



Final Statement on Pension Accounting Expected Next Month

Employers will be required to recognize on the balance sheet the funded status of defined-benefit pension and other postretirement benefit plans, according to the FASB's completed deliberations on a Statement expected to be issued in September. Calendar-year public companies will have to apply this requirement when preparing December 31, 2006 balance sheets. Prior-period financial statements will not be retrospectively adjusted to recognize the funded status in the balance sheets, as had been proposed in March 2006.¹

The Statement is expected to require fiscal-year-end measurements of plan assets and benefit obligations, eliminating the use of earlier measurement dates. But the new measurement-date requirement will not be effective until fiscal years ending after December 15, 2008.

Funded Status

The funded status of defined benefit pension plans will be measured under the expected Statement as the difference between the fair value of plan assets and the projected benefit obligation. The funded status of other postretirement benefit plans will be measured as the difference between the fair value of plan assets and the accumulated postretirement benefit obligation. These are the same measurements now required in the notes to the financial statements.²

Funded Status	1
Measurement Date	2
Classification	2
Not-For-Profit Organizations	2
Transition	2
Timing of Final Statement	3

The projected benefit obligation is the actuarial present value of pension benefits attributed to service already rendered, measured using assumptions about future compensation levels. The accumulated postretirement benefit obligation is the actuarial present value of postretirement benefits attributed to employee service already rendered. Under Statements 87 and 106 employers generally defer recognizing actuarial and experience gains and losses, prior service

¹ FASB Proposed Statement, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, March 31, 2006, available at www.fasb.org.

² FASB Statement Nos. 87, *Employers' Accounting for Pensions*, December 1985, and 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, December 1990, both available at www.fasb.org.

cost, and the transition amount from the initial adoption of the respective Statement, all of which are part of the funded status of the plan.

The FASB's decisions will not change the components of net periodic benefit cost. All amounts deferred in compliance with Statements 87 and 106 will therefore be recognized as a component of accumulated other comprehensive income, net of applicable tax effects. The adjustment to accumulated other comprehensive income includes any transition amount remaining from the initial application of Statement 87 or 106. This approach differs from the earlier proposal to recognize the remaining transition amount as an adjustment to the opening balance of retained earnings. Amounts recorded in accumulated other comprehensive income will be recognized in earnings (referred to as "recycling") when they are subsequently recognized as components of net periodic benefit cost.

The accompanying table illustrates the differences between the requirements expected in the coming Statement and existing requirements for a defined benefit pension plan.

The expected requirements for other postretirement benefit plans are similar to those illustrated in the table. However, in most cases, those plans are unfunded, in which case the funded status is the same as the benefit obligation.

Measurement Date

The FASB reaffirmed that plan assets and benefit obligations will be measured as of the balance-sheet date.³ This measurement-date requirement will eliminate the provisions in Statements 87 and 106 that permit companies to measure plan assets and benefit obligations as of a date not more than three months prior to the balance-sheet date. However, under the transition requirements, the change to the measurement date will not become effective for calendar-year entities until 2008.

Classification

The expected Statement will require the current and noncurrent portions of a net liability to be separately reported on a classified balance sheet. The portion of expected benefits to be paid over the next 12 months, or the operating cycle if longer, that exceeds the fair value of plan assets will be reported as a current liability. The entire amount of expected benefits to be paid over the next 12 months or operating cycle will be classified as current for unfunded plans, including many supplemental executive-retirement and postretirement medical plans. The Board also decided that a net postretirement benefit asset should always be classified as noncurrent.

Not-For-Profit Organizations

The Board reaffirmed that not-for-profit organizations should remain within the scope of the expected Statement. The Statement will not contain specific reporting guidance for not-for-profit organizations that present an intermediate measure of operations that is functionally equivalent to income from continuing operations. These not-for-profit organizations should refer to existing guidance.⁴

Transition

The FASB decided that prior-period financial statements will not be retrospectively adjusted to report a postretirement benefit asset or liability on the balance sheet. No pro forma disclosure of the effect of adoption on comparative prior-year financial information is expected to be required. Public companies, defined as entities whose equity securities trade in a public market, will be required to recognize on the balance sheet the funded status of their defined-benefit postretirement benefit plans in fiscal years ending after December 15, 2006. All other companies will be required to adopt these provisions in fiscal years ending after June 15, 2007.

Example Showing Existing and Expected Requirements for a Defined Benefit Pension Plan			
Assumed Facts		Statement 87	Expected Statement
Projected benefit obligation	\$ (1,000)	Note disclosure	No change
Fair value of plan assets	600	Note disclosure	No change
Funded status (net obligation)	\$ (400)	Note disclosure	Recognized on employer's balance sheet
Unrecognized actuarial loss	\$ 325	Note disclosure	Recognized as a component of accumulated other comprehensive income
Unrecognized prior service cost	100	Note disclosure	Recognized as a component of accumulated other comprehensive income
Unrecognized transition amount	50	Note disclosure	Recognized as a component of accumulated other comprehensive income
Prepaid pension asset	\$ 75	Recognized on employer's balance sheet	Not separately recognized or disclosed
The company would be required to adjust its financial statements to eliminate the \$75 prepaid pension asset that is recognized under existing requirements, record a pension liability of \$400, and accumulated other comprehensive income charge (or reduction of equity) of \$475.			

³ If the plan is sponsored by a subsidiary that is consolidated using a fiscal period different from the parent's, the date of the subsidiary's balance sheet would be the measurement date for the plan.

⁴ FASB Statement No. 117, Financial Statements of Not-for-Profit Organizations, June 1993, available at www.fasb.org; and AICPA Audit and Accounting Guide, Health Care Organizations, May 2005.



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In response to concerns expressed by constituents responding to the March 2006 proposal, the Board agreed to permit a transition alternative that will allow employers to avoid the cost of performing two separate measurements of plan assets and benefit obligations during the transition to a fiscal year-end measurement date. The expected Statement will delay to fiscal years ending after December 15, 2008 the effective date of the measurement-date provisions requiring the elimination of a lagged measurement. Under the transition alternative, employers will not be required to measure plan assets and benefit obligations at the beginning of the fiscal year that the measurement-date provisions become effective.

To illustrate this transition alternative, assume a calendar-year-end employer had measured its plan assets and benefit obligations using a September 30 measurement date. The employer measures these plan assets and benefit obligations on September 30, 2007 by applying its previous measurement policy. In accordance with the Board's expected measurement-date provisions, the employer will make its next measurement of plan assets and benefit obligations at December 31, 2008. The September 30, 2007 measurement will be used to determine net periodic benefit cost for 2008, which is the same amount that would have been recognized in 2008 before the expected adoption of the Board's measurement-date provisions. If the annual amount for 2008 is \$12 million (\$1 million per month), the employer would record that amount in 2008 and would also record \$3 million through retained earnings—representing the 3 months of net periodic pension cost that was not recorded in the income statement.

The other permitted approach, the one proposed in March 2006, would require a separate measurement at January 1, 2008, which could result in a different net periodic benefit cost for 2008 and retained earnings adjustment.

Timing of Final Statement

The FASB staff has begun drafting a Statement reflecting the decisions the Board made during its deliberations on the March 2006 proposal and will submit the revised document to the Board for final approval. The final Statement is expected to be issued in September.

The descriptive and summary statements above are not intended to be a substitute for the text of what the FASB might issue as a final Statement or for the text of any other cited or potential requirements. Reporting entities complying with adopted requirements that might emerge or complying with SEC filing requirements should consult the texts of the applicable documents that set out GAAP and SEC requirements, the particular circumstances to which the requirements are to be applied, and their accounting and legal advisors.