



## Proposed Accounting for Pension and Other Postretirement Benefits

Companies would recognize on the balance sheet the funded status of pension and other postretirement benefit plans if a proposed FASB Statement is adopted as released for public comment.<sup>1</sup> As a result, companies would recognize on their balance sheets actuarial gains and losses and prior service cost that have not yet been included in income. This could significantly increase reported liabilities for many companies with a corresponding reduction in equity reported as accumulated other comprehensive income. Defined-benefit-plan assets and obligations would be measured as of the employer's balance-sheet date, and any transition assets or obligations remaining from the initial application of Statements 87 and 106 would be recognized as an adjustment to the opening balance of retained earnings.<sup>2</sup>

Companies are currently allowed to delay recognizing in earnings specified elements of pension and postretirement benefit costs, such as most actuarial gains and losses and prior service cost. Amounts that are not yet recognized in income are also generally excluded from the balance sheet and reported only in the notes to the financial statements. The FASB's proposal would require the amounts that have not yet been recognized in income to be reported on the balance sheet, but generally would not change the amounts recognized in the income statement as net periodic benefit costs. The FASB will consider potential changes in determining net periodic benefit cost in the second phase of this project.

The proposed Statement would amend Statements 87, 88, 106, and 132(R), but most of their measurement and disclosure guidance would be retained.<sup>3</sup>

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### Funded Status

Statement 87 requires companies to report a minimum pension liability if the *accumulated* benefit obligation exceeds the fair value of plan assets. However, unless a minimum pension liability is required, the actuarial gains and losses and prior service cost that have not yet been included in net periodic benefit cost are not reported on the balance sheet.

<sup>1</sup> FASB Proposed Statement, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, March 31, 2006, available at [www.fasb.org](http://www.fasb.org).

<sup>2</sup> 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](http://www.fasb.org).

<sup>3</sup> FASB Statement Nos. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*, December 1985, and 132 (revised 2003), *Employers' Disclosures about common Pension and Other Postretirement Benefits*, December 2003, both available at [www.fasb.org](http://www.fasb.org).

<b>Terminology</b>	
Projected benefit obligation	The actuarial present value of pension benefits attributed to service already rendered and measured using assumptions as to future compensation levels.
Accumulated benefit obligation	The actuarial present value of pension benefits attributed to service already rendered and measured using current compensation levels.
Accumulated postretirement benefit obligation	The actuarial present value of postretirement benefits attributed to employee service already rendered.
Prior service cost	The cost of benefit improvements attributable to plan participants' prior service pursuant to plan amendments or plan initiation.

The proposed Statement would supersede these requirements by requiring an employer to report on its balance sheet the amount by which the defined-benefit-postretirement obligation is over- or under-funded. The amount would be measured as the difference between the fair value of plan assets and the *projected* benefit obligation (which would include all actuarial gains and losses and prior service cost). If the fair value of the plan assets is larger, the plan would be over-funded, and a net asset would be reported on the balance sheet. Conversely, if the obligation is larger, the plan would be under-funded, and a net liability would be reported.

A pension plan's benefit obligation would be the projected benefit obligation. The benefit obligation of a postretirement benefit plan other than a pension would be the accumulated postretirement benefit obligation.

The proposed Statement would eliminate the provisions of Statements 87 and 106 that allow companies to delay recognizing on the balance sheet the portion of the projected benefit obligation associated with actuarial gains and losses and prior service cost.

The proposed Statement would not change the components of net periodic benefit cost except to eliminate the amortization of the

transition amount from the initial adoption of Statements 87 and 106. However, unrecognized actuarial gains and losses and prior service costs that occurred during the period would be reported as a component of other comprehensive income, net of applicable tax effects. Amounts recognized in accumulated other comprehensive income would be adjusted or "recycled" out of accumulated other comprehensive income when they are subsequently recognized as components of net periodic benefit cost. The accompanying table is an example that illustrates the differences between the proposed and existing requirements for a pension plan.

<b>Example Showing Existing and Proposed Requirements</b>			
<b>Assumed Facts</b>		<b>Existing</b>	<b>Proposed</b>
Projected benefit obligation	\$(1,000)	Note disclosure	Note disclosure
Fair value of plan assets	600	Note disclosure	Note disclosure
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 an adjustment to retained earnings of earliest year presented
Prepaid pension asset	\$ 75	Recognized on employer's balance sheet	Not separately recognized or disclosed
<p>The company would be required to adjust its financial statements to eliminate the \$75 prepaid pension asset that is recognized under existing requirements and to record a pension liability of \$400. The offsetting amounts would be reported in equity.</p>			

Employers with more than one postretirement benefit plan would be required to aggregate all over-funded plans and report one net asset amount and to aggregate all under-funded plans and report one net liability amount. The current and non-current portions of the asset and liability would be reported separately in a classified balance sheet.

