Statement of Financial Accounting Standards No. 87

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Employers' Accounting for Pensions

December 1985

Financial Accounting Standards Board
of the Financial Accounting Foundation
401 MERRITT 7, P.O. BOX 5116, NORWALK, CONNECTICUT 06856-5116

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FAS 87: Employers' Accounting for Pensions

FAS 87 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.

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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."

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 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 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.[3] 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 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 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 **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 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 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 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. 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 paragraphs 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 expiration 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 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]

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 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 [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 amortization of unrecognized 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 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 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.[7] 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 No. 11, *Accounting for Income Taxes*.

38. When a new 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.

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.

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 [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 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

49. For purposes of measuring the minimum liability required by the provisions 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 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 may aid in estimating fair value, provided the expected cash flows are discounted at a current rate commensurate with the risk involved.[12]

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.

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 [13]
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 and 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 method 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

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 [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 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. 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 effects 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 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. 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 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

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 amounts 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 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*
Frank E. Block
Victor H. Brown
Raymond C. Lauver
David Mosso
Robert T. Sprouse
Arthur R. Wyatt

Appendix A

BASIS FOR CONCLUSIONS

CONTENTS

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 cos*t—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 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.

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. Delayed recognition and reconciliation of funded status
2. Transition
3. Amortization of unrecognized prior service cost
4. Accounting for gain or loss and timing of measurements
5. Recognition of pension liabilities, including minimum liability
6. Disclosure
7. Accounting for a business combination

Illustration 1—Delayed Recognition and Reconciliation of Funded Status

This Statement provides for delayed recognition 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.

This Statement also requires disclosure of a reconciliation of the funded status of a plan to the net pension liability or asset recognized in the employer's financial statements. This illustration shows how that reconciliation provides information about items that have not been recognized due to delayed recognition. The illustration starts with an assumed funded status at the date of initial application of this Statement and shows how a series of events that change the obligation or the plan assets are reflected in the reconciliation. (Throughout this illustration the fair value of plan assets exceeds the accumulated benefit obligation and, therefore, no recognition of an additional minimum liability is required.)

Case 1—Company T at Transition

The reconciliation as of the date of initial application of this Statement is as follows:

Projected benefit obligation	$(10,000)
Plan assets at fair value	6,500
Funded status	(3,500)
Unrecognized net (gain) or loss	0
Unrecognized prior service cost	0
Unrecognized net obligation or (net asset) at date of initial application	3,500
(Accrued)/prepaid pension cost	$ 0

The unrecognized net gain or loss and the unrecognized prior service cost are both initially zero by definition. The unrecognized net obligation or asset at transition is defined in paragraph 77 as the difference between the funded status and the accrued or prepaid pension cost already recognized. If, as in this case, the past contributions were equal to amounts recognized as net pension cost in past periods, there is no recognized accrued or prepaid pension cost in the statement of financial position and, therefore, the unrecognized net obligation or asset at transition is equal to the funded status.

Case 2—Past Contributions Lower by $400

If Company T had not made a contribution of $400 for the last year before the date of initial application but had recognized the same net periodic pension cost as in Case 1, the situation would be as follows:

Projected benefit obligation	$(10,000)
Plan assets at fair value	6,100
Funded status	(3,900)
Unrecognized net (gain) or loss	0
Unrecognized prior service cost	0
Unrecognized net obligation or (net asset) at date of initial application	3,500
(Accrued)/prepaid pension cost	$ (400)

The unrecognized net obligation at transition is unchanged. It is the amount of the projected benefit obligation not yet recognized in net periodic pension cost and is not directly affected by funding decisions.

Case 3—Past Contributions Greater by $800

If, instead, the employer had made a contribution in excess of net periodic pension cost of $800, but the company had recognized the same net periodic pension cost as in Case 1, the reconciliation would be as follows:

Projected benefit obligation	$(10,000)
Plan assets at fair value	7,300
Funded status	(2,700)
Unrecognized net (gain) or loss	0
Unrecognized prior service cost	0
Unrecognized net obligation or (net asset) at date of initial application	3,500
(Accrued)/prepaid pension cost	$ 800

After Initial Application

At any date after initial application, any change in the projected benefit obligation or the plan assets (other than contributions and benefit payments) either is unrecognized or has been included in net pension cost for some period. Contributions decrease the accrued pension cost or increase the prepaid pension cost, and benefit payments reduce the obligation and the plan assets equally. Thus, all changes in either the obligation or the assets are reflected in the reconciliation. Using Case 1 above as the starting point, the following reconciliations illustrate the effect of various events that change either the projected benefit obligation or the plan assets.

