

# SFAS 158: Employers' Accounting for Pensions and Other Postretirement Benefits



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## SFAS 158 – Pensions and OPEBs

- Balance sheet asset/liability
- Measurement date
- Financial statement footnotes

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# **SFAS 158 – Employers’ Accounting for Pensions and Other Postretirement Benefits**

## **Overview and Background**



# SFAS 158 – Pensions and OPEBs

- Basic scope – Employers' US GAAP for single-employer defined benefit pension plans and other retiree benefit plans
  - Statement of financial position – Funded status of plans
  - Measurement date – Synchronized with financial statement date
  - Financial statement footnotes – Reflecting other changes
  - Profit and loss statement – No change



## Outside the Scope of SFAS 158

- Multiemployer plans
- Defined contribution plans
- Governmental plans
- Non-retiree postemployment benefits
- Individual deferred compensation contracts
- Reporting by plans (SFAS 35)
- Special accounting standards (for example, rules applicable to insurance companies)
- International accounting standards



## SFAS 158 – Scope

- Direct scope – Amendments to:
  - SFAS 87 – Employers’ Accounting for Pensions
  - SFAS 106 – Employers’ Accounting for OPEBs
  - SFAS 132R – Financial Statement Disclosures
  - SFAS 88 – Settlements and Curtailments
  - SFAS 130 – Reporting Comprehensive Income



## SFAS 158 – Scope

- Other GAAP involved:
  - SFAS 109 – Accounting for Income Taxes
  - SFAS 71 – Certain Types of Regulation
- Outside current scope:
  - APB 12 – Deferred Compensation Contracts
  - SFAS 35 – Plans' Accounting
  - SFAS 112 – Employers' Accounting for Non-Retirement Postemployment Benefits



# Summary of Key Current GAAP

- Income statement – Projected unit credit
  - Settlement basis measurement
  - Delay and deferral of prior service costs, gains or losses, and transition amounts
  - Smoothed value of plan assets
- Balance sheet
  - Prepaid or accrued benefit cost
  - Pension minimum liability for unfunded accumulated benefit obligation





## SFAS 158 – Why?

- Recent FASB review of cash balance plan
- Broad criticism of transparency and usefulness of pension/OPEB reporting
- SEC report on off-balance sheet arrangements
- Convergence with international accounting standards
- Other broad GAAP initiatives



# FASB Pension/OPEB Project

- Phase 1 – Recognition of PBO/APBO funded status on employer's balance sheet and change of measurement date
- Phase 2 – Comprehensive review of employers' accounting for defined benefit pension plans and OPEBs
  - After completion of Phase 1
  - In coordination with multiple broad initiatives, including convergence with international accounting standards



# **SFAS 158 – Employers' Accounting for Pensions and Other Postretirement Benefits**



# SFAS 158 – Key Elements

- Balance sheet recognition of plans' funded status
- Measurement date = Fiscal year end
- Footnote disclosure modifications



## SFAS 158 – Employer's Balance Sheet

- Balance sheet recognition of difference between market value of plan assets and PBO/APBO
- Prepaid/accrued pension cost – Presentation change, but no change in cost determination
- No intangible assets or obligations
- Entry can be credit or debit to OCI – Initial effect can either increase or decrease shareholder equity
- No retrospective application



# Recognition of Plan Funded Status

- Recognition on employer's balance sheet
  - Plan funded status – Replaces prepaid cost or unfunded accrued cost currently reported
  - Unrecognized balances previously disclosed in footnotes now recognized via charge or credit to other comprehensive income (component of shareholder equity), net of taxes
  - Overfunded plans reported separately from underfunded plans



# Recognition of Plan Funded Status

- Market value of plan assets
- - Pension PBO/APBO
- = Funded status recognized on balance sheet
  
- Unrecognized balance = Credit/(charge) to accumulated other comprehensive income
- - Current net AOCI for minimum liability = Change in shareholder equity
  
- Prepaid/(accrued) – Present only via calculation of difference between balance sheet asset/liability and AOCI



# Recognition of Plan Funded Status

- Aggregation of pensions and OPEB – Permissible for balance sheet amounts
- Balance sheet liability – Aggregation of plans with assets  $\leq$  PBO/APBO
- Balance sheet asset – Aggregation of plans with assets  $\geq$  PBO/APBO