The declines in discount rates and investment returns over the past several years have caused many companies to disclose material amounts of unrecognized net pension obligations. Under the proposal, these net obligations would be recognized on the balance sheet with the offsetting reduction to equity. The reduction in equity could affect a company's ability to comply with debt-covenant provisions, such as debt-to-equity ratios. Companies may want to discuss these potential changes with their lenders.

Companies would need to consider the potential tax effects of the proposed requirements. Recognizing an additional liability generally would result in an associated deferred tax asset that would have to be evaluated for realizability. Companies evaluating whether realizability is more likely than not would need to consider all the relevant facts and circumstances, including the length of the period during which the deferred tax asset would be expected to reverse.

### **Not-for-Profit Entities**

Some not-for-profit organizations report a measure of activity for the period rather than reporting net income and comprehensive income. The proposed Statement would require not-for-profit entities that present an intermediate measure of operations (e.g., income from operations) to report outside the intermediate measure the amounts that for-profit entities would report as an element of other comprehensive income. If no intermediate measure of operations is presented, however, the not-for-profit entity

would report the amounts on a separate line apart from the entity's functional expenses.

### **Measurement Date**

Under the proposed Statement, plan assets and benefit obligations would be measured as of the balance-sheet date except for plans sponsored by a subsidiary that is consolidated using a fiscal period different from the parent's. In that case, the date of the subsidiary's balance sheet would be the measurement date for that plan. The proposed measurement-date provision would 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. Because the actuarial computations can be complex and time-consuming, companies would need to consider the challenges to year-end reporting if this proposed change in the measurement date is adopted.

### **Transition**

Except for the requirement to measure plan assets and benefit obligations as of the balance-sheet date, the provisions of the proposed Statement would be effective for fiscal years ending after December 15, 2006, with earlier application encouraged. The proposed Statement would be applied retrospectively to all prior periods by recognizing these items:

- Actuarial gains and losses and prior service costs that were not included in net periodic benefit cost for each year, which would be recognized as a component of other comprehensive income, net of applicable income taxes.
- Actuarial gains and losses and prior service costs not yet included in net periodic benefit cost as of the beginning of the first period retrospectively adjusted, which would be recognized as an adjustment of the opening balance of accumulated other comprehensive income.

- Any remaining portion of the transition asset or obligation related to the initial adoption of Statement 87 or 106, which would be recognized as an adjustment to the opening balance of retained earnings of the earliest period that is retrospectively adjusted. Any previous amortization of the transition asset or obligation would be eliminated as a component of net periodic benefit cost for any subsequent period presented. The effect of eliminating the previous amortization would be recognized, net of applicable income taxes, without affecting any net periodic benefit cost that may have been capitalized as inventory or other productive assets.

Retrospective application would be required unless the entity is unable to assess the period-specific realizability of the deferred tax assets recognized as a result of applying the Statement.

***Transition for Changes in Measurement Date.*** The proposed Statement would require public companies to measure plan assets and benefit obligations as of the employer's balance-sheet date for fiscal years beginning after December 15, 2006. Not-for-profit organizations and nonpublic entities would be required to perform the measurement on the employer's balance-sheet date for fiscal years beginning after December 15, 2007. Earlier application would be encouraged, but the proposed Statement would prohibit applying the measurement date requirement retrospectively to prior periods presented.

In the fiscal year that the measurement date is changed, the net periodic benefit cost would be determined using a beginning measurement date that matches the end of the prior fiscal year. Net periodic benefit cost for the period between the previous measurement date and the end of the employer's prior fiscal year would be



recognized as an adjustment of the opening balance of retained earnings in the fiscal year that the measurement date is changed.

For example, a calendar-year public company that previously used a measurement date of September 30 (three months prior to its year-end) would recognize its net periodic benefit cost for 2007 based on the measurement of its plan assets and benefit obligations at December 31, 2006 and December 31, 2007. The net periodic benefit cost attributable to the changes from September 30, 2006 to December 31, 2006 would be included in the opening balance of retained earnings for 2007.

Any gain or loss from curtailment or settlement that occurs during the change in the measurement period (between September 30 and December 31, 2006 in the previous example) would be recognized in earnings in that fiscal year (2006 in the previous example).



Comments on the proposed Statement are due by May 31, 2006. The Board's technical plan calls for a final Statement to be issued in the third quarter. The follow-on phase of the FASB's project on pension and other postretirement benefit obligations will evaluate all aspects of the current model for accounting for pension and postretirement benefit obligations, including the provisions of the model that permit delayed income-statement recognition of most actuarial gains and losses and prior service cost. The follow-on phase will likely be undertaken jointly with the International Accounting Standards Board.

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