

## Employers' Accounting for Pensions

December 1985

### INTRODUCTION

1. This Statement establishes standards of financial reporting and accounting for an employer that offers **pension benefits**<sup>1</sup> 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 N° 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) N° 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 state:

However, the committee believes that opinion as to the accounting for pension costs 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 N° 8, *Accounting for the Cost of Pension Plans*, in 1996. 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 1896, 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, 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 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

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<sup>1</sup>Words that appear in the glossary are set in **boldface type** the first time that they appear.

believes this Statement represents significant progress, especially in the measurement of **net period 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 pension cost<sup>2</sup> 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.

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<sup>2</sup>This Statement uses the term *net 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.

## 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 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 a plan that provides only life insurance benefits or health insurance benefits, or both, to retirees; employers are also not required to apply this Statement to postemployment health care benefits provided through a pension plan.<sup>3</sup> If the provisions of this Statement are not applied to postemployment health care benefits provided through a pension plan, obligations and assets related to such benefits shall not be considered to be pension obligations or **plan assets** for purposes of this Statement. This Statement does not change or supersede any of the requirements set forth in Statement 35 for the financial statement of a pension plan.

9. This Statement supersedes Opinion 8, as amended; FASB Statement N° 36, *Disclosures of Pension Information*; and FASB Interpretation N° 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 N° 5, *Accounting for Contingencies* and APB Opinion N° 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.

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<sup>3</sup>The Board has a separate project on its agenda to address accounting for postemployment benefits other than pensions. The fact that this Statement does not apply to postemployment health care benefits does not mean that the Board is proscribing or discouraging accrual of the cost of those benefits.

## 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 set 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 plan, a plan with minimal funding, and a well-funded plan. The other components of net periodic pension cost are **interest cost**<sup>4</sup> (interest on the **projected benefit obligation**, which is a discounted amount), **actual return on plan assets**, **amortization of unrecognized prior service cost**, and **gain or loss**. 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 benefit 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 compensations levels. For plans with flat-benefit or non-pay-related pension 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 discounted.

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<sup>4</sup>The interest cost component of net periodic pension cost shall not be considered to be interest for purposes of applying FASB Statement N° 34, *Capitalization of Interest Cost*.

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 benefit 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 unrecognized prior service cost, if any
- e. Gain or loss (including the effects of changes in assumptions) to the extent recognized (paragraph 34)
- f. Amortization of the unrecognized net obligation (and loss or cost) or unrecognized net asset (and gain) existing at the date of initial application of this Statement. (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.

#### ***Interest Cost***

22. The interest cost component recognized in a period shall be determined as the increase in the project 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. The cost of retroactive benefits (including benefits that are granted to retirees) is the increase in the projected benefit obligation at the date of the amendment. Except as specified in paragraph 26 and 27, that prior service cost shall be amortized 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.

26. To reduce the complexity and detail of the computations required, consistent use of an alternative amortization approach that more rapidly reduces the unrecognized 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 expirations of the employer's economic benefits and to recognize the cost in the periods benefited.

28. A plan amendment can reduce, rather than increase, the projected benefit obligation. Such a reduction shall be used to reduce any existing unrecognized prior service cost, and the excess, if any, shall be amortized on the same basis as the cost of benefit increases.

### *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 are unrealized. Because gains and losses may reflect refinements in estimates as well as real changes in economical 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.<sup>5</sup>

30. The **expected return on plan assets** shall be determined based on the **expected long-term rate of return of 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 (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 paragraph 32 and 33.

32. As a minimum, amortization of an **unrecognized net gain or loss** (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 unrecognized 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<sup>6</sup> 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.

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<sup>5</sup>Accounting for **plan terminations** and **curtailments** and other circumstances in which recognition of gains and losses might not be delayed is addressed in FASB Statement N° 88, *Employer's Accounting for Settlement and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*.

<sup>6</sup>The amortization must always reduce the beginning -of-the-year balance. Amortization of a net unrecognized gain results in a decrease in net periodic pension cost; amortization of a net unrecognized loss results in an increase in net periodic pension cost.

