VOLUME 13, CHAPTER 11: "ACCOUNTING FOR DEFINED BENEFIT PENSION AND OTHER POSTRETIREMENT PLANS"

SUMMARY OF MAJOR CHANGES

All changes are denoted by blue font.

Substantive revisions are denoted by an * symbol preceding the section, paragraph, table, or figure that includes the revision.

Unless otherwise noted, chapters referenced are contained in this volume.

Hyperlinks are denoted by ***bold, italic, blue and underlined font*.**

The previous version dated November 2009 is archived.

PARAGRAPH	EXPLANATION OF CHANGE/REVISION	PURPOSE
1102	Added "for Terms in Financial Accounting Statement No. 158" to the title of "Definitions" for specific terms used in Financial Accounting Statement No. 158 and re-numbered section number (previously Section 1103).	Update
1103	Added basic pension accounting principles for clarity and understanding.	Add
1107	Added basic pension funding (liability) principles for clarity and understanding.	Add

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CHAPTER 11

ACCOUNTING FOR DEFINED BENEFIT PENSION AND OTHER POSTRETIREMENT PLANS

1101 OVERVIEW

110101. Purpose

This chapter provides requirements to account for defined benefit pension and other postretirement plans for single-employer plans. This chapter does not pertain to Military Department plans that are considered multi-employer. The annual reporting of Pension Plan assets and liabilities shall be in conformance with ***Financial Accounting Standards Board Statement (FAS) No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans"***. FAS No. 158 addresses the concern that employers' existing accounting standards for defined benefit pension and postretirement plans fail to produce complete and understandable financial statements. In June 2009, all authoritative issuances of the Financial Accounting Standard Board were codified, to include Financial Accounting Statements (FAS), Interpretations (FIN), Technical Bulletins (FTB), and Staff Positions (FSP). Additionally, many other standard setters, including Accounting Principles Board (APB) Opinions, Accounting Interpretations (AIN), American Institute of Certified Public Accountant (AICPA), and Emerging Issues Task Force (EITF), were sources for the standards. FAS No. 158 cross references to the Codification Topics 715 and 958 and Subtopics 20, 30 and 60.

110102. Scope

The policies in this chapter apply to Department of Defense Nonappropriated Fund Instrumentalities (NAFIs), their supporting Accounting Offices, and joint-Service NAFI exchanges. This chapter provides basic pension accounting and funding principles and a review of the standards contained within FAS No. 158. Each NAFI and its Certified Public Accounting (CPA) firm providing financial services support should fully review the exceptions and variables associated with pension accounting prior to implementation.

*1102 DEFINITIONS FOR TERMS IN FINANCIAL ACCOUNTING STATEMENT NO. 158

The standards contained within FAS No. 158 improve existing reporting for defined benefit pension and postretirement plans by requiring an employer to recognize certain financial activity occurring in the plans in his financial statements. This activity includes the overfunded or underfunded status of defined benefit pension and postretirement plans in the balance sheet. The actuarial gains and losses, prior service costs, transition obligations, and credits that arise during the period will continue to be recognized through the income statement with several variations. In addition, it will improve the understanding of the types of plans for the financial statement reader. Several terms that the NAFIs and Military Departments should be aware of relating to FAS No. 158 follow:

110201. Plan Assets (PA)

The amount a pension plan could reasonably expect to receive for a current sale of assets held for pension benefits.

110202. Projected Benefit Obligation (PBO)

The actuarial present value, as of a specified date, of all employees' vested and non-vested pension benefits that have been attributed by the pension benefit formula to services performed by employees.

110203. Funded Status

The difference between PBO (also known as the pension liability) and the PA at fair value.

110204. Measurement Date

The date of the employer's fiscal year-end statement of financial position. The PA and PBO must be measured as of this date. (Under the old rules this could be up to three months earlier.)

110205. Net Periodic Pension Cost (NPPC)

The annual expense incurred by the employer because of the pension plan. The NPPC is composed of the SC, interest costs, expected return on assets, amortization of prior service costs, transition obligations, and unrecognized gains or losses.

110206. Pension Provider

The organization that administers a Military Department's pension plan.

110207. Statement of Financial Position

The statement of financial position is another term for the balance sheet. The term "balance sheet" will be used in this volume.

