GAIN

When Company I's plan assets and obligations were measured at December 31, 20X2, the amount of plan assets was not equal to the expected amount because of market performance better than the expected or assumed 10 percent. The results were as follows:

	Projected for 20X2	Actual for 20X2 and Projected for 20X3
Assumptions:		
Discount rate	9.00%	9.00%
Expected long-term rate of return on plan assets	10.00%	10.00%
Average remaining service	10 years	10 years

	Actual 12/31/X1	For 20X2	Projected 12/31/X2	Actual 12/31/X2	For 20X3	Projected 12/31/X3
			(Amounts in thousands)			
Projected benefit obligation	$(1,200)		$(1,266)	$(1,266)		$(1,345)
Plan assets at fair value	880		968	1,068		1,167
Funded status and recognized liability	$ (320)		$ (298)	$ (198)		$ (178)
Amounts recognized in accumulated other comprehensive income:						
Transition obligation	$ 180		$ 160	$ 160		$ 140
Prior service cost	0		0	0		0
Net (gain) or loss	140		138	38		38
	$ 320		$ 298	$ 198		$ 178
Service cost component		$ 72			$ 76	
Interest cost component		108			114	
Expected return on assets		(88)			(99)[g]	
Market-related value of assets	$ 880			$ 988[h]		
Actual return on assets—(increase)/decrease	(80)			(188)		
Amortization of:						
Transition obligation		20			20	
Prior service cost		0			0	
Net (gain) or loss		2[i]			0[i]	
Net periodic pension cost		$114			$ 111	

Contribution	$114	$111
Benefits paid	$114	$111

[g]Expected return on plan assets = (expected long-term rate of return on plan assets) × (market-related value of plan assets). If contributions occurred other than at the end of the year, market-related value would consider those amounts.

[h]Market-related asset values may be calculated in a variety of ways. This example uses an approach that adds in 20% of each of the last five years' gains and losses. The only objective of the market-related calculation is to reduce the volatility of net periodic pension cost.

Market-related value of assets at 1/1	$ 880
Expected return on assets	88
Contributions	114
Benefits paid	(114)
20% of last five years' asset gains and (losses)	20
Market-related value of assets at 12/31	$ 988

[i]The minimum amortization of the net gain or loss included in beginning accumulated other comprehensive income (paragraph 32) is calculated as follows:

	20X2	**20X3**
Net (gain) or loss included in beginning accumulated other comprehensive income	$ 140	$ 38
Plus asset gain or less asset loss not yet in market-related value of assets at 1/1—(fair value of plan assets) – (market-related value of plan assets)	0	80
Net (gain) or loss included in beginning accumulated other comprehensive income subject to amortization	140	118
Corridor = 10% of the greater of projected benefit obligation or market-related value of assets at 1/1	120	127
Net (gain) or loss included in beginning accumulated other comprehensive income outside corridor	20	0
× 1/average remaining service	0.10	0.10
Amortization recognized in net periodic pension cost	$ 2	$ 0

20X3—ASSET LOSS AND LIABILITY GAIN

When Company I's plan assets and obligations were measured at December 31, 20X3, both an asset loss and a liability gain were discovered.

	Projected for 20X3	Actual for 20X3 and Projected for 20X4
Assumptions:		
Discount rate	9.00%	9.25%
Expected long-term rate of return on plan assets	10.00%	10.00%
Average remaining service	10 years	10 years

	Actual 12/31/X2	For 20X3	Projected 12/31/X3	Actual 12/31/X3	For 20X4	Projected 12/31/X4
			(Amounts in thousands)			
Projected benefit obligation	$(1,266)		$(1,345)	$(1,320)		$(1,409)
Plan assets at fair value	1,068		1,167	1,097		1,206
Funded status and recognized liability	$ (198)		$ (178)	$ (223)		$ (203)
Amounts recognized in accumulated other comprehensive income:						
Transition obligation	$ 160		$ 140	$ 140		$ 120
Prior service cost	0		0	0		0
Net (gain) or loss	38		38	83		83
	$ 198		$ 178	$ 223		$ 203
Service cost component		$ 76			$ 79	
Interest cost component		114			122	
Expected return on assets		(99)			(109)	
Market-related value of assets	$ 988			$ 1,093[k]		
Actual return on assets—(increase)/decrease	(188)			(29)		

Amortization of:		
Transition obligation	20	20
Prior service cost	0	0
Net (gain) or loss	0[l]	0[l]
Net periodic pension cost	$111	$112
Contribution	$111	$112
Benefits paid	$111	$112

[k]Market-related asset values may be calculated in a variety of ways. This example uses an approach that adds in 20% of each of the last five years' gains and losses. The only objective of the market-related calculation is to reduce the volatility of net periodic pension cost.

Market-related value of assets at 1/1	$ 988
Expected return on assets	99
Contributions	111
Benefits paid	(111)
20% of last five years' asset gains and (losses) = .20 (100 – 70)	6
Market-related value of assets at 12/31	$1,093

[l]The minimum amortization of the net gain or loss included in beginning accumulated other comprehensive income (paragraph 32) is calculated as follows:

	20X3	**20X4**
Net (gain) or loss included in beginning accumulated other comprehensive income	$ 38	$ 83
Plus asset gain or less asset loss not yet in market-related value of assets at 1/1—(fair value of plan assets) – (market-related value of plan assets)	80	4
Net (gain) or loss included in beginning accumulated other comprehensive income subject to amortization	118	87
Corridor = 10% of the greater of projected benefit obligation or market-related value of assets at 1/1	127	132
Net (gain) or loss included in beginning accumulated other comprehensive income outside corridor	0	0
× 1/average remaining service	0.10	0.10
Amortization recognized in net periodic pension cost	$ 0	$ 0

Illustration 5

[This illustration has been deleted. See Status page.]

Illustration 6—Disclosure Requirements

[This illustration has been replaced. Refer to the illustrations in paragraphs C1 through C5 of Statement 132(R). See Status page.]

Illustration 7

[This illustration has been deleted. See Status page.]

Appendix C

BACKGROUND

262. The Board added two pensions projects to its agenda in 1974: accounting and reporting by employee benefit plans and employers' accounting for pensions. Those projects were added to the agenda in response to both the passage of ERISA and certain criticisms concerning perceived deficiencies in Opinion 8. ERISA introduced changes in the legal status and in the perceived nature of an employer's obligation for pension benefits. Critics of Opinion 8 asserted that pension cost was not comparably measured from company to company and often not even from period to period for the same company and that Opinion 8 did not portray adequately the effect of a pension plan on a company. The ability of users of financial reports to understand and assess net periodic pension cost and the funded status of the employer's obligation was challenged because those amounts were determined using a variety of measurement methods or assumptions. Concerns were expressed about the reporting of both unfunded obligations and excess assets, especially when obligations had to be settled and when assets were withdrawn.

263. The following briefly outlines the steps taken on the two major pensions projects:

a. In December 1974, the Board issued Interpretation No. 3, *Accounting for the Cost of Pension Plans Subject to the Employee Retirement Income Security Act of 1974.* That Interpretation was issued to clarify the accounting for employers' obligations for pension plans covered by the Act, pending completion of the major project on employers' accounting for pensions.
b. Task forces for both projects were formed in early 1975.
c. An FASB Discussion Memorandum, *Accounting and Reporting for Employee Benefit Plans,* was issued in October 1975.
d. In February 1976, the Board held a public hearing on the issues covered in the Discussion Memorandum. Twenty-three presentations were made at the hearing.
e. In 1976, the Board decided to focus first on the employee benefit plans project because of the lack of any standards in that area. By deferring action on the accounting by employers project, the Board also expected to benefit from further progress on its conceptual framework project.
f. An FASB Exposure Draft, *Accounting and Reporting by Defined Benefit Pension Plans,* was issued in April 1977. The Board received approximately 700 comment letters, which indicated the need to further consider the issues.
g. In July 1979, the Board issued a revised Exposure Draft, *Accounting and Reporting by Defined Benefit Pension Plans.*
h. Also in July 1979, the Board issued an Exposure Draft, *Disclosure of Pension and Other Post-Retirement Benefit Information.* It proposed amending the disclosure requirements of Opinion 8 pending the Board's comprehensive consideration of accounting and reporting by employers for pensions and similar benefits.
i. In March 1980, the Board issued Statement No. 35, *Accounting and Reporting by Defined Benefit Pension Plans,* which addresses financial reporting by plans rather than by sponsoring employers.
j. In March 1980, the FASB also published *Accounting for Pensions by Employers: A Background Paper,* which highlighted the changing pension environment, present accounting practices and concerns, and areas for consideration.
k. In May 1980, the Board issued Statement No. 36, *Disclosure of Pension Information.* Statement 36 amended Opinion 8 and required disclosure of certain information based on the requirements of Statement 35. Statement 36 made no change in the basic provisions of Opinion 8 that governed measurement of pension cost and pension liabilities. The Statement was an interim step pending completion of the major project on employers' accounting for pensions.

l. In February 1981, the Board issued a Discussion Memorandum, *Employers' Accounting for Pensions and Other Postemployment Benefits.* That memorandum analyzes basic issues related to accounting and reporting requirements for only single-employer, noninsured, defined benefit pension plans in the United States. One hundred ninety-three letters of comment were received in response to the Discussion Memorandum.

m. In July 1981, the Board held a public hearing on the issues covered in the February 1981 Discussion Memorandum. Thirty-seven presentations were made at the hearing.

n. In April 1982, the Board issued Statement No. 59, *Deferral of the Effective Date of Certain Accounting Requirements for Pension Plans of State and Local Governmental Units.* Statement 59 amended Statement 35 and deferred that Statement's effective date for plans sponsored by state or local governments.

o. In November 1982, the Board issued *Preliminary Views* on the issues addressed in the February 1981 Discussion Memorandum. That document was issued to obtain comments on the Board's tentative conclusions at that time before proceeding to an Exposure Draft.

p. In April 1983, the Board issued a Discussion Memorandum, *Employers' Accounting for Pensions and Other Postemployment Benefits,* on additional issues that were not addressed in the February 1981 Discussion Memorandum or in *Preliminary Views.* Over 500 comment letters were received on that document and *Preliminary Views.*

q. In cooperation with the Financial Executives Institute's Committee on Corporate Reporting, the Board conducted a field test of the accounting proposals in *Preliminary Views* and published a special report of the results in October 1983.

r. In November 1983, the Board issued FASB Statement No. 75, *Deferral of the Effective Date of Certain Accounting Requirements for Pension Plans of State and Local Governmental Units,* indefinitely deferring the requirements of Statement 35 for pension plans of state and local governments pending further action by the Board.

s. In January 1984, the Board held a public hearing on the issues covered in *Preliminary Views* and the April 1983 Discussion Memorandum. Fifty-nine presentations were made at the hearing.

t. In February 1984, accounting for postemployment benefits other than pensions was made a separate agenda project. Until that time, other postemployment benefits issues had been combined with the project on employers' accounting for pensions and were addressed in the documents issued as part of that project. In July 1984, the Board issued an Exposure Draft, *Disclosure of Postretirement Health Care and Life Insurance Benefits Information.*

u. In November 1984, as an interim measure pending completion of the project, the Board issued Statement No. 81, *Disclosure of Postretirement Health Care and Life Insurance Benefits.*

v. An FASB Exposure Draft, *Employers' Accounting for Pensions,* was issued in March 1985. It proposed standards of financial accounting and reporting for an employer that offers pension benefits to its employees. The Board received over 400 comment letters.

w. An FASB Exposure Draft, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits,* was issued in June 1985. The Board received over 100 comment letters.

x. In July and August 1985, the Board held a public hearing on the issues covered in the March 1985 and June 1985 Exposure Drafts. Fifty-six presentations were made at the hearing.

Appendix D

GLOSSARY

264. This appendix contains definitions of certain terms used in accounting for pensions.

Accumulated benefit obligation

The actuarial present value of benefits (whether vested or nonvested) attributed by the pension benefit formula to employee service rendered before a specified date and based on employee service and compensation (if applicable) prior to that date. The accumulated benefit obligation differs from the projected benefit obligation in that it includes no assumption about future compensation levels. For plans with flat-benefit or non-pay-related pension benefit formulas, the accumulated benefit obligation and the projected benefit obligation are the same.

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

The difference between fair value of plan assets at the end of the period and the fair value at the

beginning of the period, adjusted for contributions and payments of benefits during the period.

Actuarial funding method
Any of several techniques that actuaries use in determining the amounts and incidence of employer contributions to provide for pension benefits.

Actuarial gain or loss
See **Gain or loss.**

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 (by means of decrements for events such as death, disability, withdrawal, or retirement) between the specified date and the expected date of payment.