33. Any systematic method of amortization of unrecognized gains and 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 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 (b) amortization of the unrecognized net gain or loss from previous periods.

### **Recognition of Liabilities and Assets**

35. A liability (**unfunded accrued pension cost**) is recognized if net periodic pension cost recognized pursuant to this Statement exceeds amounts the employer has contributed to the plan. An asset (**prepaid pension cost**) is recognized if net periodic pension cost is less than amounts the employer has contributed to the plan.

36. If the accumulated benefit obligation exceeds the fair value of plan assets, the employer shall recognize in the statement of financial position a liability (including unfunded accrued pension cost) that is at least equal to the **unfunded accumulated benefit obligation**. Recognition of an additional minimum liability is required if an unfunded accumulated benefit obligation exists and (a) an asset has been recognized as prepaid pension cost, (b) the liability already recognized as unfunded accrued pension cost is less than the unfunded accumulated benefit obligation, or (c) no accrued or prepaid pension cost has been recognized.

37. If an additional minimum liability is recognized pursuant to paragraph 36, an equal amount shall be recognized as an intangible asset, provided that the asset recognized shall not exceed the amount of unrecognized prior service cost.<sup>7</sup> If an additional liability required to be recognized exceeds unrecognized prior service cost, the excess (which would represent a net loss not yet recognized as net periodic pension cost) shall be reported as a separate component (that is, a reduction) of equity, net of any tax benefits that result from considering such losses as timing differences for purposes of applying the provisions of APB Opinion N° 11, *Accounting for Income Taxes*.

38. When a determination of the amount of additional liability is made to prepare a statement of financial position, the related intangible asset and separate component of equity shall be eliminated or adjusted as necessary.

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<sup>7</sup>For purposes of this paragraph, an unrecognized net obligation existing at the date of initial application of this Statement (paragraph 77) shall be treated as unrecognized prior service cost.

## Measurements 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.<sup>8</sup> 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.

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<sup>8</sup> 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.

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**<sup>9</sup>, 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,<sup>10</sup> in proportion to the ratio of completed years of service to total projected years of 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.

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<sup>11</sup> that would affect benefits provided by the plan.

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<sup>9</sup>For example, a supplemental early retirement benefit that is a vested benefit after a stated number of years.

<sup>10</sup>For example, a death or disability benefit that is payable only if death or disability occurs during active service.

<sup>11</sup>For example, those currently imposed by Section 415 of the Internal Revenue Code.

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 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.

## Measurements of Plan Assets

49. For purpose of measuring the minimum liability required by the provision of paragraph 36 and for purposes of the disclosures required by paragraph 54, plan investments, whether equity or debt securities, real estate, or other, shall be measured at the 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 the market may be helpful in estimating fair value. If a market price is not available, a forecast of expected cash flows may aid in estimating fair value, provided the expected cash flows are discounted at a current rate commensurate with the risk involved.<sup>12</sup>

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 obligations required by this Statement shall be as of the date of the financial statements or, if used consistently from year to year, as of a date not more than three months prior to that date. 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). The additional minimum liability reported in interim financial statements shall be the same additional minimum liability ( paragraph 36) recognized in the previous year-end statement of financial position, adjusted for subsequent accruals and contributions, unless measures of both the obligation and plan assets are available as of a more current date or a significant event occurs, such as a plan amendment, that would ordinarily call for such measurements.

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<sup>12</sup>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.