*1103 Basic Pension Accounting Principles

110301. Disclosure

Pension accounting principles require pension costs to be recognized in a specific pattern to attribute the value of the benefits over a work life and require clear and consistent disclosure of pension costs, assets, and liabilities in the financial statements. ***FAS No. 87, Employers' Accounting for Pensions*** prescribes the single method that a NAFI must use to reflect the cost of pension plans on income statements and balance sheets.

110302. Measurement Date

Each NAFI selects a measurement date, generally the last day of the fiscal year. As of that date, each NAFI sets assumptions and gathers the participant data used to measure the obligations and determines the fair value of assets in the pension trust. Each NAFI uses these amounts to calculate the cost of the plan in the future year and determines if additional amounts must be recorded on the balance sheet.

110303. Basis for Calculations

The basis for calculations is the benefit obligations (i.e., PBO, the accumulated benefit obligation (ABO), and the service cost (SC) and the market related value of assets (MRVA). These are used to calculate the NPPC, which is the annual accounting expense or income each NAFI must recognize in its income statement. The NPPC is made up of several components:

A. Service Cost (SC). SC is the annual accrual of benefits.

B. Market Related Value of Assets (MRVA). The MRVA is either the plan's market value of assets ("fair value") or a calculated asset value that recognizes changes in fair value in a systematic and rational manner over not more than five years.

C. Interest Cost. The interest cost is an increase in PBO associated with the passage of time during the year. This is generally the discount rate multiplied by the beginning of year PBO adjusted for expected benefit payments.

D. Expected Return on Assets. The expected return on assets is an increase in PA associated with the passage of time during the year. This is offset against the other cost items and is generally the expected long term rate of return on assets multiplied by the beginning of year MRVA adjusted for expected benefit payments, contributions, and possibly for expected administrative expenses paid from the trust.

E. Amortization Amounts. Systematic recognition of certain changes, as follows:

1. Transition Obligation or Asset. Transition Obligation or Asset allows phased recognition on the income statement of the difference between the plan's funded status (PBO less PA) and accrued or prepaid cost on the balance sheet when the NAFIs first transitioned to this statement.

2. Prior Service Cost. Prior Service Cost allows phased recognition on the income statement of changes in the PBO associated with a plan amendment. This amount is generally amortized over the average remaining service period of plan participants.

3. Unrecognized Gains or Losses. Unrecognized gains or losses allow phased recognition of actuarial gains or losses. Actuarial gains and losses that have not yet been reflected on the income statement are accumulated each year and amortized over the average remaining service period of plan participants only to the extent their total exceeds a threshold. The threshold may be up to 10 percent of the greater of the plan's PBO or MRVA.

F. Accrued or Prepaid Pension Cost. The amount on the balance sheet that is equal to the accumulated difference between past NPPC and past plan contributions. A prepaid pension cost arises when the plan contributions exceed the NPPCs or the NPPCs are less than zero. An accrued pension cost arises when the NPPCs exceed plan contributions or the NPPCs are greater than zero. For certain plans whose fair value of assets is less than the ABO, there will be an increase in liabilities that must be reflected on the balance sheet. Note that these amounts are reflected on the balance sheet only and do not affect the income statement.

1104 BALANCE SHEET CLASSIFICATIONS

The Military Departments will calculate the funded status of a benefit plan. The funded status should be determined as of the year-end statement date (measurement date) and is defined as the difference between the PBO and PA. Depending on the differences between the PBO and PA, several areas of the balance sheet could be affected. The following examples are provided.

110401. PA greater than PBO

An overfunded plan exists when the PA is greater than the PBO, and the difference would be classified as a non-current asset in the balance sheet.

110402. PA less than PBO

An underfunded plan exists when the PA is less than the PBO, and the difference would be classified as a liability (current or long term) in the balance sheet. The classification of the liability as a current or long term liability will be determined and provided by the Pension Provider, which is the Plan's Actuary.

110403. Adjustments

Once the funded status of a benefit plan is determined, adjustments may need to be made to existing pension balances in the balance sheet. These adjustments will be posted as an offset to the equity account in the balance sheet and can be either an addition or reduction to the equity section. These temporary adjustments are treated in the equity section of the balance sheet in the same manner as the "unrealized gains/losses on investments," pursuant to ***FAS No. 115***. In addition, these temporary adjustments are not calculated in the net worth determination. The final result of these entries will result in the funded status equaling either a non-current asset or a liability based on the difference of the PA and PBO. The provisions of ***FAS No. 158*** eliminate the accounting for the potential additional minimum liability, which resulted under the old requirement.