Allocated contract
A contract with an insurance company under which payments to the insurance company are currently used to purchase immediate or deferred annuities for individual participants. See also **Annuity contract.**

Amortization
Usually refers to the process of reducing a recognized liability systematically by recognizing revenues or reducing a recognized asset systematically by recognizing expenses or costs. In pension accounting, amortization is also used to refer to the systematic recognition in net pension cost over several periods of amounts previously recognized in other comprehensive income, that is, prior service costs or credits, gains or losses, and the transition asset or obligation existing at the date of initial application of this Statement.

Annuity contract
A contract in which an insurance company unconditionally undertakes a legal obligation to provide specified pension benefits to specific individuals in return for a fixed consideration or premium. An annuity contract is irrevocable and involves the transfer of significant risk from the employer to the insurance company. Annuity contracts are also called allocated contracts.

Assumptions
Estimates of the occurrence of future events affecting pension costs, such as mortality, withdrawal, disablement and retirement, changes in compensation and national pension benefits, and discount rates to reflect the time value of money.

Attribution
The process of assigning pension benefits or cost to periods of employee service.

Benefit approach
One of two groups of basic approaches to attributing pension benefits or costs to periods of employee service. Approaches in this group assign a distinct unit of benefit to each year of credited service. The actuarial present value of that unit of benefit is computed separately and determines the cost assigned to that year. The accumulated benefits approach, benefit/compensation approach, and benefit/years-of-service approach are benefit approaches.

Benefit formula
See **Pension benefit formula.**

Benefits
Payments to which participants may be entitled under a pension plan, including pension benefits, death benefits, and benefits due on termination of employment.

Benefit/years-of-service approach
One of three benefit approaches. Under this approach, an equal portion of the total estimated benefit is attributed to each year of service. The actuarial present value of the benefits is derived after the benefits are attributed to the periods.

Captive insurance subsidiary
An insurance company that does business primarily with related entities.

Career-average-pay formula (Career-average-pay plan)
A benefit formula that bases benefits on the employee's compensation over the entire period of service with the employer. A career-average-pay plan is a plan with such a formula.

Contributory plan
A pension plan under which employees contribute part of the cost. In some contributory plans, employees wishing to be covered must contribute; in other contributory plans, employee contributions result in increased benefits.

Cost approach
One of the two groups of basic approaches to attributing pension benefits or costs to periods of service. Approaches in this group assign net pension costs to periods as level amounts or constant percentages of compensation.

Cost/compensation approach
One of two cost approaches. Net pension costs under this approach are attributed to periods so that they are a constant percentage of compensation for each period.

Curtailment
See **Plan curtailment.**

Defined benefit pension plan
A pension plan that defines an amount of pension benefit to be provided, usually as a function of one or more factors such as age, years of service, or compensation. Any pension plan that is not a defined contribution pension plan is, for purposes of this Statement, a defined benefit pension plan.

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

Discount rate
The interest rate used to adjust for the time value of money. See also **Actuarial present value.**

ERISA
The Employee Retirement Income Security Act of 1974.

Expected long-term rate of return on plan assets
An assumption as to the rate of return on plan assets reflecting the average rate of earnings expected on the funds invested or to be invested to provide for the benefits included in the projected benefit obligation.

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 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. See also **Implicit approach to assumptions.**

Final-pay formula (Final-pay plan)
A benefit formula that bases benefits on the employee's compensation over a specified number of years near the end of the employee's service period or on the employee's highest compensation periods. For example, a plan might provide annual pension benefits equal to 1 percent of the employee's average salary for the last five years (or the highest consecutive five years) for each year of service. A final-pay plan is a plan with such a formula.

Flat-benefit formula (Flat-benefit plan)
A benefit formula that bases benefits on a fixed amount per year of service, such as $20 of monthly retirement income for each year of credited service. A flat-benefit plan is a plan with such a formula.

Fund
Used as a verb, to pay over to a funding agency (as to fund future pension benefits or to fund pension cost). Used as a noun, assets accumulated in the hands of a funding agency for the purpose of meeting pension benefits when they become due.

Funding method
See **Actuarial funding method.**

Funding policy

The program regarding the amounts and timing of contributions by the employer(s), participants, and any other sources (for example, state subsidies or federal grants) to provide the benefits a pension plan specifies.

Gain or loss

A change in the value of either the projected benefit obligation or the plan assets resulting from experience different from that assumed or from a change in an actuarial assumption. Gains and losses that are not recognized in net periodic pension cost when they arise are recognized in other comprehensive income. Those gains or losses are subsequently recognized as a component of net periodic pension cost based on the amortization provisions of this Statement.

Gain or loss component (of net periodic pension cost)

The sum of (a) the difference between the actual return on plan assets and the expected return on plan assets and (b) the amortization of the net gain or loss recognized in accumulated other comprehensive income. The gain or loss component is the net effect of delayed recognition of gains and losses in determining net periodic pension cost (the net change in the gain or loss) in accumulated other comprehensive income except that it does not include changes in the projected benefit obligation occurring during the period and deferred for later recognition in net periodic pension cost.

Implicit approach to assumptions

An approach under which two or more assumptions do not individually represent the best estimate of the plan's future experience with respect to those assumptions. Instead, the aggregate effect of their combined use is presumed to be approximately the same as that produced by an explicit approach.

Interest cost component (of net periodic pension cost)

The increase in the projected benefit obligation due to passage of time.

Interest rate

See **Discount rate.**

Loss

See **Gain or loss.**

Market-related value of plan assets

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

Mortality rate

The proportion of the number of deaths in a specified group to the number living at the beginning of the period in which the deaths occur. Actuaries use mortality tables, which show death rates for each age, in estimating the amount of pension benefits that will become payable.

Multiemployer plan

A pension 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 pension plan maintained by more than one employer but not treated as a multiemployer plan. Multiple-employer plans are not as prevalent as single-employer and multiemployer plans, but

some of the ones that do exist are large and involve many employers. Multiple-employer plans are generally not collectively bargained and are intended to allow participating employers, commonly in the same industry, to pool their assets for investment purposes and reduce the costs 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. Some multiple-employer plans 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 periodic pension cost
The amount recognized in an employer's financial statements as the cost of a pension plan for a period. Components of net periodic pension cost are service cost, interest cost, actual return on plan assets, gain or loss, amortization of prior service cost or credit, and amortization of the transition asset or obligation existing at the date of initial application of this Statement. This Statement uses the term *net periodic pension cost* instead of *net pension expense* because part of the cost recognized in a period may be capitalized along with other costs as part of an asset such as inventory.

Nonparticipating annuity contract
An annuity contract that does not provide for the purchaser to participate in the investment performance or in other experience of the insurance company. See also **Annuity 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.

Participant
Any employee or former employee, or any member or former member of a trade or other employee association, or the beneficiaries of those individuals, for whom there are pension plan benefits.

Participating annuity contract
An annuity contract that provides for the purchaser to participate in the investment performance and possibly other experience (for example, mortality experience) of the insurance company.

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

PBGC
The Pension Benefit Guaranty Corporation.

Pension benefit formula (plan's benefit formula or benefit formula)
The basis for determining payments to which participants may be entitled under a pension plan. Pension benefit formulas usually refer to the employee's service or compensation or both.

Pension benefits
Periodic (usually monthly) payments made pursuant to the terms of the pension plan to a person who has retired from employment or to that person's beneficiary.

Plan amendment
A change in the terms of an existing plan or the initiation of a new plan. A plan amendment may increase benefits, including those attributed to years of service already rendered. See also **Retroactive benefits.**

Plan assets
Assets—usually stocks, bonds, and other investments—that have been segregated and restricted (usually in a trust) to provide benefits. Plan assets include amounts contributed by the employer (and by employees for a contributory plan) and amounts earned from investing the contributions, less benefits paid. Plan assets cannot ordinarily be withdrawn by the employer except in certain circumstances when a plan has assets in excess of obligations and the employer has taken certain steps to satisfy existing obligations. For purposes of this Statement, 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 such assets be used to provide pensions. Amounts accrued by the employer as net periodic pension cost but not yet paid to the plan

are not plan assets for purposes of this Statement. 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 may be considered as reductions of plan assets for purposes of this Statement.

Plan assets available for benefits
See **Plan assets.**

Plan curtailment
An event that significantly reduces the expected years of future service of present employees or eliminates for a significant number of employees the accrual of defined benefits for some or all of their future services.

Plan's benefit formula
See **Pension benefit formula.**

Plan suspension
An event in which the pension plan is frozen and no further benefits accrue. Future service may continue to be the basis for vesting of nonvested benefits existing at the date of suspension. The plan may still hold assets, pay benefits already accrued, and receive additional employer contributions for any unfunded benefits. Employees may or may not continue working for the employer.

Plan termination
An event in which the pension plan ceases to exist and all benefits are settled by purchase of annuities or 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.

Prepaid pension cost
Cumulative employer contributions in excess of accrued net pension cost.

Prior service cost
The cost of retroactive benefits granted in a plan amendment.

Projected benefit obligation
The actuarial present value as of a date of all benefits attributed by the pension benefit formula to employee service rendered prior to that date. The projected benefit obligation is measured using assumptions as to future compensation levels if the pension benefit formula is based on those future compensation levels (pay-related, final-pay, final-average-pay, or career-average-pay plans).

Retroactive benefits
Benefits granted in a plan amendment (or initiation) that are attributed by the pension benefit formula to employee services rendered in periods prior to the amendment. The cost of the retroactive benefits is referred to as prior service cost.

Return on plan assets
See **Actual return on plan assets component** and **Expected return on plan assets.**

Service
Employment taken into consideration under a pension plan. Years of employment before the inception of a plan constitute an employee's past service; years thereafter are classified in relation to the particular actuarial valuation being made or discussed. Years of employment (including past service) prior to the date of a particular valuation constitute prior service; years of employment following the date of the valuation constitute future service; a year of employment adjacent to the date of valuation, or in which such date falls, constitutes current service.

Service cost component (of net periodic pension cost)
The actuarial present value of benefits attributed by the pension benefit formula to services rendered by employees during that period. The service cost component is a portion of the projected benefit obligation and is unaffected by the funded status of the plan.

Settlement
An irrevocable action that relieves the employer (or the plan) of primary responsibility for a pension 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 pension benefits and (b) purchasing nonparticipating annuity contracts to cover vested benefits.

Single-employer plan
A pension 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.

Sponsor
In the case of a pension plan established or maintained by a single employer, the employer; in the case of a plan established or maintained by an employee organization, the employee organization; in the case of a plan established or maintained jointly by two or more employers or by one or more employers and one or more employee organizations, the association, committee, joint board of trustees, or other group of representatives of the parties who have established or who maintain the pension plan.

Turnover
Termination of employment for a reason other than death or retirement.

Unallocated contract
A contract with an insurance company under which payments to the insurance company are accumulated in an unallocated fund (not allocated to specific plan participants) to be used either directly or through the purchase of annuities, to meet benefit payments when employees retire. Funds held by the insurance company under an unallocated contract may be withdrawn and otherwise invested.

Unfunded accrued pension cost
Cumulative net pension cost accrued in excess of the employer's contributions.

Unfunded projected benefit obligation
The excess of the projected benefit obligation over plan assets.

Vested benefit obligation
The actuarial present value of vested benefits.

Vested benefits
Benefits for which the employee's right to receive a present or future pension benefit is no longer contingent on remaining in the service of the employer. (Other conditions, such as inadequacy of the pension fund, may prevent the employee from receiving the vested benefit.) Under graded vesting, the initial vested right may be to receive in the future a stated percentage of a pension based on the number of years of accumulated credited service; thereafter, the percentage may increase with the number of years of service or of age until the right to receive the entire benefit has vested.

Appendix E

ADDITIONAL IMPLEMENTATION GUIDANCE

Note: This appendix contains additional implementation guidance for applying the provisions of this Statement. Numbers in brackets refer to the paragraphs in this Statement to which the question and answer relate. To simplify the illustrations, the effects of income taxes have been ignored.

E1. [This question has been deleted. See Status page.]

E2. *Q*—Does this Statement apply to a non-U.S. pension plan that provides death and disability benefits that are greater than the incidental death and disability benefits allowed in U.S. tax-qualified pension plans? [7, 8, 72]

A—Yes, if the non-U.S. pension plan is, in substance, similar to a U.S. pension plan. The relative level of death and disability benefits paid by a plan that provides primarily pension benefits should not, in itself, cause the pension plan to be "in substance" different from a U.S. pension plan.

E3. [This question has been deleted. See Status page.]