Case 4—Fair Value of Assets Increases by $400

	Before	**After**
Projected benefit obligation	$(10,000)	$(10,000)
Plan assets at fair value	6,500	6,900
Funded status	(3,500)	(3,100)
Unrecognized net (gain) or loss	0	(400)
Unrecognized prior service cost	0	0
Unrecognized net obligation or (net asset) at date of initial application of initial application	3,500	3,500
(Accrued)/prepaid pension cost	$ 0	$ 0

Case 5—Increase in Discount Rate Reduces Obligation by $900

	Before	After
Projected benefit obligation	$(10,000)	$ (9,100)
Plan assets at fair value	6,500	6,500
Funded status	(3,500)	(2,600)
Unrecognized net (gain) or loss	0	(900)
Unrecognized prior service cost	0	0
Unrecognized net obligation or (net asset) at date of initial application of initial application	3,500	3,500
(Accrued)/prepaid pension cost	$ 0	$ 0

Case 6—Plan Amendment Increases the Obligation by $1,500

	Before	After
Projected benefit obligation	$(10,000)	$(11,500)
Plan assets at fair value	6,500	6,500
Funded status	(3,500)	(5,000)
Unrecognized net (gain) or loss	0	0
Unrecognized prior service cost	0	1,500
Unrecognized net obligation or (net asset) at date of initial application of initial application	3,500	3,500
(Accrued)/prepaid pension cost	$ 0	$ 0

Case 7—Employer Accrues Net Pension Cost

Net pension cost includes:

Service cost	$ 600
Interest cost	1,000
Amortization of initial unrecognized net obligation	233
Return on assets	(650)
	$1,183

No contribution is made.

	Before	**After**
Projected benefit obligation	$(10,000)	$(11,600)
Plan assets at fair value	6,500	7,150
Funded status	(3,500)	(4,450)
Unrecognized net (gain) or loss	0	0
Unrecognized prior service cost	0	0
Unrecognized net obligation or (net asset) at date of initial application of initial application	3,500	3,267
(Accrued)/prepaid pension cost	$ 0	$ (1,183)

Illustration 2—Transition

Case 1

As of December 31, 1985, the projected benefit obligation and plan assets of a noncontributory defined benefit plan sponsored by Company A were:

Projected benefit obligation	$(1,500,000)
Plan assets at fair value	1,200,000
Initial unfunded obligation	$ (300,000)

Company A elected to apply the provisions of this Statement for its financial statements for the year ending December 31, 1986. At December 31, 1985, no prepaid or accrued pension cost had been recognized in Company A's statement of financial position (that is, all amounts accrued as net periodic pension cost had been contributed to the plan). The average remaining service period of active plan participants expected to receive benefits was estimated to be 16 years at the date of transition. In this situation the initial unrecognized net obligation (and loss or cost) of $300,000 is to be amortized (recognized as a component of net periodic pension cost) on a straight-line basis over the average remaining service period of 16 years (paragraph 77) as follows:

Year	Beginning-of-Year Balance	Amortization [a]	End-of-Year Balance
1986	300,000	18,750	281,250
1987	281,250	18,750	262,500
1988	262,500	18,750	243,750
1989	243,750	18,750	225,000
1990	225,000	18,750	206,250
1991	206,250	18,750	187,500
1992	187,500	18,750	168,750
1993	168,750	18,750	150,000
1994	150,000	18,750	131,250
1995	131,250	18,750	112,500
1996	112,500	18,750	93,750
1997	93,750	18,750	75,000
1998	75,000	18,750	56,250
1999	56,250	18,750	37,500
2000	37,500	18,750	18,750
2001	18,750	18,750	0

[a] 300,000 ÷ 16 = 18,750.

Case 2

As of December 31, 1985, the projected benefit obligation and plan assets of a noncontributory defined benefit plan sponsored by Company B were:

Projected benefit obligation	$(1,400,000)
Plan assets at fair value	1,600,000
Initial overfunded obligation	$ 200,000

Company B elected to apply the provisions of this Statement for its financial statements for the year ending December 31, 1986. In previous periods, Company B's plan was deemed to be fully funded for tax purposes, and the company decided not to make contributions that would not have been currently tax deductible. As a result, contributions were less than net pension cost for those periods, and the company had recognized unfunded accrued pension cost (a liability) of $150,000 at December 31, 1985.

The unrecognized net asset at transition defined in paragraph 77 consists of amounts previously charged to net pension cost in excess of the projected benefit obligation. Amounts charged to net pension cost in past periods include amounts contributed (plan assets) and amounts unfunded. In this case, at December 31, 1985 those amounts were:

Plan assets in excess of obligation	$200,000
Unfunded accrued pension cost	150,000
Unrecognized net asset	$350,000

The average remaining service period of active plan participants expected to receive benefits was estimated to be 10 years at the date of transition. In this situation, the initial unrecognized net asset of $350,000 may be amortized on a straight-line basis over either 10 years or 15 years (paragraph 77. That amortization will result in an annual credit to net periodic pension cost of either $35,000 or $23,333.

Illustration 3—Amortization of Unrecognized Prior Service Cost

Case 1—Assigning Equal Amounts to Future Years of Service

Determination of Expected Future Years of Service

The amortization of unrecognized prior service cost defined in 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 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, 1987), 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.