## No Change to Cost Calculation

- Unrecognized balances retained for cost determination
  - Underlying basis of SFAS 88 recognition for income statement also remains intact
- Changes in plan funded status recognized immediately in credits/(charges) to OCI
- Prepaid/(accrued) cost – Continues to accumulate as difference between cost and contribution, but presented only indirectly via difference between balance sheet asset/liability and AOCI



# Beyond Minimum Liability

- Based on PBO
  - Note: In some cases (e.g., plan freeze),  
PBO=ABO
- Applies to both pensions and OPEBs
- No ceiling when assets exceed liabilities
  - Even plans with assets in excess of PBO will be affected ... typically, adversely
  - Employer contributions (including past excess amounts) will not erase or directly modify the OCI entry



## Example 1 – Simple Illustration

|  |                  |                |              |
|--|------------------|----------------|--------------|
| Projected benefit obligation           | (\$258,000)      |                |              |
| Market value of plan assets            | <u>\$227,000</u> |                |              |
| PBO funded status                      | (\$31,000)       |                |              |
| Unrecognized balances in footnotes     | \$74,000         |                |              |
|  |                  | <u>Current</u> | <u>New</u>   |
|  |                  | <u>Rules</u>   | <u>Rules</u> |
| Prepaid/(accrued) pension cost         | \$43,000         |                | \$0          |
| Asset/(liability) for pension benefits | \$0              |                | (\$31,000)   |
| Deferred tax asset                     |                  |                | \$25,900     |
| Accumulated other comprehensive income | \$0              |                | (\$48,100)   |



## Example 2 – Cannot Fund AOCI Away

|  |  |                      |                  |
|--|--|----------------------|------------------|
| Projected benefit obligation           |  |                      |                  |
| Pre-contribution plan assets           |  |                      |                  |
| Contribution                           |  |                      |                  |
| Post-contribution plan assets          |  |                      |                  |
| PBO funded status                      |  |                      |                  |
|  |  |                      |                  |
| Unrecognized balances in footnotes     |  |                      |                  |
|  |  |                      |                  |
|  |  | <u>Current Rules</u> | <u>New Rules</u> |
| Prepaid/(accrued) pension cost         |  | \$74,000             | \$0              |
| Asset/(liability) for pension benefits |  | \$0                  | \$0              |
| Deferred tax asset                     |  |                      | \$25,900         |
| Accumulated other comprehensive income |  | \$0                  | (\$48,100)       |



## Example 3 – Net Unrecognized Gain

|  |                      |                  |
|--|----------------------|------------------|
| Projected benefit obligation           | (\$258,000)          |                  |
| Market value of plan assets            | <u>\$227,000</u>     |                  |
| PBO funded status                      | (\$31,000)           |                  |
| Unrecognized balances in footnotes     | (\$4,000)            |                  |
|  | <u>Current Rules</u> | <u>New Rules</u> |
| Prepaid/(accrued) pension cost         | (\$35,000)           | \$0              |
| Asset/(liability) for pension benefits |                      | (\$31,000)       |
| Deferred tax asset/(liability)         |                      | (\$1,400)        |
| Accumulated other comprehensive income | \$0                  | \$2,600          |



## Example 4 – Plan with Minimum Liability

|  |                      |                  |
|--|----------------------|------------------|
| Projected benefit obligation           | (\$258,000)          |                  |
| Market value of plan assets            | <u>\$207,000</u>     |                  |
| PBO funded status                      | (\$51,000)           |                  |
| Unrecognized balances in footnotes     | \$74,000             |                  |
|  | <u>Current Rules</u> | <u>New Rules</u> |
| Prepaid/(accrued) pension cost         | \$23,000             | \$0              |
| Asset/(liability) for pension benefits |                      | (\$51,000)       |
| Deferred tax asset                     |                      | \$25,900         |
| Accumulated other comprehensive income | (\$7,800)            | (\$48,100)       |