E4. *Q*—How should an employer with regulated operations account for the effects of applying this Statement for financial reporting purposes if another method of accounting for pensions is used for determining allowable pension cost for rate-making purposes? [7, 36, 210]

A—This Statement applies to employers with regulated operations. Paragraph 210 states:

> For rate-regulated enterprises, FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation,* may require that the difference between net periodic pension cost as defined in this Statement and amounts of pension cost considered for rate-making purposes be recognized as an asset or a liability created by the actions of the regulator. Those actions of the regulator change the timing of recognition of net pension cost as an expense; they do not otherwise affect the requirements of this Statement.

Accordingly, if Statement 71 applies to the employer, and the amount of net periodic pension cost determined under the method used for rate-making purposes differs from that determined under this Statement, the difference would be (a) an asset if the criteria in paragraph 9 of Statement 71 are met or (b) a liability if the situation is as described in paragraph 11(b) of Statement 71.

Usually, continued use of different methods for rate-making purposes and general purpose external financial reporting purposes would result in either the criteria in paragraph 9 of Statement 71 being met or the situation described in paragraph 11(b) of Statement 71. However, if pension cost determined in accordance with this Statement exceeds pension cost determined in accordance with the method used in setting current rates, the criteria in paragraph 9 of Statement 71 would not be met if (a) it is probable that the regulator soon will accept a change for rate-making purposes so that pension cost is determined in accordance with this Statement and (b) it is not probable that the regulator will provide revenue to recover the excess cost that results from the use of this Statement for financial reporting purposes during the period between the date that the employer adopts this Statement and the rate case implementing the change.

Similarly, if pension cost determined in accordance with the method used in setting current rates exceeds pension cost determined in accordance with this Statement, the situation would not be as described in paragraph 11(b) of Statement 71 if it is probable that (a) the regulator soon will accept a

change for rate-making purposes so that pension cost is determined in accordance with this Statement, (b) the regulator will not hold the employer responsible for the costs that were intended to be recovered by the current rates and that have been deferred by the change in method, and (c) the regulator will provide revenue to recover those same costs when they are eventually recognized under the method required by this Statement.

Because a regulator cannot eliminate a liability that was not imposed by its actions, the need to recognize the underfunded status of a defined benefit pension plan as a liability under paragraphs 35 and 36 of this Statement is unaffected by regulation.

Refer to Illustration 1 below for an example of the employer's accounting when paragraphs 9 and 11(b) of Statement 71 apply.

Illustration 1—Accounting for Pensions by an Employer with Regulated Operations

An employer with regulated operations sponsors a defined benefit pension plan which is accounted for pursuant to this Statement. To simplify the illustration, it is assumed that there are no remaining differences between amounts previously recognized as net periodic pension cost and amounts allowable for rate-making purposes. The employer's determination of net periodic pension cost (NPPC) under this Statement, however, differs from that allowable for rate-making purposes. The following schedule shows the amounts under both bases for the years 20X0–20X3.

Year	NPPC under This Statement	Allowable for Rate-Making	Difference for the Period	Cumulative Difference
20X0	120	200	(80)	(80)
20X1	200	100	100	20
20X2	170	140	30	50
20X3	120	200	(80)	(30)

Journal Entries

Year 20X0

In 20X0, the amount allowable for rate-making purposes exceeds net periodic pension cost determined under this Statement. In that case, paragraph 11(b) of Statement 71 requires the amount determined under this Statement ($120) to be recognized as net periodic pension cost in the employer's financial statements.

The difference ($80) between net periodic pension cost determined under this Statement ($120) and that allowable for rate-making purposes ($200) is recognized as a liability (unearned revenue) and represents an amount collected or collectible for recovery of future pension cost. When that pension cost is incurred for financial reporting purposes, the liability (unearned revenue) should be eliminated and revenue should be recognized.

The journal entries to account for the accrual of net periodic pension cost and the contribution made to the pension plan during the year are as follows:

Journal Entry 1

Net periodic pension cost	120	
Revenue	80	
Pension liability		120
Unearned revenue		80

To record net periodic pension cost for the period and the liability created by actions of the regulator

Journal Entry 2

Pension liability	200	
Cash		200

To record contribution to pension plan

No modifications of the disclosure required by paragraph 5(h) of FASB Statement No. 132 (revised 2003), *Employers' Disclosures about Pensions and Other Postretirement Benefits,* are required in this case because the accounting required by Statement 71 does not change the amount of net periodic pension cost recognized under this Statement. (Refer to Table 2 below.)

Year 20X1

In 20X1, the amount allowable for rate-making purposes is less than net periodic pension cost determined under this Statement by $100. Of that amount, $80 was allowable for rate-making purposes in 20X0. Therefore, the 20X0 unearned revenue of $80 is recognized as revenue for 20X1. Paragraph 9 of Statement 71 requires the remaining portion of the $100 difference ($20) to be capitalized as an incurred cost for which future recovery is assured by actions of the regulator.

The journal entries to account for the accrual of net periodic pension cost and the contribution made to the pension plan during the year are as follows:

Journal Entry 1

Net periodic pension cost	180	
Capitalized cost for future recovery	20	
Unearned revenue	80	
Pension liability		200
Revenue		80

To record net periodic pension cost for the period and the asset created by actions of the regulator

Journal Entry 2

Pension liability	100	
Cash		100

To record contribution to pension plan

In this case, the accounting required by Statement 71 changes the amount of net periodic pension cost that otherwise would have been recognized under this Statement requiring modification of the disclosure required by paragraph 5(h) of Statement 132(R). (Refer to Table 2.)

Year 20X2

In 20X2, the amount allowable for rate-making purposes is less than net periodic pension cost determined under this Statement by $30. None of that amount was allowable for rate-making purposes in prior years. Paragraph 9 of Statement 71 requires the $30 to be capitalized as an incurred cost for which future recovery is assured by actions of the regulator.

The journal entries to account for the accrual of net periodic pension cost and the contribution made to the pension plan during the year are as follows:

Journal Entry 1

Net periodic pension cost	140	
Capitalized cost for future recovery	30	
Pension liability		170

To record net periodic pension cost for the period and the asset created by actions of the regulator

Journal Entry 2

Pension liability	140	
Cash		140

To record contribution to pension plan

The situation in 20X2 is similar to that in 20X1, necessitating additional disclosure. (Refer to Table 2.)

Year 20X3

In 20X3, the amount allowable for rate-making purposes exceeds net periodic pension cost determined under this Statement by $80. In prior years (20X1 and 20X2), $50 of that amount was recognized as a capitalized cost.

Accordingly, that capitalized cost ($50) is expensed in 20X3. Additionally, paragraph 11(b) of Statement 71 requires recognition of a liability (unearned revenue) equal to the remaining portion ($30) of the amount allowable for rate-making purposes in excess of net periodic pension cost determined under this Statement [($200 – $120) – $50 = $30]. When that pension cost is incurred for financial reporting purposes, the $30 liability (unearned revenue) should be eliminated and revenue should be recognized.

The journal entries to account for the accrual of net periodic pension cost and the contribution made to the pension plan during the year are as follows:

Journal Entry 1

Net periodic pension cost	170	
Revenue	30	
Capitalized cost for future recovery		50
Pension liability		120
Unearned revenue		30

To record net periodic pension cost for the period and the liability created by actions of the regulator

Journal Entry 2

Pension liability	200	
Cash		200
To record contribution to pension plan		

The situation in 20X3 is similar to that in 20X1 and 20X2, necessitating additional disclosure. (Refer to Table 2 below.)

Table 1

[This table has been deleted.]

Table 2

The following table illustrates the disclosure of the components of net periodic pension cost for 20X0–20X3. It is assumed that there is no transition asset or obligation remaining in accumulated other comprehensive income and there are no gains or losses for the four-year period.

	20X0	20X1	20X2	20X3
Service cost*	$ XXX	$ XXX	$ XXX	$ XXX
Interest cost*	XXX	XXX	XXX	XXX
Expected return on plan assets*	(XXX)	(XXX)	(XXX)	(XXX)
Net amortization and deferral	0	0	0	0
Net periodic pension cost determined under this Statement	120	200	170	120
Amount (capitalized) expensed due to actions of the regulator	—	(20)	(30)	50
Net periodic pension cost recognized	$ 120	$ 180	$ 140	$ 170

*Amounts are excluded for illustrative purposes only.

E5. *Q*—If an employer has a pension plan that also provides postemployment health care benefits, should this Statement apply to those benefits? [8]

A—No. Accounting for postemployment health care benefits is covered by FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions.*

E6. *Q*—Does footnote 4 of this Statement (which states that "the interest cost component of net periodic pension cost shall not be considered to be interest for purposes of applying FASB Statement No. 34, *Capitalization of Interest Cost*") proscribe the capitalization of the interest cost component of net periodic pension cost when employee compensation is capitalized as part of the cost of inventory or other assets? [16]

A—No. A fundamental aspect of this Statement is to combine or aggregate the various pension cost components (service cost; interest cost; expected return on plan assets; and amortization of the following items recognized in accumulated other comprehensive income: (a) net transition asset or obligation, (b) prior service cost or credit, and (c) net gain or loss). In the aggregate, net periodic pension cost is viewed as an element of employee compensation. Therefore, when it is appropriate to capitalize employee compensation in connection with the construction or production of an asset, the net periodic pension cost applicable to the pertinent employees for the period, *not* individual components of that amount, is the relevant amount.

E7. *Q*—May an employer have net periodic pension cost that is a net credit (that is, net periodic pension income)? [16, 20]

A—Yes. Net periodic pension cost is an aggregation of various pension cost components, some of which are expenses or losses (which increase net periodic pension cost) and some of which are revenues or gains (which decrease net periodic pension cost). It is possible for the revenue or gain components to exceed the expense or loss components, resulting in net periodic pension income. For example, a pension plan may have an expected return on plan assets or amortization of a transition asset remaining in accumulated other comprehensive income that exceeds the other net periodic pension cost components.

E8. *Q*—If an employer has net periodic pension cost that is a net credit (that is, net periodic pension income), how should that be treated if employee compensation is capitalized as part of the cost of inventory or other assets? [16, 20]

A—If a cost allocation process capitalizes net periodic pension cost as part of the cost of inventory or other assets, net periodic pension income also should be capitalized, thereby reducing the total employee compensation and other costs being capitalized.

E9. *Q*—If an employer sponsoring a pension plan that is overfunded has net periodic pension cost that is a net credit (that is, net periodic pension income) and the employer makes no contribution to the pension plan because it cannot currently deduct that amount for tax purposes, is the difference between net periodic pension income and the tax deductible amount a temporary difference as discussed in paragraphs 10–11 of FASB Statement No. 109, *Accounting for Income Taxes?* If it is a temporary difference, when and how will it reverse? [16, 20]

A—Yes. The difference between net periodic pension income and the tax deductible amount represents the origination or reversal of a portion of the overall temporary difference related to a pension plan for which deferred taxes should be provided. Ultimately, the employer's cost of providing pension benefits to employees equals the net amount funded, which is equal to the total benefits paid less earnings on plan assets. Thus, cumulative pension cost for accounting purposes will equal the cumulative amount recognized for tax purposes.

The overall temporary difference will reverse in one of two ways. First, at some future time the pension plan may not be so overfunded because of poor investment performance or because of increases in the obligation due to (a) a decline in interest rates, (b) additional pension benefits earned for future years of service, or (c) amendments to the pension plan that increase pension benefits. In this case, net periodic pension cost for future years would eventually exceed amounts funded in those years. Second, if the pension plan remains overfunded and continually generates investment returns in excess of increases in the pension obligation, the employer may terminate the pension plan to recapture excess assets. In this case, the gain for accounting purposes from the pension plan termination would be less than the taxable amount resulting from that event. Although the reversal of the temporary difference may be far in the future and may be somewhat under the employer's control, there is a temporary difference for which deferred taxes should be provided.

E10. *Q*—If transferable securities issued by the employer are included in plan assets, should the measurement of plan assets also include the interest accrued but not yet received on those securities? [19]

A—Yes. The exclusion from plan assets in paragraph 19 of "amounts accrued by the employer but not yet paid to the plan" is intended to relate to a recognized pension liability.

E11. *Q*—If an employer has a nonqualified pension plan (for tax purposes) that is funded with life insurance policies owned by the employer, should the cash surrender value of those policies be considered plan assets for purposes of applying this Statement? [19, 62]

A—No. If the employer is the owner or beneficiary, the life insurance policies do not qualify as plan assets and the accounting for those policies should be in accordance with FASB Technical Bulletin No. 85-4, *Accounting for Purchases of Life Insurance,* and EITF Issue No. 06-5, "Accounting for Purchases of Life Insurance—Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4."