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
Amortization Fraction		100/1,050	95/1,050	90/1,050	85/1,050	80/1,050	75/1,050	70/1,050	65/1,050	60/1,050	55/1,050	50/1,050	45/1,050	40/1,050	35/1,050	30/1,050	25/1,050	20/1,050	15/1,050	10/1,050	5/1,050

Amortization of Unrecognized Prior Service Cost

On January 1, 1987, Company E granted retroactive credit for prior service pursuant to a plan amendment. This amendment generated unrecognized prior service cost of $750,000. The amortization of the unrecognized prior service cost resulting from the plan amendment is based on the expected future years of service of active participants as discussed in the previous paragraph.

Amortization of Unrecognized Prior Service Cost

Year	Beginning-of-Year Balance	Amortization Rate	Amortization	End-of-Year Balance
1987	750,000	100/1050	71,429	678,571
1988	678,571	95/1050	67,857	610,714
1989	610,714	90/1050	64,286	546,428
1990	546,428	85/1050	60,714	485,714
1991	485,714	80/1050	57,143	428,571
1992	428,571	75/1050	53,571	375,000
1993	375,000	70/1050	50,000	325,000
1994	325,000	65/1050	46,429	278,571
1995	278,571	60/1050	42,857	235,714
1996	235,714	55/1050	39,286	196,428
1997	196,428	50/1050	35,714	160,714
1998	160,714	45/1050	32,143	128,571
1999	128,571	40/1050	28,571	100,000
2000	100,000	35/1050	25,000	75,000
2001	75,000	30/1050	21,429	53,571
2002	53,571	25/1050	17,857	35,714
2003	35,714	20/1050	14,286	21,428
2004	21,428	15/1050	10,714	10,714
2005	10,714	10/1050	7,143	3,571
2006	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 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) had elected 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 would have been as follows:

Amortization of Unrecognized Prior Service Cost

Year	Beginning-of-Year Balance	Amortization [a]	End-of-Year Balance
1987	750,000	71,429	678,571
1988	678,571	71,429	607,142
1989	607,142	71,429	535,713
1990	535,713	71,429	464,284
1991	464,284	71,429	392,855
1992	392,855	71,429	321,426
1993	321,426	71,429	249,997
1994	249,997	71,429	178,568
1995	178,568	71,429	107,139
1996	107,139	71,429	35,710
1997	35,710	35,710	0

[a]750,000 ÷ 10.5 = 71,429.

Illustration 4—Accounting for Gains and Losses and Timing of Measurements

The following shows the funded status of Company I's pension plan at December 31, 1986 and its assumptions and expected components of net periodic pension cost for the following year (all amounts are in thousands):

DECEMBER 1986—INITIAL SITUATION

Assumptions:	
Discount rate	10.00%
Expected long-term rate of return on plan assets	10.00%
Average remaining service	10 years

	Actual 12/31/86	For 1987	Projected 12/31/87
Projected benefit obligation	$(1,000)		$(1,060)
Plan assets at fair value	800		880
Funded status	(200)		(180)
Unrecognized net obligation existing at January 1, 1987	200		180
Unrecognized prior service cost	0		0
Unrecognized net (gain) or loss	0		0
(Accrued)/prepaid	$ 0		$ 0
Service cost component		$ 60 [a]	
Interest cost component		100	
Expected return on assets		(80)	
Amortization of:			
Unrecognized net obligation existing at January 1, 1987		20	
Unrecognized prior service cost		0	
Unrecognized net (gain) or loss		0	
Net cost		$100	
Contribution		$100	
Benefits paid		$100	

Company I elected to apply the provisions of this section as of January 1, 1987 rather than as of an earlier date. Also, the company elected to measure pension-related amounts as of year-end. Alternatively, the company could have chosen to make the measurements as of another date not earlier than September 30. (Throughout this illustration it is assumed that the fair value of plan assets exceeds the accumulated benefit obligation and, therefore, no recognition of an additional minimum liability is required. For simplicity, all contributions and benefit payments are assumed to occur on the last day of the year.)

1987—LIABILITY LOSS

When Company I's plan assets and obligations were measured at December 31, 1987, 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:

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 12/31/86	**For 1987**	**Projected 12/31/87**	**Actual 12/31/87**	**For 1988**	**Projected 12/31/88**
Projected benefit obligation	$(1,000)		$(1,060)	$(1,200)		$(1,266) b
Plan assets at fair value	800		880	880		968 c
Funded status	(200)		(180)	(320)		(298)
Unrecognized net obligation existing at January 1, 1987	200		180	180		160
Unrecognized prior service cost	0		0	0		0
Unrecognized net (gain) or loss	0		0	140		138
(Accrued)/prepaid	$ 0		$ 0	$ 0		$ 0
Service cost component		$ 60			$ 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:						
Unrecognized net obligation existing at January 1, 1987		20			20	
Unrecognized prior service cost		0			0	
Unrecognized net (gain) or loss		0 d			2 d	
Net cost		$100			$114	
Contribution		$100			$114	
Benefits paid		$100			$114	