## Example 5 – Pension + OPEB

|  | <u>Pension</u>       | <u>OPEB</u> |                  |             |
|--|----------------------|-------------|------------------|-------------|
| PBO/APBO                               | (\$258,000)          | (\$75,000)  |                  |             |
| Assets                                 | <u>\$227,000</u>     | <u>\$0</u>  |                  |             |
| Funded status                          | (\$31,000)           | (\$75,000)  |                  |             |
| Unrecognized amounts                   | \$74,000             | (\$3,000)   |                  |             |
|  | <u>Current Rules</u> |             | <u>New Rules</u> |             |
|  | <u>Pension</u>       | <u>OPEB</u> | <u>Pension</u>   | <u>OPEB</u> |
| Prepaid/(accrued)<br>Asset/(liability) | \$43,000             | (\$78,000)  | (\$31,000)       | (\$75,000)  |
| Deferred tax asset                     |                      |             | \$25,900         | (\$1,050)   |
| AOCI                                   | \$0                  | #N/A        | (\$48,100)       | (\$1,950)   |



## Example 6 – Year-to-Year Change

|                     | EOY 2008         | Amortization | New<br>Unrecognized | Other<br>Changes | EOY 2009         |
|---------------------|------------------|--------------|---------------------|------------------|------------------|
| PBO                 | (\$258,000)      |              | (\$3,000)           | (\$2,000)        | (\$263,000)      |
| Assets              | <u>\$227,000</u> |              | <u>(\$5,000)</u>    | <u>\$20,000</u>  | <u>\$242,000</u> |
| Funded Status       | (\$31,000)       |              |                     |                  | (\$21,000)       |
| Unrecognized Losses | \$74,000         | (\$5,000)    | \$8,000             |                  | \$77,000         |
| Asset/(Liability)   | (\$31,000)       |              | (\$8,000)           | \$18,000         | (\$21,000)       |
| Deferred Tax Asset  | \$25,900         | (\$1,750)    | \$2,800             |                  | \$26,950         |
| AOCI                | (\$48,100)       | \$3,250      | (\$5,200)           |                  | (\$50,050)       |





# S&P 500 Pension Plan Sponsors

| <b>Pensions</b>                                    | <b>2005</b>      | <b>2004</b>      |
|--|------------------|------------------|
| Projected Benefit Obligation                       | (1,488,857)      | (1,397,690)      |
| Market Value of Plan Assets                        | <u>1,344,019</u> | <u>1,243,992</u> |
| <b>PBO Funded Status</b>                           | <b>(144,838)</b> | <b>(153,699)</b> |
| PBO Funded Status                                  | (144,838)        | (153,699)        |
| Prepaid/(Accrued) Cost                             | <u>240,778</u>   | <u>226,788</u>   |
| <b>Unrecognized Gain/(Loss) and Other Balances</b> | <b>(385,616)</b> | <b>(380,487)</b> |
| SFAS 158 Pre-Tax Credit(CHarge) to AOCI            | (385,616)        | (380,487)        |
| Pre-Tax AOCI under Minimum Liability Rule          | <u>(116,032)</u> | <u>(113,653)</u> |
| <b>Pre-Tax Change to Equity from SFAS 158</b>      | <b>(269,584)</b> | <b>(266,834)</b> |
| Pre-Tax Change to Equity from SFAS 158             | (269,584)        | (266,834)        |
| Estimated Post-Tax Change                          | (175,230)        | (173,442)        |
| Aggregate % Reduction in Shareholder Equity        | -5.18%           | -5.51%           |
| <b>Median % Reduction in Shareholder Equity</b>    | <b>-2.87%</b>    | <b>-2.89%</b>    |



## S&P 500 OPEB Sponsors

| OPEBs  | 2005             | 2004             |
|--|------------------|------------------|
| Accumulated Postretirement Benefit Obligation      | (415,079)        | (405,751)        |
| Market Value of Plan Assets                        | <u>91,462</u>    | <u>84,517</u>    |
| <b>APBO Funded Status</b>                          | <b>(323,617)</b> | <b>(321,234)</b> |
| APBO Funded Status                                 | (323,617)        | (321,234)        |
| Prepaid/(Accrued) Cost                             | <u>(208,962)</u> | <u>(197,183)</u> |
| <b>Unrecognized Gain/(Loss) and Other Balances</b> | <b>(114,655)</b> | <b>(124,051)</b> |
| Pre-Tax Change to Equity from SFAS 158             | (114,655)        | (124,051)        |
| Estimated Post-Tax Change                          | (74,525)         | (80,633)         |
| Aggregate % Reduction in Shareholder Equity        | -2.19%           | -2.56%           |
| <b>Median % Reduction in Shareholder Equity</b>    | <b>-0.31%</b>    | <b>-0.38%</b>    |