E12. *Q*—If the actual return on plan assets for a period is a component of net periodic pension cost, how does the expected return on plan assets affect the determination of net periodic pension cost? [23, 30–34]

A—The expected return on plan assets generally will be different from the actual return on plan assets for the year. This Statement provides for recognition of that difference (a net gain or loss) in other comprehensive income in the period it arises. The amount recognized in other comprehensive income is also a component of net periodic pension cost for the current period. Thus, the amount recognized in other comprehensive income and the actual return on plan assets, when aggregated, equal the expected return on plan assets. The amount recognized in accumulated other comprehensive income affects future net periodic pension cost through subsequent amortization, if any, of the net gain or loss.

E13. *Q*—If an employer has a substantive commitment to have a formula greater than the pension plan's written formula, how should the difference between the effects of a retroactive plan amendment that were anticipated as part of that substantive commitment and the effects of the actual retroactive plan amendment be accounted for? [24–34, 41]

A—If that difference results from an intended modification of the formula for which there is a substantive commitment, the accounting should be that prescribed in paragraphs 24–28 for a retroactive plan amendment. Otherwise, that difference is a gain or loss subject to the accounting specified in paragraphs 29–34.

E14. *Q*—Once a schedule of amortization of prior service cost from a specific retroactive plan amendment has been established, should that schedule remain the same or is it subject to revision on a periodic basis? [24–28, 167]

A—The initial schedule should be revised only if a curtailment occurs (paragraphs 6 and 12 of FASB Statement No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*) or if events indicate that (a) the period during which the employer expects to realize future economic benefits from the retroactive plan amendment giving rise to the prior service cost is shorter than originally estimated or (b) the future economic benefits have been impaired. The schedule should not be revised because of ordinary variances in expected service lives of employees. This Statement proscribes revising the schedule so that the prior service cost would be recognized in net periodic pension cost more slowly.

[Note: After the adoption of Statement 141(R) (effective for business combinations with an acquisition date on or after the beginning of the first annual reporting period beginning on or after 12/15/08), paragraph E15 is deleted.]

E15. *Q*—If the acquiring employer in a business combination accounted for in accordance with FASB Statement No. 141, *Business Combinations,* includes the employees of the acquired employer in its pension plan and grants them credit for prior service (the acquired employer did not have a pension plan), should the credit granted for prior service be treated as prior service cost and recognized in other comprehensive income or treated as part of the cost of the acquisition? [24–27, 74]

A—The answer to this question depends on an analysis of all the facts and circumstances surrounding the acquisition. If the acquiring employer's granting of credit for prior service to the employees is required by the seller as part of the consummation of the acquisition, then it should be considered as part of the cost of the acquisition. Otherwise, the credit granted for prior service should be accounted for as a retroactive plan amendment.

If the credit granted for prior service is considered part of the cost of the acquisition, the debit offsetting the increase in the projected benefit obligation should be an adjustment of the goodwill otherwise determined for the acquisition. If the credit granted for prior service is accounted for as a retroactive plan amendment, the prior service cost is recognized in other comprehensive income and subject to amortization as specified in paragraphs 24–27. The effects of the alternatives on the balance sheet, income statement, and other comprehensive income could differ.

E16. *Q*—In determining the periods for (a) amortization of prior service cost included in accumulated other comprehensive income, (b) minimum amortization of net gain or loss included in accumulated other comprehensive income, or (c) amortization of the transition asset or obligation remaining in accumulated other comprehensive income, is it necessary to include the service periods of employees who are expected to receive *only* a return of *their* contributions (plus interest, if applicable) to a contributory defined benefit pension plan in determining the future service periods of employees expected to receive benefits under that pension plan? [24–26, 32, 77]

A—No. Only the future service periods of those employees who are expected to receive an *employer*-provided benefit should be included.

E17. *Q*—Are the service periods of employees expected to terminate before their benefits are vested included in the determination of the average remaining service period of employees expected to receive benefits under the pension plan? [24, 26, 32, 77]

A—No. Only the service periods of those employees working as of the date for which the determination is made and who are expected to actually receive employer-provided benefits are included.

E18. *Q*—Is there a specific threshold for determining if a pension plan has "almost all" inactive participants for purposes of selecting the amortization period for certain components of net periodic pension cost? [25, 26, 32, 77]

A—No. The threshold for using the average life expectancy of inactive participants requires judgment based on the facts and circumstances of the particular pension plan.

E19. *Q*—May an employer adopt an accounting policy to recognize immediately as a component of net periodic pension cost the cost of all plan amendments that grant increased benefits for services rendered in prior periods (prior service cost)? [26, 27]

A—No. An accounting policy to recognize immediately as a component of net periodic pension cost the cost of *all* plan amendments that grant increased benefits for services rendered in prior periods is not permitted. Prior service cost is recognized immediately in other comprehensive income, unless, based on an assessment of the facts and circumstances, the employer does not expect to realize any future economic benefits from that retroactive plan amendment. (Refer to paragraph 27.) Adopting an accounting policy to recognize immediately prior service cost in net periodic pension cost would preclude making that assessment for future plan amendments *as they occur.*

The Board did not intend to include immediate recognition as a component of net periodic pension cost among those alternative amortization methods for prior service cost permitted by paragraph 26. Rather, the permissibility of adopting an alternative method as an accounting policy was intended to be responsive to respondents' concerns that the method defined in paragraph 25 would be unnecessarily complex and would require employers to maintain detailed records for long periods. The Board agreed to allow alternative methods of amortization that would simplify computations and record keeping but with the intent that such methods would consider employees' service lives (or inactive participants' remaining lives, if applicable) and would not have the effect of delaying recognition of prior service cost as a component of net periodic pension cost to a greater extent than the method defined in paragraph 25.

E20. *Q*—If an employer has a history of granting retroactive plan amendments every three years, should the resulting prior service costs be amortized over a three-year period? [27]

A—One of the objectives of this Statement is to amortize the cost of a retroactive plan amendment over the period benefited if that period is shorter than the employees' remaining service period. If an employer has a history of granting retroactive plan amendments every three years, for example, as part of union negotiations, the period benefited may be three years. If employees expect the pattern to continue, the future economic benefits to be obtained from a retroactive plan amendment may not continue if the pattern is broken; effectively, the future economic benefit of each retroactive plan amendment may expire over the period of the union contract (in this case, three years). In that situation, amortization of prior service cost included in accumulated other comprehensive income over a three-year period would be appropriate. Whether three years is the appropriate amortization period for a retroactive plan amendment that is part of a three-year amendment pattern should be determined based on the facts and circumstances of the particular situation.

E21. *Q*—If an employer grants a retroactive plan amendment that reduces the projected benefit obligation (a negative retroactive plan amendment), what method should be used to reduce any prior service cost included in accumulated other comprehensive income when several prior retroactive plan amendments in the aggregate have resulted in prior service costs included in accumulated other comprehensive income that exceed the effects of the negative retroactive plan amendment? [28]

A—Unless the retroactive plan amendment that reduces benefits can be specifically related to a prior retroactive plan amendment, any systematic and rational method (for example, Last-In, First-Out; First-In, First-Out; or pro rata), applied on a consistent basis, is acceptable.

E22. *Q*—If an employer amends a pension plan to delete a provision that a percentage of the employee's accumulated benefits be paid to the employee's spouse upon death of the employee prior to a specified age, should the reduction in benefits be accounted for as a retroactive plan amendment? [28]

A—Yes.

E23. [This question has been deleted. See Status page.]

E24. *Q*—Should the amount and timing of pension plan contributions and benefit payments expected to be made during the year be considered in determining the expected return on plan assets for that year? [30]

A—Yes. The expected return on plan assets should take into consideration the availability of all plan assets for investment throughout the year. For example, if the employer's pension plan contribution for the year is expected to be made two months before the next measurement date, then the expected return on plan assets should include an amount related to the expected return on that contribution only for those two months.

E25. [This question and its related Illustration 2 have been deleted. See Status page.]

E26. *Q*—May an employer that has several pension plans with similar plan assets use different asset valuation methods to determine the market-related value of those plan assets? [30]

A—An employer should use different asset valuation methods for similar plan assets only if the pension plans' inherent facts and circumstances justify the difference in methodology. Otherwise, the use of a variety of asset valuation methods for similar plan assets is inconsistent with this Statement's objective of enhancing the comparability of reported pension information.

E27. *Q*—Is there a limitation on the number of classes into which plan assets may be divided for purposes of selecting asset valuation methods for determining the market-related value of plan assets? [30]

A—No. However, the asset valuation method selected for each class should accomplish the objective of recognizing changes in the fair value of those plan assets in a systematic and rational manner over not more than five years. Once that method is selected, it should be applied consistently for that class of plan assets as should the method for dividing plan assets into classes.

E28. *Q*—Is the following an acceptable asset valuation method for determining the market-related value of plan assets?

The market-related value of plan assets is determined with a total return-on-plan asset component consisting of three layers:

a. An expected return-on-plan asset component based on the beginning-of-year market-related value of plan assets, cash flow during the year, and the expected long-term rate of return on plan assets
b. An amount equal to the change in the accumulated benefit obligation that resulted from any change during the year in the assumed discount rates used to determine the accumulated benefit obligation (The amount is reduced pro rata if plan assets are less than the accumulated benefit obligation.)
c. A variance component equal to a percentage (for example, 20 percent if a five-year-averaging period is used) of the difference between the actual return on plan assets based on the fair values of those plan assets and the expected return on plan assets derived from components (a) and (b). [30]

A—No. The method described introduces a factor (refer to layer (b)) that can be unrelated to the change in the fair value of plan assets. For a method to meet this Statement's criteria of being systematic and rational, it should reflect only the changes in the fair value of plan assets between various dates.

The use of a market-related value of plan assets was developed as a response to suggestions to reduce the asset-related volatility of net periodic pension cost. The method described appears intended to accomplish an objective that the use of a market-related value was not designed to achieve, namely, to smooth further the effects of changes in assumed discount rates.

E29. *Q*—How does the use of a market-related value of plan assets affect the determination of net periodic pension cost? [30–32]

A—The use of a market-related value of plan assets affects the determination of net periodic pension cost in two ways. First, the market-related value of plan assets is the basis on which the *expected return on plan assets* is computed. Second, to the extent that gains or losses based on the fair value of plan assets are not yet reflected in the market-related value of plan assets, such amounts are excluded from the net gain or loss included in accumulated other comprehensive income that is subject to amortization beginning in the following year. Although those excluded gains or losses eventually affect net periodic pension cost, their impact is delayed through use of a market-related value of plan assets.

E30. [This question has been deleted. See Status page.]

E31. *Q*—If all or almost all of a pension plan's participants are inactive due to a temporary suspension of the pension plan (that is, for a limited period of time, employees will not earn additional defined benefits), should the minimum amortization of a net gain or loss included in accumulated other comprehensive income be determined based on the average remaining life expectancy of the temporarily inactive participants? [32]

A—No. The minimum amortization of a net gain or loss included in accumulated other comprehensive income should be determined based on the average remaining service period of the temporarily inactive participants expected to receive benefits under the pension plan.

E32. *Q*—If all employees covered by a pension plan are terminated but not retired, should the minimum amortization of a net gain or loss included in accumulated other comprehensive income be determined based on the average remaining life expectancy of the inactive participants? [32]

A—Yes. The situation described could arise, for example, if a division with its own pension plan is sold by the employer thus terminating the related employees, but the pension plan remains in existence and it retains the obligation for benefits accrued to the date of sale. In that situation, the minimum amortization of a net gain or loss included in accumulated other comprehensive income should be determined based on the average remaining life expectancy of the inactive participants.

E33. *Q*—May an employer immediately recognize gains and losses as a component of net periodic pension cost instead of initially recognizing them in other comprehensive income? [33, 54]

A—Yes. Immediate recognition of gains and losses as a component of net periodic pension cost is permitted if (a) that method is applied consistently, (b) the method is applied to *all* gains and losses (on both plan assets and obligations), and (c) the method used is disclosed in accordance with paragraph 5(o) of Statement 132(R).

E34–E36. [These questions have been deleted. See Status page.]

E37. [This question and its related Illustration 3 have been deleted. See Status page.]

E38–E42. [These questions have been deleted. See Status page.]

E43. [This question and its related Illustration 4 have been deleted. See Status page.]

E44. *Q*—If a career-average-pay pension plan has a formula that provides pension benefits equal to 1 percent of each year's salary for that year's service and prospective (flat-benefit) plan amendments are granted every three years as part of union negotiations (for example, a negotiated increase may provide that additional benefits of $360 per year are earned for each of the following three years of service), should the projected unit credit method be used for both the career-average-pay and the flat-benefit portions of the pension benefits provided under the pension plan? [39, 40]

A—No. The projected unit credit method should be used to attribute the career-average-pay portion of the pension benefits over employees' service periods, and the unit credit method should be used for the flat-benefit portion for the limited service period, which, for this example, is three years.