The 1987 financial statements will include the following disclosures:

Cost Components		Reconciliation of Funded Status	
Service cost	$ 60	Projected benefit obligation	$(1,200)
Interest cost	100	Plan assets at fair value	880
Actual return on assets	(80)		
Net amortization and deferral	20 [e]	Funded status	(320)
		Unrecognized net obligation existing at January 1, 1987	180
Net cost	$100	Unrecognized prior service cost	0
		Unrecognized net (gain) or loss	140
		(Accrued)/prepaid	$ 0 [f]

1988—ASSET GAIN

When Company I's plan assets and obligations were measured at December 31, 1988, 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:

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 12/31/87	For 1988	Projected 12/31/88	Actual 12/31/88	For 1989	Projected 12/31/89
Projected benefit obligation	$(1,200)		$(1,266)	$(1,266)		$(1,345)
Plan assets at fair value	880		968	1,068		1,167
Funded status	(320)		(298)	(198)		(178)
Unrecognized net obligation existing at January 1, 1987	180		160	160		140
Unrecognized prior service cost	0		0	0		0
Unrecognized net (gain) or loss	140		138	38		38
(Accrued)/prepaid	$ 0		$ 0	$ 0		$ 0
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:		
Unrecognized net obligation existing at January 1, 1987	20	20
Unrecognized prior service cost	0	0
Unrecognized net (gain) or loss	2 [i]	0 [i]
Net cost	$114	$111
Contribution	$114	$111
Benefits paid	$114	$111

The 1988 financial statements will include the following disclosures:

Cost Components		Reconciliation of Funded Status	
Service cost	$ 72	Projected benefit obligation	$(1,266)
Interest cost	108	Plan assets at fair value	1,068
Actual return on assets	(188)		
Net amortization and deferral	122 [j]	Funded status	(198)
		Unrecognized net obligation existing at January 1, 1987	160
Net cost	$114	Unrecognized prior service cost	0
		Unrecognized net (gain) or loss	38
		(Accrued)/prepaid	$ 0

1989—ASSET LOSS AND LIABILITY GAIN

When Company I's plan assets and obligations were measured at December 31, 1989, both an asset loss and a liability gain were discovered.

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 12/31/88	For 1989	Projected 12/31/89	Actual 12/31/89	For 1990	Projected 12/31/90
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	(198)		(178)	(223)		(203)
Unrecognized net obligation existing at January 1, 1987	160		140	140		120
Unrecognized prior service cost	0		0	0		0
Unrecognized net (gain) or loss	38		38	83		83
(Accrued)/prepaid	$ 0		$ 0	$ 0		$ 0
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:						
Unrecognized net obligation existing at January 1, 1987		20			20	
Unrecognized prior service cost		0			0	
Unrecognized net (gain) or loss		0 [l]			0 [l]	
Net cost	$111				$112	
Contribution	$111				$112	
Benefits paid	$111				$112	

The 1989 financial statements will include the following disclosures:

Cost Components	
Service cost	$ 76
Interest cost	114
Actual return on assets	(29)
Net amortization and deferral	(50) [m]
Net cost	$111

Reconciliation of Funded Status	
Projected benefit obligation	$(1,320)
Plan assets at fair value	1,097
Funded status	(223)
Unrecognized net obligation existing at January 1, 1987	140
Unrecognized prior service cost	0
Unrecognized net (gain) or loss	83
(Accrued)/prepaid	$ 0

Illustration 5—Recognition of Pension Liability, Including Minimum Liability

Case 1—Minimum Liability Less Than Unrecognized Prior Service Cost

Company K elected to apply the provisions of this Statement, including those requiring recognition of minimum liability, for its 1986 financial statements. The funded status of its plan for the years 1988 through 1991 is shown below.

	As of December 31,			
	1988	1989	1990	1991
	(in thousands)			
FUNDED STATUS—COMPANY K				
Assets and obligations:				
Accumulated benefit obligation	$(1,254)	$(1,628)	$(1,616)	$(1,554)
Plan assets at fair value	1,165	1,505	1,622	1,517
Unfunded accumulated benefits	$ (89)	$ (123)		$ (37)
Overfunded accumulated benefits			$ 6	
Projected benefit obligation	$(1,879)	$(2,442)	$(2,424)	$(2,331)
Plan assets at fair value	1,165	1,505	1,622	1,517
Items not yet recognized in earnings:				
Unrecognized net obligation (net asset) at January 1, 1986	280	260	240	220
Unrecognized prior service cost	715	1,314	1,172	1,039
Unrecognized net gain	(251)	(557)	(460)	(476)
(Accrued)/prepaid pension cost	$ 30	$ 80	$ 150	$ (31)
DETERMINATION OF AMOUNTS TO BE RECOGNIZED				
(Accrued)/prepaid pension cost at beginning of year	$ 0	$ 30	$ 80	$ 150
Net periodic pension cost	(304)	(335)	(397)	(361)
Contribution	334	385	467	180
(Accrued)/prepaid pension cost at end of year	$ 30	$ 80	$ 150	$ (31)
Required minimum liability (unfunded accumulated benefits)	$ (89)	$ (123)	$ 0	$ (37)
Adjustment required to reflect minimum liability:				
Additional liability [a]	$ (119)	$ (84)	$ 203	$ (6)
Intangible asset (not to exceed unrecognized prior service cost)	$ 119	$ 84	$ (203)	$ 6
Balance of additional liability	$ (119)	$ (203)	$ 0	$ (6)
Balance of intangible asset	$ 119	$ 203	$ 0	$ 6