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. An employer sponsoring a defined benefit pension plan shall disclose the following:

- a. A description of the plan including employee groups covered, type of benefit formula, **funding policy**, types of assets held and significant nonbenefit liabilities, if any, and the nature and effect of significant matters affecting comparability of information for all periods presented.
- b. The amount of net periodic pension cost for the period showing separately the service cost component, the interest cost component, the actual return on assets for the period, and the net total of other components<sup>13</sup>
- c. A schedule reconciling the funded status of the plan with amounts reported in the employer's statement of financial position, showing separately:
  - (1) The fair value of plan assets
  - (2) The projected benefit obligation identifying the accumulated benefit obligation and the vested benefit obligation
  - (3) The amount of unrecognized prior service cost
  - (4) The amount of unrecognized net gain or loss (including asset gains and losses not yet reflected in market-related value)
  - (5) The amount of any remaining unrecognized net obligation or net asset existing at the date of initial application of this Statement.
  - (6) The amount of any additional liability recognized pursuant to paragraph 36
  - (7) The amount of net pension asset or liability recognized in the statement of financial position pursuant to paragraphs 35 and 36 (which is the net result of combining the preceding six items)
- d. The weighted-average assumed discount rate of compensation increase (if applicable) used to measure the projected benefit obligation and the weighted-average expected long-term rate of return on plan assets
- e. If applicable, the amounts and types of securities of the employer and related parties included in plan assets, and the approximate amount of annual benefits of employees and retirees covered by annuity contracts issued by the employer and related parties. Also, if applicable, the alternative amortization methods used pursuant to paragraphs 26 and 33, and the existence and nature of the commitment discussed in paragraph 41.

## Employers with Two or More Plans

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<sup>13</sup>The net total of other components is the net effect during the period of certain delayed recognition provisions of this Statement. That net total includes:

- a. The net asset gain or loss during the period deferred for later recognition (in effect, an offset or a supplement to the actual return on assets)
- b. Amortization of the net gain or loss from earlier periods
- c. Amortization of unrecognized prior service cost
- d. Amortization of the unrecognized net obligation or net asset existing at the date of initial application of this Statement.

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 or 36 for one plan shall not be reduced or eliminated because another plan has assets in excess of its accumulated benefit obligation or because the employer has prepaid pension cost related to another plan.

56. Except as noted below, disclosures required by this Statement may be aggregated for all of an employer's single-employer defined benefit plans, or plans may be disaggregated in groups so as to provide the most useful information. For purposes of the disclosures required by paragraph 54(c), plans with assets in excess of the accumulated benefit obligation shall not be aggregated with plans that have accumulated benefit obligations that exceed plan assets. Disclosures for plans outside the U.S. shall not be combined with those for U.S. plans unless those plans use similar economic assumptions.

## Annuity Contracts

57. An annuity contract is a contract in which an insurance company<sup>14</sup> 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 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.

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<sup>14</sup>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.

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 participant's 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. An employer that sponsors one or more defined contribution plans shall disclose the following separately from its defined benefit plan disclosures:

- a. A description of the plan(s) including employee groups covered, the basis for determining contributions, and the nature and effect of significant matters affecting comparability of information for all periods presented
- b. The amount of cost recognized during the period.

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 and disclosure requirements shall be determined in accordance with the provisions of this Statement applicable to a defined benefit plan.

### **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 plan is that assets contributed by one 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. An employer that participates in one or more multiemployer plans shall disclose the following separately from disclosures for a **single-employer plan**:
  - a. A description of the multiemployer plan(s) including the employee groups covered, the type of benefits provided (defined benefit or defined contribution), and the nature and effect of significant matters affecting comparability of information for all periods presented
  - b. The amount of cost recognized during the period.
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 multi-employer plans for purposes of this Statement, and each employer's accounting shall be based in 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

74. When an employer is acquired in a business combination that is accounted for by the purchase method under Opinion 16 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 unrecognized net gain or loss, unrecognized prior service cost, or unrecognized net obligation or net asset existing at the date of initial application of this Statement. Subsequently, to the extent that those amount are considered in determining the amounts of contributions, differences between the purchaser's net pension cost and amounts contributed will reduce the liability or asset recognized at the date of the combination. 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.

## 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 N° 87, *Employer's 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 16, 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 obligations (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 be used to recognize any unrecognized net obligation related to a defined contribution plan.

**STATEMENT FINANCIAL ACCOUNTING  
STANDARDS N° 87**