E45. *Q*—If an employer has a pension plan that provides a pension benefit of 1 percent of final pay for each year of service up to a maximum of 20 years of service and final pay is frozen at the 20th year, should the employer attribute the total projected benefits under the pension plan for an employee over the employee's expected service period even if that service period is anticipated to exceed the 20-year limitation? [39, 40]

A—No. Footnote 8 (paragraph 40) limits the attribution period to the 20-year period for an employee anticipated to work beyond that period.

Although total projected benefits ordinarily should be attributed to years of service based on the pension plan's formula, paragraph 42 explains that some pension plans have formulas that attribute a disproportionate share of those pension benefits to later years of service and requires attribution of those pension benefits ratably over the service period (which would be faster than the pension plan formula). However, no basis exists for attribution of pension benefits to years of service more slowly than the pension plan's formula. For this example, the service cost component of net periodic pension cost for the employee should be zero after year 20. However, interest cost should continue to accrue on the projected benefit obligation.

E46. *Q*—Would the answer to the question in paragraph E45 be different if the pension plan's formula provided a pension benefit of 1 percent of final pay for each year of service up to a maximum of 20 years of service and final pay is not frozen at the 20th year? [39, 40]

A—No, except to note that gains or losses will occur after the 20-year period if experience is different from that assumed regarding the final level of compensation.

E47. *Q*—How should an employer determine the accumulated and projected benefit obligations if a pension plan has more than one formula and an employee's pension benefits are determined based on the formula that provides the greatest pension benefit at the time the employee terminates or retires (for example, if the employee terminates in year 10, the pension plan's flat-benefit formula provides a greater pension benefit than does the pension plan's pay-related formula, while if the employee terminates in year 11, the pension plan provides that same employee with a greater benefit under its pay-related formula than under its flat-benefit formula)? [39, 40]

A—This question relates to a pension plan that effectively has a formula that defines different benefits for different years of service and accordingly, an attribution approach that does not assign the same amount of pension benefit to each year of an employee's service may be required.

Under this Statement, the accumulated benefit obligation cannot exceed the projected benefit obligation. If a pension plan has more than one formula, the accumulated benefit obligation should be based on the greatest of the pension benefits determined by applying each of the plan's formulas to service to date. The projected benefit obligation should be determined based on the same formula until an allocation of incremental pension benefits for the remaining expected service period using another formula provides a greater pension benefit allocated to service in the current year. As indicated previously, that may result in differing levels of benefits attributed to different years of an employee's service.

Refer to Illustration 5 below for an example of how an employer should determine the accumulated and projected benefit obligation for a pension plan that has more than one benefit formula.

Illustration 5—Determination of Benefits for a Pension Plan with a Flat-Benefit and a Pay-Related Formula

An employer has a pension plan that provides a pension benefit that is the greater of two formulas. Formula A provides a flat benefit of $450 for each of the first 20 years of an employee's service, but no additional benefits are earned for years of service beyond 20 years; Formula B provides a benefit equal to 1 percent of final pay for each year of service. In the following cases, it is assumed that an employee starts at a salary of $11,000 in year 1 and receives a $1,000 increase in salary for each year of service. To simplify the illustration, the actuarial present values of the accumulated benefit obligation (ABO) and projected benefit obligation (PBO) have not been determined. Rather, those obligations are expressed in terms of the annual pension benefits that begin when the employee retires.

Case 1—30-Year Service Period

It is assumed that an employee will retire at the end of year 30 with a final salary of $40,000. For that employee, Formula A provides an annual pension benefit of $9,000 for 30 years of service ($450 for each of the first 20 years of service and no additional benefits for years of service 21–30); Formula B provides an annual pension benefit of $12,000 for 30 years of service (30 × 1% × $40,000 or $400 for each year of service). The attribution of pension benefits to years of service for Formulas A and B is presented in Chart I.

Chart I

Attribution
Formula A vs. Formula B

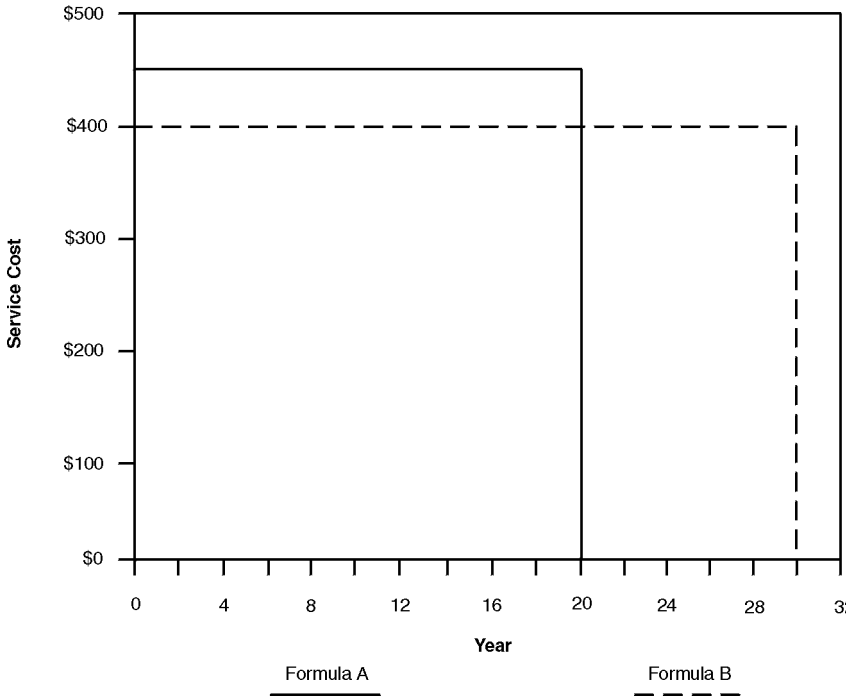
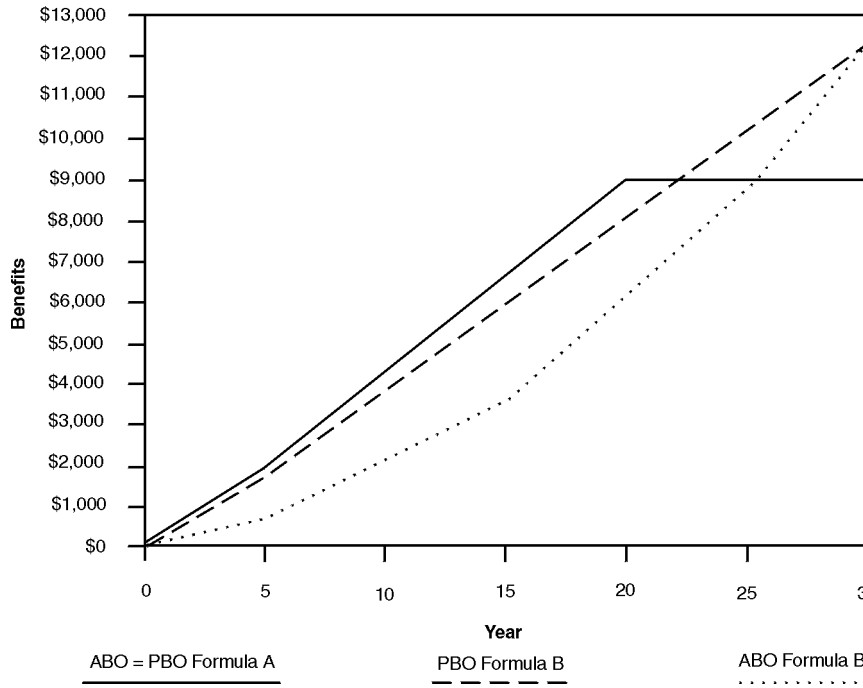


Chart II shows the increase in accumulated and projected benefits for each year of service for the employee under Formulas A and B. As can be seen, Formula A provides a greater accumulated and projected benefit for years 1–20.

Chart II

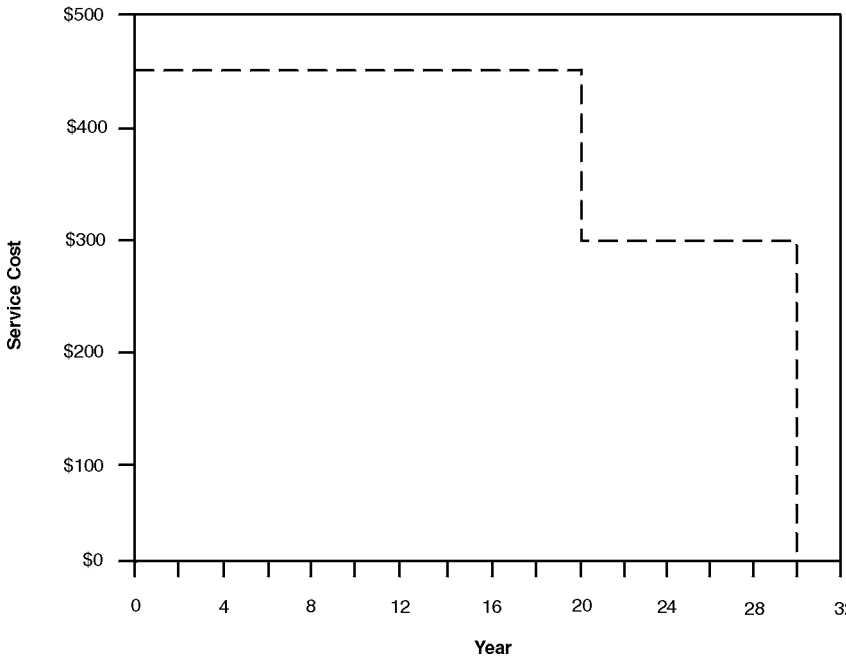
Accumulated and Projected Benefit Obligation
Formula A vs. Formula B



Beginning in year 21, no additional pension benefits are provided under Formula A. At that point, Formula B begins to provide a portion of the total projected benefit attributed to years 21–30. The additional pension benefit expected to be provided under Formula B for service in years 21–30 is $3,000 ($9,000 accumulated benefit at year 20 under Formula A as compared with $12,000 accumulated benefit at year 30 under Formula B); that additional pension benefit is attributed to service ratably over years 21–30 ($300 per year). Note that although no additional pension benefits are "earned" in years 21 and 22 (refer to projected benefit obligation in Chart II) because the projected benefit under Formula B in those years is less than $9,000, pension benefits are attributed to those years of service based on the total incremental pension benefit for years 21–30. Attribution of total projected benefits to years of service is illustrated in Chart III.

Chart III

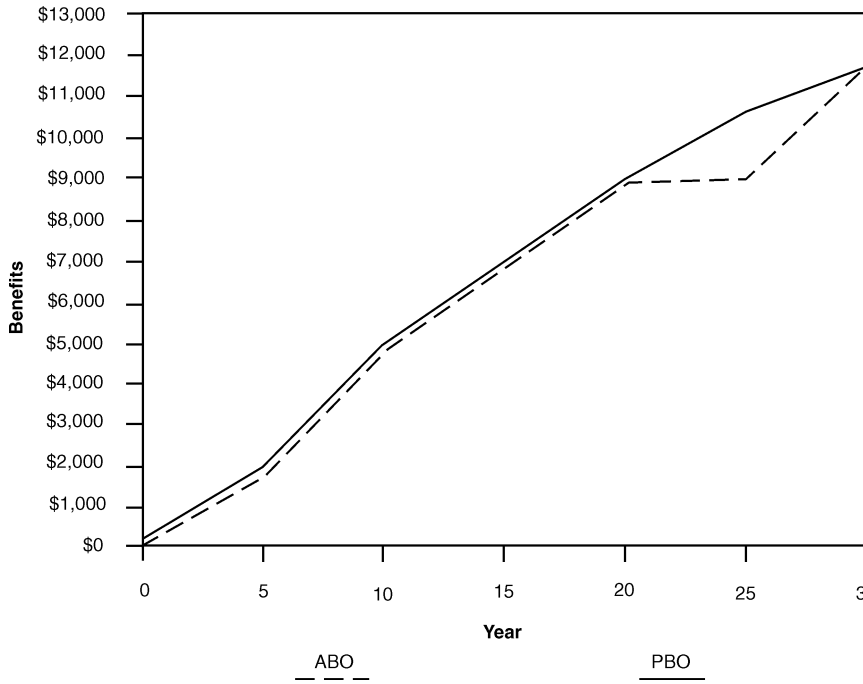
Attribution of Benefits over Service



Thus, while the accumulated benefit obligation at any point in time represents the greater of the pension benefits determined under Formulas A and B, the projected benefit obligation is determined on the basis of the formula providing the greater pension benefit (Formula A) until an allocation of incremental pension benefits for the remaining service period using another formula provides a greater pension benefit allocated to service in the current year. In this example, the allocation of $3,000 of incremental benefits to years 21–30 under Formula B provides a greater benefit allocated to service in those years ($300 per year) than Formula A would allocate ($0). Chart IV presents the increase in the accumulated benefit obligation and projected benefit obligation when the plan benefits are the greater of those determined under Formulas A and B.