Journal Entries

The journal entries required to reflect the accounting for the company's pension plan for the years 1988 through 1991 are as follows (in thousands):

Year 1988

Journal Entry 1

Net periodic pension cost	304	
Accrued/prepaid pension cost		304
To record net pension cost for the period (paragraph 35)		

Journal Entry 2

Accrued/prepaid pension cost	334	
Cash		334
To record contribution (paragraph 35)		

Journal Entry 3

Intangible asset	119	
Additional liability		119
To record an additional liability to reflect the required minimum liability (For financial statement presentation, the additional liability account balance is combined with the accrued/prepaid pension cost account balance. Since prepaid pension cost of $30 has been recognized, an additional liability of $119 is needed to reflect the required minimum liability of $89 [equal to unfunded accumulated benefits]. Because the additional liability is less than unrecognized prior service cost, an intangible asset also is recognized.) (paragraphs 36 and 37)		

Year 1989

Journal Entry 1

Net periodic pension cost	335	
Accrued/prepaid pension cost		335
To record net pension cost for the period (paragraph 35)		

Journal Entry 2

Accrued/prepaid pension cost	385	
Cash		385
To record contribution (paragraph 35)		

Journal Entry 3

Intangible asset	84	
Additional liability		84
To adjust the additional liability to reflect the required minimum liability (For financial statement presentation, the additional liability account balance is combined with the accrued/prepaid pension cost account balance. The required minimum liability is determined independently of any prior years' amounts. Since unfunded accumulated benefits are $123 and a prepaid pension cost of $80 has been recognized, the amount of the additional liability is $203 or an increase of $84 from the previous period. Because the balance of the additional liability is less than unrecognized prior service cost, an intangible asset also is recognized.) (paragraphs 36 and 37)		

Year 1990

Journal Entry 1

Net periodic pension cost	397	
Accrued/prepaid pension cost		397
To record net pension cost for the period (paragraph 35)		

Journal Entry 2

Accrued/prepaid pension cost	467	
Cash		467
To record contribution (paragraph 35)		

Journal Entry 3

Additional liability	203	
Intangible asset		203
To reverse additional liability no longer required (Since plan assets exceed accumulated benefits, no additional liability is necessary.) (paragraph 38)		

Year 1991

Journal Entry 1

Net periodic pension cost	361	
Accrued/prepaid pension cost		361
To record net pension cost for the period (paragraph 35)		

Journal Entry 2

Accrued/prepaid pension cost	180	
Cash		180
To record contribution (paragraph 35)		

Journal Entry 3

Intangible asset	6	
Additional liability		6
To record an additional liability to reflect the required minimum liability amount (For financial statement presentation, the additional liability account balance is combined with the accrued/prepaid pension cost account balance. Since unfunded accumulated benefits of $37 exceed unfunded accrued pension cost of $31, recognition of an additional liability of $6 is necessary. Because the balance of additional liability is less than unrecognized prior service cost, an intangible asset also is recognized.) (paragraphs 36 and 37)		

Case 2—Minimum Liability in Excess of Unrecognized Prior Service Cost

Company L elected to apply the provisions of this Statement, including those requiring recognition of minimum liability, for its 1986 financial statements. The funded status of its plan for the years 1988 and 1989 is shown below.

	As of December 31,	
	1988	1989
	(in thousands)	
FUNDED STATUS—COMPANY L		
Assets and obligations:		
Accumulated benefit obligation	$(1,270)	$(1,290)
Plan assets at fair value	1,200	1,304
Unfunded accumulated benefits	$ (70)	
Overfunded accumulated benefits		$ 14
Projected benefit obligation	$(1,720)	$(1,807)
Plan assets at fair value	1,200	1,304
Items not yet recognized in earnings:		
Unrecognized prior service cost	92	86
Unrecognized net loss	486	497
(Accrued)/prepaid pension cost	$ 58	$ 80
DETERMINATION OF AMOUNTS TO BE RECOGNIZED		
(Accrued)/prepaid pension cost at beginning of year	$ 0	$ 58
Net periodic pension cost	(141)	(144)
Contribution	199	166
(Accrued)/prepaid pension cost at end of year	$ 58	$ 80
Required minimum liability (unfunded accumulated benefits)	$ 70	$ 0
Adjustment required to reflect minimum liability:		
Additional liability [a]	$ (128)	$ 128
Intangible asset (not to exceed unrecognized prior service cost)	$ 92	$ (92)
Charge to equity (excess of additional pension liability over unrecognized prior service cost)	$ 36	$ (36)
Balance of additional liability	$ (128)	$ 0
Balance of intangible asset	$ 92	$ 0
Balance of equity account	$ 36	$ 0