1105 INCOME STATEMENT CLASSIFICATIONS

The NPPC is the annual expense incurred by the employer because of the pension plan. Under ***FAS No. 158***, the pension expense will continue to be recognized as a component of the income statement similar to the previous reporting process. Accounting rules can produce a negative expense, which appears as income on the financial statements. While the expense

(debit) is recognized through the income statement, the second part of the entry (credit) results in adjustments to the balance sheet accounts, which have been expanded to include the adjustment to the equity account. The net of the SC, interest cost, and expected return on PA will continue to be an adjustment as a component of either the non-current asset or the liability, whichever component the NAFI is reflecting in the financial statements due to the new funded status. The amounts of the net gain or loss, net prior service costs or credits, and net transition asset or obligation will be offset against the equity account.

1106 DISCLOSURES

The CPA firm or external auditors receive annual valuation reports from outside actuaries to prepare the financial statement disclosures. At a minimum, the CPA firm will provide additional information about certain effects on net periodic benefit cost, and the amount and timing of any PA expected to be returned to the Military Departments and NAFIs. In addition, amounts recorded as adjustments to the equity section of the balance sheet will result in an adjustment to the income statement. The actuaries should provide this information to the CPA firm for inclusion in the audited financial statements.

*1107 BASIC PENSION FUNDING (LIABILITY) PRINCIPLES

110701. Calculation of Liabilities

A pension plan's liabilities can be calculated in different ways, but the same principles always apply. However, accounting and funding calculation principles are different. The actuary calculates the expected future pension payments for each participant in the plan using the entity's participant data and plan provisions. These future benefit payments consider the individual's compensation and service history, and when that individual might be expected to die, quit, become disabled or retire. Each future payment is discounted from the date of payment to present day using the actuarial assumptions. Actuaries call this discounted amount the present value of future benefits (PVFB) and it represents the present value of all benefits expected to be paid from the plan to current plan participants. If assumptions are correct (and if it were allowed), then the NAFI could theoretically set aside that amount of money in a plan today and it would cover payments from the plan, including those for service not yet rendered. Note this amount considers future service the participant is expected to earn and future pay increases.

110702. Cost Methods

Actuaries developed the following cost methods to be used to determine the amount of the liabilities (current and long-term) to be reported on the balance sheet. These cost methods divide the PVFB into past service, current year of service, and future years of service:

A. Actuarial Liability (AL). AL is the portion of the PVFB that is attributed to past service. This is the current value of the compensation that was deferred in prior years. For pension accounting purposes, the AL is referred to as the PBO. Different cost methods calculate the AL differently, but it always reflects past service only. Sometimes the AL reflects expected future pay increases because many pension plans are designed so that the retirement

benefit is based on the pay at retirement. To allow the plan sponsor to recognize the cost of the plan gradually over the participant's lifetime, the actuary considers the portion of the future benefit due to past service to already include expected future pay increases. The portion of the PVFB that only recognizes benefits accrued to date (i.e., without future pay increases) is called the present value of accumulated benefits (PVAB). This reflects current service and current salary. For pension funding, the PVAB may also be called the current liability; however, the current liability is calculated using Internal Revenue Service mandated interest and mortality assumptions. For pension accounting purposes, the PVAB is referred to as the ABO.

B. Normal Cost (NC). NC is the portion of the PVFB that is attributed to the current year of service. This is the current value of the compensation that is being deferred this year. Different cost methods calculate the NC differently, but generally it reflects the current year of service and may reflect expected future pay increases. For pension accounting purposes, the NC is referred to as the SC.

C. Present Value of Future Normal Costs (PVFNC). PVFNC is the portion of the PVFB that will be attributed to future years of service. It covers compensation that has not yet been earned. This number is not disclosed and is rarely used in any cost calculations. However, it is disclosed in valuation reports for plans that use the Entry Average Normal (EAN) funding method.

110703. Methods Used for Present Value of Future Benefits

PVFB can be divided into the AL, NC, and PVFNC under many different actuarial cost methods. The three most common cost methods are the Projected Unit Credit Cost Method (PUC), Unit Credit (UC) Cost Method, and the EAN Cost Method.

A. PUC Cost Method. This method considers expected future pay increases in the calculation of the liability and normal cost.

B. UC Cost Method. This method does not reflect expected future pay increases in the liability, and only reflects one year's expected growth in pay in the normal cost.

C. EAN Cost Method . This method tends to generate a normal cost from year-to-year that is a level percentage of payroll for each individual on the system with a single date of retirement, not multiple dates of retirement.