Chart IV

Accumulated and Projected Benefit Obligation
Greater of Benefit under Formulas A and B



The accumulated and projected benefit obligation for years 1–30 are as follows:

Year	ABO	PBO
1–19	[a]	[a]
20	$ 9,000[a]	$ 9,000[a]
21	9,000[a]	9,300[b]
22	9,000[a]	9,600[b]
23	9,000[a]	9,900[b]
24	9,000[a]	10,200[b]
25	9,000[a]	10,500[b]
26	9,360[c]	10,800[b]
27	9,990[c]	11,100[b]
28	10,640[c]	11,400[b]
29	11,310[c]	11,700[b]
30	12,000[c]	12,000[b]

[a]$450 × years of service, not to exceed 20 years (Formula A).

[b]Formula A benefits earned through year 20 plus attribution of additional projected benefits under Formula B (for 21–30 years of service) in proportion to the number of completed years of service to the number of years of service that are expected to be completed for the period during which Formula B is applied.

[c]One percent of salary for the year noted for each year of service already rendered (Formula B).

Case 2—20-Year Service Period

It is assumed that an employee will retire at the end of year 20 with a final salary of $30,000. For that employee, Formula A provides an annual pension benefit of $9,000 ($450 for each year of service); Formula B provides an annual pension benefit of $6,000 (20 × 1% × $30,000 or $300 for each year of service). Since Formula A provides the greater benefit in each year, attribution will be determined under Formula A. The accumulated benefit obligation and projected benefit obligation will be equal in years 1–20 since Formula A is not pay-related.

Case 3—40-Year Service Period

It is assumed than an employee will retire at the end of year 40 with a final salary of $50,000. For that employee, Formula A provides an annual pension benefit of $9,000 for 40 years of service ($450 for each of the first 20 years of service and no additional benefits for service in years 21–40); Formula B provides an annual pension benefit payable at retirement of $20,000 for 40 years of service (40 × 1% × $50,000 or $500 for each year of service). Since Formula B provides the greater pension benefit in each year, attribution of the projected benefit obligation will be determined under Formula B for all years of service. The accumulated benefit obligation, however, continues to be determined for each year of service by the formula that provides the greater accumulated benefit.

E48. *Q*—Is it possible for a pension plan to have an accumulated benefit obligation that *exceeds* the projected benefit obligation? [39–40, 42]

A—No. Under the attribution approach described in paragraphs 40 and 42, the projected benefit obligation should always equal or exceed the accumulated benefit obligation.

Under certain plans (typically non-U.S. plans), however, the actuarial present value of the benefits to which an employee is entitled if the employee terminates immediately may exceed the actuarial present value of the benefits to which the employee is entitled at the employee's expected date of separation

based on service to date. In those situations, EITF Issue No. 88-1, "Determination of Vested Benefit Obligation for a Defined Benefit Pension Plan," states that the employer may record either the actuarial present value of vested benefits to which the employee is entitled if the employee separates or the actuarial present value of the vested benefits to which the employee is currently entitled based on the employee's expected date of separation or retirement. The SEC Observer noted that the method used should be disclosed.

E49. *Q*—How is the projected benefit obligation attributed to a qualified pension plan (for tax purposes) and an excess benefit (top-hat) pension plan during an employee's service period if the employee is expected to receive a pension benefit under the excess benefit pension plan (that is, the employee's pension benefit at retirement is expected to exceed the Section 415 limitations of the U.S. Internal Revenue Code)? [39, 40, 46, 47, 55]

A—The projected benefit obligation should be attributed to the qualified pension plan (for tax purposes) until it equals the assumed benefit limitations imposed by Section 415. (Refer to the answer to the question in paragraph E63.) Any incremental projected benefits for subsequent years of service should then be attributed to the excess benefit pension plan.

Under this Statement, net periodic pension cost, liabilities, and assets are determined on a plan-by-plan basis. Until an employee's projected benefits for service already rendered reach the benefit limitations of the underlying qualified pension plan, the employee is not eligible for benefits under an excess benefit pension plan and no cost or obligation should be attributed to that pension plan.

Refer to Illustration 6 below for an example of attribution of pension benefits to a qualified pension plan (for tax purposes) and an excess benefit pension plan.

Illustration 6—Attribution of Pension Benefits to a Qualified and an Excess Benefit Pension Plan

A pension plan's formula is an annual pension benefit of 2 percent of final pay for each year of service. It is assumed than an employee starts at a salary of $200,000 in year 1, receives annual salary increases of $15,000, and retires at the end of 21 years at a salary of $500,000. It is further assumed that the Section 415 limitation for annual pension benefit payments is $90,000 in year 1 and that the limitation under the existing law will increase to permit annual pension benefit payments of $120,000 for all the years the employee will receive benefit payments.

Attribution of the accumulated benefit obligation (ABO) and projected benefit obligation (PBO) for the employee is as follows. To simplify the illustration, the actuarial present values of the accumulated and projected benefit obligation have not been determined. Rather, those obligations are expressed in terms of the annual pension benefits that begin when the employee retires.

Year of Service	Salary	Total ABO	Total PBO	Qualified Pension Plan ABO	Qualified Pension Plan PBO	Excess Benefit Pension Plan ABO	Excess Benefit Pension Plan PBO
1	$200,000	$ 4,000	$ 10,000	$ 4,000	$ 10,000		
2	215,000	8,600	20,000	8,600	20,000		
3	230,000	13,800	30,000	13,800	30,000		
4	245,000	19,600	40,000	19,600	40,000		
5	260,000	26,000	50,000	26,000	50,000		
6	275,000	33,000	60,000	33,000	60,000		
7	290,000	40,600	70,000	40,600	70,000		
8	305,000	48,800	80,000	48,800	80,000		
9	320,000	57,600	90,000	57,600	90,000		
10	335,000	67,000	100,000	67,000	100,000		
11	350,000	77,000	110,000	77,000	110,000		
12	365,000	87,600	120,000	87,600	120,000		
13	380,000	98,800	130,000	98,800	120,000		$10,000
14	395,000	110,600	140,000	110,600	120,000		20,000
15	410,000	123,000	150,000	120,000	120,000	$ 3,000	30,000
16	425,000	136,000	160,000	120,000	120,000	16,000	40,000
17	440,000	149,600	170,000	120,000	120,000	29,600	50,000
18	455,000	163,800	180,000	120,000	120,000	43,800	60,000
19	470,000	178,600	190,000	120,000	120,000	58,600	70,000
20	485,000	194,000	200,000	120,000	120,000	74,000	80,000
21	500,000	210,000	210,000	120,000	120,000	90,000	90,000

E50. *Q*—If a pension plan's formula provides an annual pension benefit equal to 1 percent of each year's salary (that is, it does not base pension benefits for the current year on any future salary level), should the projected unit credit method be used to attribute the service cost component of net periodic pension cost over employees' service periods? [39, 40, 143]

A—Yes. This Statement requires use of the projected unit credit method for pay-related pension plans. A pension plan that describes the pension benefits earned as 1 percent of current pay for each year of service is the same as a pension plan that describes the pension benefits earned as 1 percent of total career pay. Both are, in effect, a career-average-pay pension plan. Because similar pension benefits could be provided by a final-pay pension plan that includes almost the entire service period (for example, service period minus the first year) in determining the average final pay on which pension benefits are based, the line between career-average-pay and final-pay pension plans would need to be an arbitrary one if the two types of formulas were to be treated differently. The Board decided to treat all pay-related pension plans the same; therefore, the projected unit credit method should be used for both final-pay and career-average-pay pension plans.

E51. *Q*—What is intended by the fourth sentence of paragraph 143 which states the following: "The Board perceives a difference between an employer's promise to pay a benefit of 1 percent of an employee's *final* pay and a promise to pay an employee a fixed amount that happens to equal 1 percent of the employee's *current pay*"? Is the Board referring to a career-average-pay pension plan in the latter part of the sentence? [39, 40, 143]

A—No. The intent of the sentence was to differentiate a final-pay pension plan from a flat-benefit pension plan (*not* a career-average-pay pension plan). In reading the sentence, the emphasis should be on

the word "happens." To illustrate the distinction the sentence is intending to make, assume that an employee's current salary is $30,000 and the employee's final salary will be $50,000. If future salary levels were not considered in measuring the current obligation of a 1 percent final-pay pension plan, the pension benefits promised for the current year of service for that employee would be $300. If the plan were a flat-benefit pension plan that promises $300 of pension benefits for each year of service, the measure of the obligation would be the same. The Board perceives a difference regarding the employer's promise under the two pension plans. Including the future salary variable on which the obligation in the first case is based results in recognizing that difference (a projected annual benefit of $500 under the final-pay pension plan as compared to a $300 projected benefit under the flat-benefit pension plan).

E52. *Q*—What constitutes a "substantive commitment" requiring recognition of pension benefits beyond those defined in the pension plan's written formula? [39, 41]

A—Paragraph 41 states that "in some situations a history of regular increases in non-pay-related benefits or benefits under a career-average-pay plan and other evidence may indicate that an employer has a present commitment to make future amendments and that the substance of the plan is to provide benefits attributable to prior service that are greater than the benefits defined by the written terms of the plan." The determination of whether a substantive commitment exists to provide pension benefits for employees beyond the written terms of the pension plan's formula requires careful consideration of all the facts and circumstances surrounding the pension plan. Actions of the employer, including communications to the employees, can demonstrate the existence of that commitment. (For example, paragraph 41 requires disclosure of the commitment in the financial statements.) However, a history of retroactive plan amendments is not enough, in isolation, to establish a substantive commitment. Absent other evidence of a substantive commitment, such a history should be considered in applying paragraph 27.

E53. *Q*—Should an employer's accounting for its pension plan anticipate a retroactive plan amendment that is *not* part of a series of retroactive plan amendments necessary to effect a substantive commitment to have a formula greater than its written form? [39, 41]

A—No.

E54. *Q*—Is it *always* necessary for assumed compensation levels to change each time assumed discount rates (and expectations of future inflation rates inherently contained in the assumed discount rates) change? [39, 43, 46, 202]

A—No. This Statement requires that assumed compensation levels be *consistent* with assumed discount rates only to the extent that both incorporate expectations of the same future economic conditions. It does not require that both assumptions contain the *same* future inflation component unless that would be appropriate under the circumstances to reflect the best estimate of the pension plan's future experience. For example, an employer that competes with significant foreign enterprises may not increase its assumed compensation levels even though assumed discount rates increase because the employer expects that it could not successfully compete in the future if its labor costs increased at a rate greater than that already assumed. Another employer would increase its assumed compensation levels if assumed discount rates increased because changes in that employer's labor costs over time have been highly correlated with changes in inflation rates and the employer expects that correlation to continue.

E55. *Q*—May an employer determine a range of discount rates each year based, for example, on the Pension Benefit Guaranty Corporation's interest rates and high-quality bond rates and continue to use the prior year's assumed discount rates as long as those rates fall within the range? [39, 44]

A—No. Paragraph 44 states:

> Assumed discount rates shall reflect the rates at which the pension benefits could be effectively settled. It is appropriate in estimating those rates to look to available information about rates implicit in current prices of annuity contracts that could be used to

> effect settlement of the obligation. . . . In making those estimates, employers may also look to rates of return on high-quality fixed-income investments currently available and expected to be available during the period to maturity of the pension benefits.

The intent of this Statement is for the assumed discount rates to reflect the interest rates inherent in the price at which the pension benefits could be effectively settled—currently. Each year those rates should be reevaluated to determine whether they reflect the best estimate of the current effective settlement rates. If interest rates generally decline or rise, the assumed discount rates should change.

E56. *Q*—May an employer determine a range of discount rates as described in the question in paragraph E55, and then arbitrarily select the assumed discount rates from within that range? [39, 44]

A—No. An employer should not select arbitrarily the assumed discount rates from within a range but should select the *best* estimate of the interest rates at which the pension benefits could be effectively settled at that point in time.