Journal Entries

The journal entries required to reflect the accounting for the company's pension plan for the years 1988 and 1989, are as follows (in thousands):

Year 1988

Journal Entry 1

Net periodic pension cost	141	
Accrued/prepaid pension cost		141
To record net pension cost for the period (paragraph 35)		

Journal Entry 2

Accrued/prepaid pension cost	199	
Cash		199
To record contribution (paragraph 35)		

Journal Entry 3

Excess of additional pension liability over unrecognized prior service cost	36	
Intangible asset	92	
Additional liability		128
To record an additional liability to reflect the required minimum liability (For financial statement presentation, the additional liability account balance is combined with the accrued/prepaid pensioncost account balance. Since prepaid pension cost of $58 has beenrecognized, an additional liability of $128 is needed to reflect the required minimum liability of $70 [equal to unfunded accumulated benefits]. Because the additional liability is greater than unrecognized prior service cost, an intangible asset is recognized for the amount of additional liability up to the amount of unrecognized prior service cost, and equity is charged for the excess of the additional liability over unrecognized prior service cost.) (paragraphs 36 and 37)		

Year 1989

Journal Entry 1

Net periodic pension cost	144	
Accrued/prepaid pension cost		144
To record net pension cost for the period (paragraph 35)		

Journal Entry 2

Accrued/prepaid pension cost	166	
Cash		166
To record contribution (paragraph 35)		

Journal Entry 3

Additional liability	128	
Excess of additional pension liability over unrecognized prior service cost		36
Intangible asset		92
To reverse additional liability no longer required (Since plan assets exceed accumulated benefits, no additional liability is necessary.) (paragraph 38)		

Illustration 6—Disclosure Requirements

Case 1—Simple Case

The following illustrates the disclosure for a sponsor with a single-employer defined benefit pension plan presenting only one year's financial statements.

Note P: The company has a defined benefit pension plan covering substantially all of its employees. The benefits are based on years of service and the employee's compensation during the last five years of employment. The company's funding policy is to contribute annually the maximum amount that can be deducted for federal income tax purposes. Contributions are intended to provide not only for benefits attributed to service to date but also for those expected to be earned in the future.

The following table sets forth the plan's funded status and amounts recognized in the company's statement of financial position at December 31, 1988 (in thousands):

Actuarial present value of benefit obligations:	
Accumulated benefit obligation, including vested benefits of $287	$(335)
Projected benefit obligation for service rendered to date	$(500)
Plan assets at fair value, primarily listed stocks and U.S. bonds	475
Projected benefit obligation in excess of plan assets	(25)
Unrecognized net gain from past experience different from that assumed and effects of changes in assumptions	(53)
Prior service cost not yet recognized in net periodic pension cost	19
Unrecognized net obligation at January 1, 1986 being recognized over 15 years	77
Prepaid pension cost included in other assets	$ 18

Net pension cost for 1988 included the following components (in thousands):

Service cost—benefits earned during the period	$ 26
Interest cost on projected benefit obligation	39
Actual return on plan assets	(45)
Net amortization and deferral [a]	10
Net periodic pension cost	$ 30

The weighted-average discount rate and rate of increase in future compensation levels used in determining the actuarial present value of the projected benefit obligation were 9 percent and 6 percent, respectively. The expected long-term rate of return on assets was 10 percent.

Case 2—Disclosures for Multiple Plans

Note S: The company and its subsidiaries have a number of noncontributory pension plans covering substantially all U.S. employees. Plans covering salaried and management employees provide pension benefits that are based on the employee's compensation during the three years before retirement. The company's funding policy for those plans is to contribute annually at a rate that is intended to remain a level percentage of compensation for the covered employees (presently 12.9 percent). Plans covering hourly employees and union members generally provide benefits of stated amounts for each year of service and provide for significant supplemental benefits for employees who retire with 30 years of service before age 65. The company's funding policy for those plans is to make the minimum annual contributions required by applicable regulations.

