

Pension Accounting Reform School
A Brief Introduction to SFAS No. 158

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What Did the FASB Threaten to Do?

- Fully recognize the outstanding balance of transition asset/obligation.
- Define funded status with Projected Benefit Obligation (PBO) rather than Accumulated Benefit Obligation (ABO).

(Move the PBO from the footnotes to the statement of financial position.)

- Change the definition of Accumulated Other Comprehensive Income.
- Make the end of the fiscal year the only measurement date.
- Apply changes retroactively.

What Did the FASB Threaten to Do?

Example of one of the things they didn't like.

PBO	10,000,000	
FVA	9,000,000	
Funded Status	(1,000,000)	
Unrecognized Prior Service Cost	500,000	
Unrecognized Loss	2,000,000	
Unrecognized Trans		
Net Amount Recognized	1,500,000	(prepaid pension cost)

The sponsor had contributed \$1,500,000 more than they had expensed thus they had a \$1,500,000 “asset” yet they had \$1,000,000 more liability than they had assets.

FASB did everything but fully recognize the outstanding balance of the transition asset/obligation and require retroactive application

Why these changes? To improve financial reporting.

- Reporting is more complete because funded status is moved from the notes to the statement of financial position.
- Reporting is more timely because transactions and events affecting funded status appear in comprehensive income in the year they occur. Measurements are as of fiscal year-end.
- Reporting is more understandable because no more need for a reconciliation from what is in the notes to the financial statement.

Why did FASB not call for full recognition of outstanding balance of transition asset/obligation?

That would have been a modification to Expense. This “Phase 1” was only concerned with Disclosure.

FASB concluded the costs would have exceeded the benefits. (FAS’87 has been around so long now is transition asset/obligation really significant?)

Changes in Expense reporting are being contemplated for a later Phase.

Why did FASB not call for retroactive application?

FASB concluded the costs would have exceeded the benefits.

Define Funded Status with PBO Rather Than ABO

Accrued Benefit Liability (unfunded ABO) is replaced by Funded Status (unfunded PBO.)

For plans where PBO equals ABO this won't be a change.

- Frozen plans
- Flat benefit/hourly plans
- Career average plans?

All other plans will have to recognize the liability associated with (expected) future salary increases that is inherent in the PBO.

Define Funded Status with PBO Rather Than ABO

Accrued Benefit Liability (unfunded ABO) is replaced by Funded Status (unfunded PBO.)

There are compelling arguments for and against this (and the other changes) Is it “right?” Is it “wrong?”

It’s accounting.

A thorough read of SFAS 158 (especially Appendix B – Background Information and Basis for Conclusions) reveals all the arguments for.

Of all the arguments against that I have seen I think the one by COPA was the best. See “FASB Comments” at

www.CollegeOfPensionActuaries.org/CommentLetters

Define funded status with PBO rather than ABO

Accrued Benefit Liability (unfunded ABO) is replaced by Funded Status (unfunded PBO.)

For retiree medical plans this is not a change since they used Accumulated Postretirement Benefit Obligation (APBO) under the old rules and the new rules don't change this. APBO is analogous to PBO.

Define funded status with PBO rather than ABO

Effective Date

For a publicly traded sponsor, the end of the fiscal year ended after December 15, 2006.

For a non publicly traded sponsor, the end of the fiscal year ended after June 15, 2007.

Change the Definition of Accumulated Other Comprehensive Income (AOCI) (AOCI used to be called Reduction in Equity.)

Under the old definition AOCI was a balancing item.

(It could be calculated directly.)

When it existed it (along with any intangible asset) effectively reconciled the Accrued Benefit Liability (unfunded ABO) with the Net Amount Recognized.

Disadvantages included

- Difficulty explaining it and reconciling it from year to year.
- The Intangible Asset could mix a PBO number with an ABO number and that was logically inconsistent.

Advantages? We were all so used to it! (Is tradition worth nothing?)

Change the Definition of Accumulated Other Comprehensive Income (AOCI)

Under the new definition AOCI is simply the sum of the outstanding balance of unrecognized prior service costs, unrecognized gain/loss and unrecognized transition asset/obligation.

It exists whenever any of these items exist, whether or not there is an unfunded ABO.

It reconciles the Funded Status with the Net Amount Recognized. (So it still can be viewed as a balancing item.)