E57. *Q*—If an employer changes its basis of estimating assumed discount rates, for example, by using high-quality bond rates for one year and annuity rates for the following year, is that a change in method of applying an accounting principle? [39, 44]

A—No. The purpose of paragraph 44 is to describe the objective of selecting assumed discount rates, namely, to determine the interest rates inherent in the price at which the pension benefits could be effectively settled—currently. If an employer that previously used double A bond rates believes in a subsequent year that, in consideration of its pension plan's particular facts and circumstances, the interest rates that would be inherent in an effective settlement of the pension benefits are now more closely reflected by the rates implicit in current prices of annuity contracts, then those rates should be used and the change is viewed as a change in estimate (the estimate's being the determination of the effective settlement rates). The key is that the employer is using the rates implicit in current prices of annuity contracts as the basis to determine the best estimate of the effective settlement rates. The decision to use a particular methodology in a particular year does not mean that the employer must use that methodology in subsequent years. A change in the facts and circumstances may warrant the use of a different source that better reflects the rates at which the obligation could be effectively settled—currently. A position that holds such a change as a change in accounting principle would lend credence to the view that there are two or more acceptable alternatives. That is not the case. The objective is to select the *best* estimate of the effective settlement rates.

Another aspect of this issue is determining when to change the basis of estimation from one particular methodology (for example, double A bond rates) to another (for example, rates implicit in current prices of annuity contracts). There is no prescribed mathematical formula for making that decision. As indicated above, the emphasis in selecting assumed discount rates should be the use of the *best* estimate. Changes in the methodology used to determine that best estimate should be made when facts or circumstances change (for example, a general decline or rise in interest rates that has not, as yet, been reflected in the rates implicit in the current prices of annuity contracts). If the facts and circumstances do not change from year to year, it would be inappropriate to change the basis of selection, particularly if the intent in changing the basis is to avoid a change in the assumed discount rates.

E58. *Q*—If a pension plan has a bond portfolio that was dedicated at a yield significantly higher or lower than current interest rates, may the historical rates of return as of the dedication date be used in discounting the projected and accumulated benefit obligations to their present value? [39, 44]

A—No. Although it is acceptable in selecting the assumed discount rates for an employer to look to "rates of return on high-quality fixed-income investments," it is the current rates of return on those investments (not historical rates of return as of the dedication date) that are relevant.

Use of assumed discount rates based on historical rates of return is inconsistent with this Statement's requirement to value plan assets at fair value. If interest rates decline or rise, the effect of this Statement's requirement to use current rates is to increase or decrease the present value of the projected benefit obligation. That increase or decrease in the obligation is a loss or gain that would be offset to the

extent of the gain or loss in the fair value of the plan's dedicated portfolio of fixed-income investments. Any net gain or loss is subject to amortization as a component of net periodic pension cost.

E59. *Q*—May the assumed discount rates used to discount the vested, accumulated, and projected benefit obligations be different? [39, 44]

A—Yes, if the employer can justify such differences in terms of this Statement's requirement to make the best estimate of the assumed discount rates. For example, different rates should be used to measure the pension obligations for active and retired employees if necessary to reflect differences in the maturity and duration of pension benefit payments. The assumed discount rates for pension benefits that mature in a particular year should not differ, however, regardless of whether the obligation for those pension benefits is presently classified as a vested, accumulated, or projected benefit obligation.

E60. [This question has been deleted. See Status page.]

E61. *Q*—Because a current settlement of the portion of the projected benefit obligation that relates to future compensation levels is unlikely, may an employer use those interest rates implicit in *current prices* of annuity contracts to determine the accumulated benefit obligation, and use interest rates expected to be implicit in *future prices* of annuity contracts to determine the pension obligation in excess of the accumulated benefit obligation? [39, 44, 191]

A—No. The use of rates implicit in future annuity prices is not consistent with this Statement. The assumed discount rates used to determine the projected, accumulated, and vested benefit obligations should reflect the interest rates inherent in the price at which the pension benefits could be effectively settled—currently. It is acknowledged that ordinarily an employer would not want to purchase annuities for that portion of the pension benefit obligation related to future compensation levels and that an insurance company would be unwilling to undertake an unconditional obligation based on future compensation levels without charging increased premiums for the additional risk. However, under this Statement, how the accumulated benefit obligation or the projected benefit obligation (before discounting) is determined, that is, whether assumptions as to future inflation or compensation levels are considered, is not relevant in selecting discount rates.

This Statement requires an explicit approach to assumptions. Those factors that are relevant for determining the timing and amount of estimated future annuity payments should not be reflected by an implicit approach to selecting discount rates. Once the estimated future annuity payments are determined, the discounting process using an explicit approach does not consider anything other than the time value of money for purposes of determining the single sum which, if invested at the measurement date, would generate the necessary cash flows to pay the pension benefits when due (the sum necessary to settle effectively the pension obligation assuming no future experience gains or losses).

The purpose of the guidance in paragraphs 44 and 44A is to direct the employer to the proper sources for selecting assumed discount rates. Its intent is not necessarily to arrive at a discounted amount that would be the price an insurance company would charge to assume the same pension benefit promise to employees. Many factors affect the price at which an insurance company would undertake a particular obligation. The insurance company's assessment of the risks related to mortality obviously affect that price as does the profit margin the insurance company hopes to achieve. Had this Statement intended to arrive at the insurer's price, it would have stated that the actuarial present value of the projected benefit obligation be the best estimate of the price at which the insurance company would assume the employer's obligations. In that case, the approach to selecting various assumptions would be to select those inherent in annuity prices rather than those that "reflect the best estimate of the *plan's* future experience" (paragraph 191, emphasis added). Instead, this Statement identifies as *one* source for selecting assumed discount rates, the (explicit) rates implicit in current prices of annuity contracts. The rates inherent in a dedicated high-quality bond portfolio (for example, zero-coupon treasury securities) is another identified source. Paragraphs 186–188 of Statement 106 provide additional guidance on selecting the discount rate(s).

E62. *Q*—Should the expected return on future years' contributions to a pension plan be considered in determining the expected long-term rate of return on plan assets? [39, 45]

A—No. The expected long-term rate of return on plan assets should reflect long-term earnings expectations only on existing plan assets and those contributions expected to be received during the current year. The words "to be invested" in the first sentence of paragraph 45 were intended to refer only to the reinvestment of returns on existing plan assets.

E63. *Q*—Should changes *under existing law* in benefit limitations, such as those currently imposed by Section 415 of the U.S. Internal Revenue Code, that would affect benefits provided by a pension plan be anticipated in measuring the service cost component of net periodic pension cost and the projected benefit obligation? [39, 46]

A—Yes. If the existing law provides for indexing or has a schedule of changes inherent in it, those effects should be considered in determining the service cost component of net periodic pension cost and the projected benefit obligation to the extent consistent with other assumptions (that is, salary and inflation). However, possible amendments of the law should not be considered in determining those pension measurements.

E64. *Q*—If Section 415 of the U.S. Internal Revenue Code is incorporated by reference into a pension plan's formula thereby limiting certain participants' accumulated benefits, should determination of the pension plan's *accumulated* benefit obligation reflect the current limitation if (a) the pension plan's formula requires automatic increases in accumulated benefits as each change in the limitation under existing law occurs and (b) future service is not a prerequisite for participants to receive those increases? [39, 47, 48]

A—No. The determination of the pension plan's accumulated benefit obligation should not reflect the current limitation but should reflect those increases in the limitation under existing law that would be consistent with the pension plan's other assumptions. As described, the pension plan formula incorporates the type of automatic benefit increases addressed in paragraph 48. However, if employees would not automatically receive those pension benefit increases should they retire or terminate their service, then paragraph 47 would proscribe anticipating those increases and, therefore, the current limitation would be used in determining the *accumulated* benefit obligation in that situation.

E64A. [This question has been deleted. See Status page.]

E65. *Q*—If an actuarial valuation is made as of a pension plan's year-end and that date precedes the date of the employer's fiscal year-end statement of financial position, is it always necessary to have another actuarial valuation made as of that date? [52, 53]

A—No. This Statement requires that the projected benefit obligation reflect the actuarial present value of all benefits attributed to employee service rendered prior to the date of the employer's fiscal year-end statement of financial position, with limited exceptions. The measurement of that obligation should be based on actuarial assumptions appropriate for the date of the employer's fiscal year-end statement of financial position (for example, turnover, mortality, discount rates, and so forth) and census data as of that date. However, if an employer is assured that the reliability of the measurement of that obligation determined by rolling forward data based on a valuation prior to the date of the employer's fiscal year-end statement of financial position is sufficiently high so that the amount of the pension obligation is substantially the same as would be determined by an actuarial valuation as of that date, then another actuarial valuation is not required. This is analogous to the acceptability of having an annual physical inventory taken as of a date prior to the financial report date if it has been demonstrated that reliance can be placed on perpetual records or another system that reflects subsequent events.

E66. *Q*—How should net periodic pension cost for the year be determined if it is necessary to have an actuarial valuation as of the employer's fiscal year-end (for example, December 31) in addition to the actuarial valuation made as of the pension plan's preceding year-end (for example, June 30)? [52, 53]

A—Measurement of net periodic pension cost should be based on the most recent measurements of plan assets and obligations. If actuarial valuations are made as of June 30 and December 31, net periodic pension cost for the year should be the sum of two six-month measurements (January 1–June 30, determined as of the preceding December 31; July 1–December 31, determined as of the preceding June 30).

E67. *Q*—If an employer that has a December 31 financial report date measures its plan assets and obligations as of an interim date during its fiscal year, for example, because of a significant retroactive plan amendment, should net periodic pension cost for the subsequent interim periods be based on those measurements? [52, 53]

A—Yes. Net periodic pension cost for the remainder of the fiscal year should be based on the most recent pension measurements. Paragraph 53 states that "measurements of net periodic pension cost for both interim and annual financial statements shall be based on the assumptions used for the previous year-end measurements unless more recent measurements of both plan assets and obligations are available. . . ."

E68. *Q*—Under the circumstances described in the question in paragraph E67, should net periodic pension cost for the preceding interim periods be adjusted? [52, 53]

A—No.

E69. *Q*—An employer uses a measurement date of December 31 but does not complete the actual measurements until some time later in the year, for example, in January. Should the determination of the pension obligations be based on the assumed discount rates and other actuarial assumptions as of January? [52, 53]

A—No. The employer should use the actuarial assumptions (including assumed discount rates) that were appropriate as of the measurement date of December 31 because the objective is to determine the various pension measurements (including plan assets) as of that date.

E70–E72. [These questions have been deleted. See Status page.]

E73. [This question has been moved to paragraph E88A.]

E74–E78. [These questions have been deleted. See Status page.]

E79. *Q*—Should the assumptions disclosed be as of the beginning or ending measurement date? [FAS132, ¶5]

A—The disclosed weighted-average assumed discount rate and rate of compensation increase, if applicable, should be as of the year-end measurement date because that is the date for which the projected benefit obligation is presented.

The weighted-average expected long-term rate of return on plan assets is used to determine net periodic pension cost, and, therefore, in the absence of a subsequent interim measurement of both pension assets and obligations (refer to paragraph 53), the disclosed rate is the rate determined as of the beginning of the year measurement date. However, if that rate changes because of a subsequent interim measurement of both pension assets and obligations, disclosure of the beginning and more recently assumed rate, or a properly weighted combination of the two, should be made.

E80. *Q*—If an employer combines several of its pension plans and the assets of each predecessor pension plan are available to satisfy the previously existing obligations of the other, how should the combined pension plan be accounted for? [55]

A—Except for prior service costs included in accumulated other comprehensive income, similar amounts of the predecessor pension plans should be aggregated, and a single amortization schedule for each of the combined amounts should be used. That is, (a) the amortization of the transition asset or obligation remaining in accumulated other comprehensive income should reflect a reasonably weighted average of the remaining amortization periods used by the separate pension plans for that item and (b) the minimum amortization of the aggregate net gain or loss included in accumulated other comprehensive income should reflect the average remaining service period of the combined employee group. The prior service cost included in accumulated other comprehensive income of each pension plan at the time of the combination should continue to be amortized as previously determined based on specific employee groups covered.

Refer to Illustration 7 below.

Illustration 7—Combining of Two Plans

An employer has two pension plans (Plan A and Plan B) that are combined at December 31, 20X0. The following shows the assumptions and methods of amortizing pension amounts initially recognized in other comprehensive income and the funded status of each pension plan immediately before and after the combination of Plan A and Plan B.