Net periodic pension cost for 1988 and 1987 included the following components (in thousands):

	1988	**1987**
Service cost—benefits earned during the period	$ 66	$ 66
Interest cost on projected benefit obligation	100	96
Actual return on assets	(79)	(63)
Net amortization and deferral	88	78
Net periodic pension cost	$175	$177

Assumptions used in the accounting were:

	As of December 31,	
	1988	**1987**
Discount rates	9.0%	8.75%
Rates of increase in compensation levels	6.0%	6.0%
Expected long-term rate of return on assets	9.5%	9.5%

The following table sets forth the plan's funded status and amounts recognized in the company's statement of financial position at December 31, 1988 and 1987, for its U.S. pension plans (in thousands):

	December 31, 1988		**December 31, 1987**	
	Assets Exceed Accumulated Benefits	**Accumulated Benefits Exceed Assets**	**Assets Exceed Accumulated Benefits**	**Accumulated Benefits Exceed Assets**
Actuarial present value of benefit obligations:				
Vested benefit obligation	$(298)	$(385)	$(268)	$(363)
Accumulated benefit obligation	$(339)	$(442)	$(311)	$(427)
Projected benefit obligation [a]	$(502)	$(620)	$(470)	$(640)
Plan assets at fair value [b]	604	228	548	205
Projected benefit obligation (in excess of) or less than plan assets	102	(392)	78	(435)
Unrecognized net (gain) or loss	(114)	30	(117)	41
Prior service cost not yet recognized in net periodic pension cost	120	292	132	321
Unrecognized net obligation at January 1, 1986	180	225	200	250
Adjustment required to recognize minimum liability	0	(369)	0	(399)
Prepaid pension cost (pension liability) recognized in the statement of financial position	$ 288	$(214)	$ 293	$(222)

Case 3—Disclosure for a Defined Contribution Plan

Note T: The company sponsors a defined contribution pension plan covering substantially all of its employees in both its engine parts and tire subsidiaries. Contributions and cost are determined as 1.5 percent of each covered employee's salary and totaled $231,000 in 1987 and $215,000 in 1986.

Case 4—Disclosure for a Multiemployer Plan

Note W: One of the company's subsidiaries participates in a multiemployer plan. The plan provides defined benefits to substantially all unionized workers in the company's trucking subsidiary. Amounts charged to pension cost and contributed to the plan in 1987 and 1986 totaled $598,000 and $553,000, respectively.

Illustration 7—Accounting for a Business Combination

The following example illustrates how the liability (or asset) recognized by the acquiring firm at the date of a business combination accounted for as a purchase would be reduced in years subsequent to the date of the business combination.

Company R purchased Company S on January 1, 1987. Company S sponsors a single-employer defined benefit pension plan. The reconciliation of funded status of the Company S plan before and after the combination was as follows (in thousands):

	Precombination	Postcombination
Pension benefit obligation	$(1,000)	$(1,000)
Plan assets at fair value	500	500
Unrecognized loss	200	0
Unrecognized prior service cost	300	0
Liability recognized in the statement of financial position—unfunded accrued pension cost	$ 0	$ (500)

In subsequent periods, net periodic pension cost would not include any amortization of either the unrecognized prior service cost or the unrecognized loss existing at the date of the combination. However, the funding of the plan is not directly affected by a business combination. Whatever the basis of funding, it will, over time, reflect the past amendments and losses that underlie those amounts. As they are reflected in the funding process, contributions will, in some periods, exceed the net pension cost, and that will reduce the liability (unfunded accrued pension cost) recognized at the date of acquisition.

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 previously *unrecognized* amounts, including unrecognized prior service cost and unrecognized net gain or loss.

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**.

Fair value

The amount that a pension plan could reasonably expect to receive for an investment in a current sale between a willing buyer and a willing seller, that is, other than in a forced or liquidation sale.

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. See also **Unrecognized net gain or loss**.

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 unrecognized net gain or loss from previous periods. The gain or loss component is the net effect of delayed recognition of gains and losses (the net change in the unrecognized net gain or loss) except that it does not include changes in the projected benefit obligation occurring during the period and deferred for later recognition.

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.

Measurement date

The date as of which plan assets and obligations are measured.

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 unrecognized prior service cost, and amortization of the unrecognized net obligation or asset 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. See also **Unrecognized prior service cost**.

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 accumulated benefit obligation

The excess of the accumulated benefit obligation over plan assets.

Unfunded projected benefit obligation

The excess of the projected benefit obligation over plan assets.

Unrecognized net gain or loss

The cumulative net gain or loss that has not been recognized as a part of net periodic pension cost. See **Gain or loss**.

Unrecognized prior service cost
That portion of prior service cost that has not been recognized as a part of net periodic pension cost.

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.

Footnotes

FAS87, Footnote 1--Words that appear in the glossary are set in **boldface type** the first time that they appear.

FAS87, Footnote 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.

FAS87, Footnote 3--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.

FAS87, Footnote 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*.

FAS87, Footnote 5--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 No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*.

FAS87, Footnote 6--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.

FAS87, Footnote 7--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.

FAS87, Footnote 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.

FAS87, Footnote 9--For example, a supplemental early retirement benefit that is a vested benefit after a stated number of years.

FAS87, Footnote 10--For example, a death or disability benefit that is payable only if death or disability occurs during active service.

FAS87, Footnote 11--For example, those currently imposed by Section 415 of the Internal Revenue Code.

FAS87, Footnote 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.

FAS87, Footnote 13--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.

FAS87, Footnote 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.

FAS87, Footnote 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.