Change the Definition of Accumulated Other Comprehensive Income (AOCI)

Advantages?

- it is easy to explain and reconcile
- It may increase equity?

Disadvantages?

- it may be much larger than the old definition
- sponsors can no longer contribute their way out of an AOCI*

Change the Definition of Accumulated Other Comprehensive Income (AOCI)

Effective Date

Same as the effective date for defining funded status with PBO rather than ABO.

For a publicly traded sponsor, the end of the fiscal year ended after December 15, 2006.

For a non publicly traded sponsor, the end of the fiscal year ended after June 15, 2007.

Illustrative Example 1

	(old) FAS'132	(new) FAS'158
PBO	12,000,000	12,000,000
ABO	10,000,000	10,000,000
FVA	8,000,000	8,000,000
Funded Status	(4,000,000)	(4,000,000)
Unrecognized Prior		
Service Cost	1,500,000	1,500,000
Unrecognized Loss	2,300,000	2,300,000
Unrecognized Transition	800,000	800,000
Net Amount Recognized	600,000	600,000
Prepaid Benefit Cost	-	-
(Benefit Liability)	(2,000,000)	(4,000,000)
Intangible Asset	2,300,000	N/A
Accumulated Other		
Comprehensive Income	300,000	4,600,000
Net Amount Recognized	600,000	600,000

Illustrative Example 2

	(old) FAS'132	(new) FAS'158
PBO	10,000,000	10,000,000
ABO	7,000,000	7,000,000
FVA	8,000,000	8,000,000
Funded Status	(2,000,000)	(2,000,000)
Unrecognized Prior		
Service Cost	1,300,000	1,300,000
Unrecognized Loss	2,000,000	2,000,000
Unrecognized Transition	200,000	200,000
Net Amount Recognized	1,500,000	1,500,000
Prepaid Benefit Cost		-
(Benefit Liability)		(2,000,000)
Intangible Asset		N/A
Accumulated Other		
Comprehensive Income		3,500,000
Net Amount Recognized		1,500,000

Illustrative (?) Example 3

	(old) FAS'132	(new) FAS'158
PBO	10,000,000	10,000,000
ABO	7,000,000	7,000,000
FVA	8,000,000	8,000,000
Funded Status	(2,000,000)	(2,000,000)
Unrecognized Prior Service Cost	700,000	700,000
Unrecognized (Gain)	(2,000,000)	(2,000,000)
Unrecognized Transition	-	-
Net Amount Recognized	(3,300,000)	(3,300,000)
Prepaid Benefit Cost (Benefit Liability)		- (2,000,000)
Intangible Asset		N/A
Accumulated Other Comprehensive Income		(1,300,000)
Net Amount Recognized		(3,300,000)

Make the End of the Fiscal Year the Only Measurement Date

Under the old rules a measurement date could be up to three months before the fiscal year-end.

Under the new rules the measurement date must be the fiscal year-end.

There are exceptions. For example, a plan that is sponsored by a subsidiary that is consolidated using a fiscal period that differs from its parent.

If a parent company with a calendar year-end has a subsidiary with a September 30 year-end the measurement date for the subsidiary in the consolidated statement is September 30, not December 31.

Make the End of the Fiscal Year the Only Measurement Date

Effective Date

Fiscal year ending after December 15, 2008.

Earlier application is encouraged but earlier application must be for all of an employer's plans.

Make the End of the Fiscal Year the Only Measurement Date

FAS' 158 provides two approaches to transition to a fiscal year-end measurement date.

First Approach: Measure assets and obligations as of the beginning of the fiscal year that the new measurement date provisions are applied.

Example. Assume no early application.

Fiscal year is calendar year but measurement date is 9/30.

Assets and liabilities measured at 12/31/07 (1/1/08?)

Under this approach you will effectively have a short fiscal year 10/1/07 to 12/31/07 to deal with. (Talk to the accountant.)

Make the End of the Fiscal Year the Only Measurement Date

FAS' 158 provides two approaches to transition to a fiscal year-end measurement date.

Second Approach: Use measurements determined for the year-end reporting as of the fiscal year immediately preceding the year the measurement date provisions are applied.

Example. Assume no early application.

Fiscal year is calendar year but measurement date is 9/30.

Assets and liabilities measured at 9/30/07 (10/1/07?)