December 31, 20X0—Prior to Combination of Plan A and Plan B

	Plan A	Plan B
Assumptions:		
Weighted-average discount rate	10%	9.25%
Expected long-term rate of return on plan assets	10%	10%
Average remaining service period	17 years	15 years
Number of employees as of December 31, 20X0 expected to receive benefits under the pension plan	300	420
Amortization method:		
Prior service cost	Straight-line amortization over average remaining service period of employees expected to receive benefits (17 years)	Straight-line amortization over average remaining service period of employees expected to receive benefits (15 years)

	Plan A	Plan B
Projected benefit obligation	$(502)	$(640)
Plan assets at fair value	804	205
Funded status and recognized asset (liability)	$ 302	$(435)
Amounts recognized in accumulated other comprehensive income:		
Net (gain) loss	$(114)	$ 41
Prior service cost (credit)	120	321
	$ 6	$ 362

December 31, 20X0—Subsequent to Combination of Plan A and Plan B

	Combined Plan AB
Assumptions:	
Weighted-average discount rate	9.6%[a]
Expected long-term rate of return on plan assets	10%[b]
Average remaining service period	15.8 years[c]
Number of employees as of December 31, 20X0 expected to receive benefits under the pension plan	720
Amortization method:	
Prior service cost	The existing prior service costs continued to be amortized on the bases applied prior to the combination
Net gain or loss	Minimum amortization specified in paragraph 32 (average remaining service period is 15.8 years)[c]

	Combined Plan AB
Projected benefit obligation	$(1,142)
Plan assets at fair value	1,009
Funded status and recognized asset (liability)	$ (133)
Amounts recognized in accumulated other comprehensive income:	
Net (gain) loss	$ (73)
Prior service (credit) cost	441
	$ 368

[a]The weighted-average assumed discount rate reflects the rates at which the combined pension benefits could be effectively settled. (For purposes of this illustration, 9.6 percent is presumed to be the appropriate rate. It was not actually calculated using any of the data for the previously separate plans.)

[b]The expected long-term rate of return on plan assets does not change because both pension plans used the same rate.

[c]The average remaining service period of employees expected to receive benefits under the pension plan is weighted by the number of covered employees from each group as follows: (17 years × 300/720) + (15 years × 420/720) = 15.8 years (rounded). That should be the same period that would be determined by a new calculation for the combined group.

E81. *Q*—If an employer divides a pension plan into two or more separate pension plans subsequent to the date of initial application of this Statement, how should (a) the transition asset or obligation remaining in accumulated other comprehensive income, (b) the net gain or loss included in accumulated other comprehensive income, and (c) any prior service cost included in accumulated other comprehensive income be allocated to each of the separate plans? [55]

A—Using Statement 88[17] as guidance for this issue, an employer should allocate (a) the transition asset or obligation remaining in accumulated other comprehensive income and (b) the net gain or loss included in accumulated other comprehensive income, in proportion to the projected benefit obligations of the two surviving plans. Prior service cost included in accumulated other comprehensive income should be allocated to the surviving plans based on the applicable individuals included in the employee groups covered.

Refer to Illustration 8 below.

Illustration 8—Division of One Pension Plan into Separate Pension Plans

An employer has a pension plan that covers employees of the parent company and its consolidated subsidiaries (Subsidiaries B and C). The employer divides its pension plan into three separate pension plans (Plan A, Plan B, and Plan C) that are sponsored by the parent company and Subsidiaries B and C, respectively.

The following shows the funded status of the pension plans immediately before and after the division.

	Prior to Division	After Division		
	(Parent) Plan ABC	(Parent) Plan A	(Subsidiary B) Plan B	(Subsidiary C) Plan C
Projected benefit obligation	$ (90,000)	$ (54,000)[a]	$(18,000)[a]	$(18,000)[a]
Plan assets at fair value	160,000	132,000[b]	15,000[b]	13,000[b]
Funded status and recognized asset (liability)	$ 70,000	$ 78,000	$ (3,000)	$ (5,000)
Amounts recognized in accumulated other comprehensive income:				
Net gain	$ (55,000)	$ (33,000)[c]	$(11,000)[c]	$(11,000)[c]
Prior service cost	25,000	17,500[d]	5,000[d]	2,500[d]
Transition asset	(40,000)	(24,000)[c]	(8,000)[c]	(8,000)[c]
	$ (70,000)	$ (39,500)	$(14,000)	$(16,500)

[a]Allocation based on individual employees covered by each plan.

[b]Allocation determined by employer. (Illustration presumes that no regulatory requirements apply.)

[c]Allocation based on percent of total projected benefit obligation ($90,000) assumed by each pension plan. For Plans A, B, and C, that is 60 percent, 20 percent, and 20 percent, respectively.

[d]Allocation based on applicable individual employees covered by each plan. (Illustration presumes prior service cost not allocable on the same percentage basis as projected benefit obligation assumed by each pension plan.)

[17]Statement 88 states that the pro rata amount of the maximum gain or loss to be recognized in earnings when a pension obligation is settled is equal to the percentage reduction in the projected benefit obligation. Paragraph 31 of Statement 88 indicates that determination could have been based on the reduction of assets since a decrease in the amount of plan assets also affects the possibility of future gains and losses. However, the Board concluded that it would be simpler and more practical to base the measurement only on the obligation settled.

Journal Entries

The journal entries to account for the division of the pension plan are as follows:

Parent Company

Pension asset	8,000	
Accumulated other comprehensive income	30,500	
Investment in Subsidiary B		17,000
Investment in Subsidiary C		21,500

To record the transfer of pension assets, obligations, and amounts included in accumulated other comprehensive income from the parent company to Subsidiaries B and C

Subsidiary B

Stockholder's equity*	17,000	
Pension liability		3,000
Accumulated other comprehensive income		14,000

To record the receipt of pension assets, obligations, and amounts included in accumulated other comprehensive income from the parent company

Subsidiary C

Stockholder's equity*	21,500	
Pension liability		5,000
Accumulated other comprehensive income		16,500

To record the receipt of pension assets, obligations, and amounts included in accumulated other comprehensive income from the parent company

*The accounting within the equity section is not addressed.

E82. *Q*—Are annuity contracts defined differently in this Statement and Statement 88? If so, how are the definitions different, and why? [57–61]

A—Yes. Annuity contracts are defined differently in this Statement and Statement 88. The difference in the definition of annuity contracts is that footnote 1 of Statement 88 excludes from settlement accounting those annuity contracts purchased from *an enterprise that is controlled by the employer,* whereas footnote 14 of this Statement excludes from annuity contracts those purchased from *a captive insurer.*[18] Therefore, an employer who purchases annuity contracts from an insurance company that it controls should not recognize any settlement gain or loss associated with the transaction (that is, the transaction should not qualify for settlement accounting under Statement 88). However, unless the insurance company is a captive insurer, the pension benefits covered by the annuity contracts should be excluded from the projected benefit obligation and the contracts should be excluded from plan assets (except for any participation rights) for purposes of applying this Statement.

In Statement 88, the Board decided that the circumstances under which an employer should recognize in earnings the net gain or loss included in accumulated other comprehensive income should be limited and that such recognition should not occur if the settlement transaction is between an employer and an

[18]Paragraph 60 of this Statement states that benefits covered by annuity contracts shall be excluded from the projected benefit obligation and the accumulated benefit obligation, and, except for participation rights, annuity contracts shall be excluded from plan assets.

entity that it controls. In the Board's view, such a transaction merely shifts the risks from one part of the entity to another part of the same entity. In the Exposure Draft preceding this Statement, the Board proposed to treat such contracts as plan assets. However, the Board was persuaded by constituents' views that the cost incurred to treat those contracts as plan assets and to include the related benefits in the measurement of the projected benefit obligation was too high to justify that accounting unless the contracts were with a captive insurer. The Board then concluded that disclosure of the approximate amount of annual benefits covered by annuity contracts issued by the employer and related parties should be required.

E83. *Q*—Is a guaranteed investment contract an annuity contract? [62]

A—No. Guaranteed investment contracts are not annuity contracts because they transfer only investment risk to the insurer. The insurer does not unconditionally undertake a legal obligation to provide specified pension benefits to specific individuals.

E84. *Q*—If a guaranteed investment contract is not considered an annuity contract, how should an employer value the contract if it has a specified maturity date and there is no intent to liquidate the contract before that date? [62]

A—Evidence of the fair value of a guaranteed investment contract might be obtained by looking to current yields on fixed-maturity securities having similar risk characteristics and duration.

E85. *Q*—Should the market value adjustment in an immediate participation guarantee investment contract be considered in determining its fair value? [62]

A—Yes. In effect, the contract value adjusted for any such market value adjustment represents the "cash surrender value" referred to in paragraph 62. If an immediate participation guarantee investment contract can be converted into an annuity contract, the conversion value of the contract should be considered in determining its fair value. The evidence noted in the answer to the question in paragraph E84 also should be considered.

E86. *Q*—If a not-for-profit organization has a defined benefit pension plan that covers employees at the national and all local chapters and (a) each chapter is required to contribute to the pension plan based on a predetermined formula (for example, on a percentage-of-salary basis), (b) plan assets are not segregated or restricted on a chapter-by-chapter basis, and (c) if a chapter withdraws from the pension plan, the pension obligations for its employees are retained by the pension plan as opposed to being allocated to the withdrawing chapter, should that arrangement be accounted for as a single-employer or multiemployer pension plan? [67–68]

A—The arrangement should be accounted for as a single-employer pension plan in the not-for-profit organization's consolidated financial statements. In each chapter's separate financial statements, however, the arrangement should be accounted for as a multiemployer pension plan. It is unclear how an allocation of net periodic pension cost or the overfunded or underfunded status of the defined benefit pension plan would be made if each chapter were to view its respective participation as a single-employer pension plan because the assets are not segregated or restricted by chapter and obligations are not assumed by a withdrawing chapter. Accounting for the pension plan as a multiemployer pension plan requires that a chapter's contribution for the period (in this example, the amount required to be contributed to the pension plan based on a percentage of its employees' salaries) be recognized as net periodic pension cost. A liability would be recognized for any contributions due and unpaid. Each chapter should provide the disclosures required by paragraph 12 of Statement 132(R) as well as any related-party disclosures required by FASB Statement No. 57, *Related Party Disclosures.*

E87. *Q*—Does the answer provided to the previous question also apply to a similar parent-subsidiary arrangement if the subsidiaries issue separate financial statements? [67–68]

A—Yes. Each subsidiary should account for its participation in the overall single-employer pension plan as a participation in a multiemployer pension plan. The parent company should, of course, account for the pension plan as a single-employer pension plan in its consolidated financial statements.

[Note: After the adoption of Statement 141(R) (effective for business combinations with an acquisition date on or after the beginning of the first annual reporting period beginning on or after 12/15/08), paragraph E88 is deleted.]

E88. *Q*—If the acquired enterprise sponsors a single-employer defined benefit pension plan at the date of the acquisition, should the pension asset or pension liability recognized by the acquiring employer be separately amortized to income in periods subsequent to the acquisition? [74]

A—No. The pension asset or pension liability should not be separately amortized. Rather, it is affected by the accounting for the pension plan in future periods.

E88A. *Q*—If an employer has (a) a qualified pension plan (for tax purposes) and (b) a nonqualified pension plan (which pays pension benefits in excess of the maximum allowed for the qualified pension plan by Section 415 of the U.S. Internal Revenue Code—an excess benefit [top-hat] pension plan) and the plans cover the same employees, may those pension plans be considered in substance a single pension plan under this Statement? [55–56]

A—No. In most circumstances the plan assets of a qualified pension plan (for tax purposes) are segregated and restricted to provide pension benefits only under that pension plan. Therefore, unless an employer *clearly* has a legal right to use the plan assets of the qualified pension plan to pay directly the pension benefits of the nonqualified pension plan (a right that generally does not exist), the determination of net periodic pension cost, including amortization periods and patterns for recognition in earnings of the cost of retroactive plan amendments and gains or losses, and recognition of an underfunded or overfunded status should be on a plan-by-plan basis. Also, the disclosures required by paragraph 6 of Statement 132(R) may need to be made separately for each plan. The fact that an employer could (a) fund less to the qualified pension plan and use those withheld funds to pay the benefits of the nonqualified pension plan or (b) engage in an asset reversion transaction of the qualified pension plan and use those withdrawn funds to pay the pension benefits of the nonqualified pension plan does not, in itself, allow the pension plans to be reported as a single pension plan.

An additional reason that excess benefit (top-hat) pension plans should be viewed as separate pension plans is that sometimes those pension plans cover employees of several different qualified pension plans, in which case it would not be possible to sustain a one-plan view.

E89–E106. [These questions have been deleted. See Status page.]

E107. *Q*—If a pension plan curtailment occurs causing almost all of the pension plan's participants to become inactive, should the employer continue to amortize any transition asset or obligation remaining in accumulated other comprehensive income using the same amortization period determined at that date? [77]

A—Yes. The employer should continue to amortize any transition asset or obligation remaining in accumulated other comprehensive income (the amount remaining after the employer accounts for the curtailment as required by paragraphs 12 and 13 of Statement 88) using the same amortization period determined at the date of initial application of this Statement.