FAS87, Footnote 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.

FAS87, Par. 261, Ill. 4, Footnote a--Throughout this illustration the service cost component is assumed as an input rather than calculated as part of the illustration.

FAS87, Par. 261, Ill. 4 Footnote b--
(Actual projected benefit obligation at 12/31/87) + (service component) + (interest component) - (benefits paid).

FAS87, Par. 261, Ill. 4, Footnote c--
(Actual plan assets at 12/31/87) + (expected return on assets) + (contributions) - (benefits paid).

FAS87, Par. 261, Ill. 4, Footnote d--Paragraph 32 provides that net periodic pension cost may be based on unrecognized net gain or loss as of the beginning of the period. In the year of transition (1987) the beginning balance of unrecognized net gain or loss is zero by definition. The minimum amortization of unrecognized net gain or loss is calculated as follows:

	1987	1988
Unrecognized net (gain) or loss at 1/1	$ 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
Unrecognized net (gain) or loss 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
Unrecognized net (gain) or loss outside corridor	0	20
x 1/average remaining service	0.10	0.10
Amortization	$ 0	$ 2

FAS87, Par. 261, Ill. 4, Footnote e--The "net amortization and deferral" consists of:

Amortization of unrecognized net obligation existing at January 1, 1987	$ 20
Amortization of unrecognized prior service cost	0
Amortization of unrecognized net (gain) or loss	0
Asset gain/(loss) deferred	0
	$ 20

FAS87, Par. 261, Ill. 4, Footnote f--The (accrued)/prepaid is the amount included in the company's statement of financial position. If the accumulated benefit obligation had been greater than the plan assets, an additional minimum liability would have been required and would have been shown as an additional item in this reconciliation.

FAS87, Par. 261, Ill. 4 Footnote g--Expected return on plan assets = (expected long-term rate of return on plan assets) x (market-related value of plan assets). If contributions occurred other than at the end of the year, market-related value would consider those amounts.

FAS87, Par. 261, Ill. 4, Footnote 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 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 & (losses)	20
Market-related value of assets at 12/31	$988

FAS87, Par. 261, Ill. 4, Footnote i--Amortization of unrecognized net gain or loss is calculated as follows:

	1988	1989
Unrecognized net (gain) or loss at 1/1	$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
Unrecognized net (gain) or loss 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
Unrecognized net (gain) or loss outside corridor	20	0
x 1/average remaining service	0.10	0.10
Amortization	$ 2	$ 0

FAS 87, Par. 261, Ill. 4, Footnote j--The "net amortization and deferral" consists of:

Amortization of unrecognized net obligation existing at January 1, 1987	$ 20
Amortization of unrecognized prior service cost	0
Amortization of unrecognized net (gain) or loss	2
Asset gain/(loss) deferred	100
	$122

FAS87, Par. 261, Ill. 4, Footnote 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 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 & (losses) = .20 (100 - 70)	6
Market-related value of assets at 12/31	$1093

FAS87, Par. 261, Ill. 4, Footnote l--Amortization of unrecognized net gain or loss is calculated as follows:

	1989	1990
Unrecognized net (gain) or loss at 1/1	$ 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
Unrecognized net (gain) or loss 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
Unrecognized net (gain) or loss outside corridor	0	0
x 1/average remaining service	0.10	0.10
Amortization	$ 0	$ 0

FAS 87, Par. 261, Ill. 4, Footnote m--The "net amortization and deferral" consists of:

Amortization of unrecognized net obligation existing at January 1, 1987	$ 20
Amortization of unrecognized prior service cost	0
Amortization of unrecognized net (gain) or loss	0
Asset gain/(loss) deferred	(70)
	$(50)

FAS87, Par. 261, Ill. 5, Case 1 Footnote a--This amount is equal to unfunded accumulated benefits, plus prepaid (or minus accrued) pension cost, minus the previous balance. For financial statement presentation, the additional liability is combined with the (accrued)/prepaid pension cost.

FAS87, Par. 261, Ill. 5, Case 2 Footnote a--This amount is equal to unfunded accumulated benefits, plus prepaid (or minus accrued) pension cost, minus the previous balance. For financial statement presentation, the additional liability is combined with the (accrued)/prepaid pension cost.

FAS87, Par. 261, Ill. 6, Case 1 Footnote a--The net effects of delayed recognition of certain events (for example, unanticipated investment performance) arising during the current period and amortization (recognition) of the net unrecognized effects of past similar events at a rate based on employees' average remaining service life.

FAS87, Par. 261, Ill. 6, Footnote a--The projected benefit obligation and plan assets at December 31, 1988 and 1987 do not include amounts related to an annuity contract purchased from an affiliated company covering annual benefits of approximately $42.

FAS87, Par. 261, Ill. 6, Footnote b--Plan assets include common stock of the company of $50 and $45 at December 31, 1988 and 1987, respectively. About half of the plan assets are invested in listed stocks and bonds. The balance is invested in income-producing real estate.