Under this approach you will effectively have a long fiscal year 10/1/07 to 12/31/08 to deal with. (Talk to the accountant.)

Odds & Ends

Current Liability and Noncurrent Liability

Current Liability is the amount by which the value of benefits payable in the upcoming 12 months exceeds the fair value of assets. Noncurrent Liability is the rest.

How many funded qualified plans don't have enough assets to cover 12 months of benefit payments?

In effect applicable to only unfunded nonqualified plans.

Odds & Ends

Disclose the amounts in accumulated other comprehensive income expected to be recognized as components of net periodic benefit cost over the following fiscal year, showing separately the net gain or loss, net prior service cost or credit, and net transition asset or obligation.

What Should We Actuaries Be Doing?

- Make sure sponsors know this is coming and what it could mean.

Sponsors who have gotten used to avoiding the AOCI by making a contribution the day before the fiscal year-end may not comprehend they cannot do that anymore.

We are many years into an era of steadily declining discount rates so there are probably large unrecognized losses.

Sponsors may not comprehend that all those losses will go directly into the AOCI.

- Work closely with the accountants and be proactive. Call them before they call you.

Details of implementing the change to a year-end measurement date will require actuary and accountant to put their heads together.

What's Really Going On? Outside-In and Inside-Out

Return to Example 2

	(old) FAS'132	(new) FAS'158
PBO	10,000,000	10,000,000
ABO	7,000,000	7,000,000
FVA	8,000,000	8,000,000
Funded Status	(2,000,000)	(2,000,000)
Unrecognized Prior		
Service Cost	1,300,000	1,300,000
Unrecognized Loss	2,000,000	2,000,000
Unrecognized Transition	200,000	200,000
Net Amount Recognized	1,500,000	1,500,000
Prepaid Benefit Cost		-
(Benefit Liability)		(2,000,000)
Intangible Asset		N/A
Accumulated Other		
Comprehensive Income		3,500,000
Net Amount Recognized		1,500,000

What's Really Going On? Outside-In and Inside-Out

Under the old rules there is an asset of \$1,500,000, the Net Amount Recognized, a.k.a. prepaid pension cost.

One way of looking at this number is it indicates that the sponsor has contributed \$1,500,000 more than it has expensed. In this sense it represents an asset. (Like a Credit Balance.)

But PBO is \$2,000,000 greater than the assets.

How can we say the pension plan represents an asset of \$1,500,000 when it is underfunded by \$2,00,000? There's a \$3,500,000 discrepancy here. (This discrepancy was one of the things that people didn't like about the old rules.)

The \$3,500,000 discrepancy can be explained by the outstanding balances of the prior service cost, loss and transition obligation.

What's Really Going On? Outside-In and Inside-Out

Rather than think of the Net Amount Recognized as the cumulative difference between amounts contributed and amounts expensed think of it as follows.

Total PBO is \$10,000,000. \$1,300,000 of this is being “taken care of” by some other accounting mechanism - the expense each year contains an amortization of this prior service cost.

$$\$10,000,000 - \$1,300,000 = \$8,700,000.$$

Similarly for the loss and transition obligation.

$$\$8,700,000 - \$2,000,000 - \$200,000 = \$6,500,000.$$

So of the \$10,000,000 PBO all but \$6,500,000 is being “taken care of” by another accounting mechanism. Since there are \$8,000,000 in assets the plan is thus \$1,500,000 overfunded.

What's Really Going On? Outside-In and Inside-Out

Under the old rules the accounting measure of funded is the Net Amount Recognized = \$1,500,000. With this measure there is liability on the outside being brought in each year.

It is being brought in because each year the outstanding balances are reduced by the amortization components in the expense so the amount subtracted from the PBO gets smaller.

Under the new rules all this liability that was outside is brought inside because the AOCI is defined to be the outstanding balances of the prior service cost, loss and transition obligation.

Each year the amortization components in the expense act to decrease the balances in the AOCI.

What's Really Going On? Outside-In and Inside-Out

Under the old rules liability was kept outside and gradually brought in. Under the new rules the liability that was outside is brought inside and gradually brought out.

In the Red-Line version of FAS'87, for example, you see phrases like, “*amortization of unrecognized prior service cost*” replaced with phrases like, “*amortization of prior service cost included in AOCI*”

“unrecognized prior service” = outside

“prior service cost included” = inside