# S&P 500 Pension/OPEB Sponsors

| <b>Pensions + OPEBs - S&amp;P500 Plan Sponsors</b> | <b>2005</b>   | <b>2004</b>   |
|--|---------------|---------------|
| Pre-Tax Change to Equity from SFAS 158             | (384,239)     | (390,885)     |
| Estimated Post-Tax Change                          | (249,755)     | (254,075)     |
| Aggregate % Reduction in Shareholder Equity        | -7.37%        | -8.07%        |
| <b>Median % Reduction in Shareholder Equity</b>    | <b>-3.67%</b> | <b>-3.44%</b> |

**Compares with SEC estimate of aggregate FYE 2004 off-balance sheet pre-tax amounts for all employers of \$535 billion (comprised of \$414 billion net unrecognized pension amounts and \$121 net unrecognized OPEB amounts).**



## S&P 500 Pension/OPEB Sponsors

- 4 – Employers with negative shareholder equity and pension/OPEB charge
- +5 – Employers with pension/OPEB charge >100% of shareholder equity
- +3 – Employers with pension/OPEB charge  $\leq$ 100% but >50% of shareholder equity
- +80 – Employers with pension/OPEB charge  $\leq$  50% but >10% of shareholder equity
- = 92 – (About  $\frac{1}{4}$  of pension/OPEB sponsors) with material charge to shareholder equity



## S&P 500 Pension/OPEB Sponsors

- 19 – Employers (about 5% of pension/OPEB sponsors) with credit to shareholder equity
  - Pensions – Unrecognized net gains
  - OPEBs – Negative unrecognized prior service cost
- ~150 – Employers with no pension/OPEB exposure under SFAS 158



# Measurement Date

- Rule permitting measurement date up to three months preceding financial statement date will be eliminated
- Transition – Alternatives:
  - Two measurement dates in year preceding implementation
  - Prorated cost for year of implementation with remainder charged to retained earnings



## S&P 500 Pension/OPEB Sponsors

- At least 113 (close to 1/3) – Main measurement date precedes FYE
  - Typically more the case for non-calendar FY
- Common for measurement date for non-US plans to precede FYE
- For some that use FYE measurement date for pensions, measurement date for OPEBs precedes FYE



# Footnote Disclosure Modifications

- Elimination of irrelevant disclosures
  - Measurement date
  - Minimum liability information
- Reorganization of funded status information
- New disclosures – Amortization amounts for next year's cost





## SFAS 158 – Summary

- PBO-based OCI credits or charges for pensions; APBO-based amounts for OPEBs
  - Reduction or increase in shareholder equity
  - Balance sheet volatility
- Change in measurement date
- Footnote disclosure modifications



## SFAS 158 – Effective Dates

- Balance sheet recognition – Effective for fiscal years ending after 12/15/2006
  - Delayed effective date for non-public employers – FYE after 6/15/2007
- Measurement date changes – Fiscal years ending after 12/15/2008
- Retrospective application for periods of comparative balance sheet presentation – Not permitted



# FASB Pension/OPEB Project – Phase 2



## Phase 2 – Comprehensive Review

- Scope of benefits accounting standard
- Measurement of assets and obligations
- Recognition of costs
- Other issues



## Phase 2 - Scope

- Deferred compensation arrangements under SFAS 87 or APB 12
- Legally enforceable claims – Should recognition be restricted to legally enforceable claims?



## Phase 2 – Measurement

- Assets – Amounts for which market value is not readily available
- Determination of discount rate
  - Credit rating of employer
- Inclusion of future salary levels
- Plans with lump-sum settlement features



## Phase 2 - Recognition

- Expected rate of return vs. actual
- Market-related value of assets
- Gain/loss recognition
- Recognition of plan amendments
- Minimum liability



## Phase 2 – Other Issues

- Multiemployer plans
- Classification of information
  - Operating expense
  - Financing expense





## **SFAS 158 and Phase 2 – What Next?**



## FASB Project – What Next?

- Calculate the current *and* future financial effect that SFAS 158 is expected to have
  - New balance sheet liability or asset
  - Potential increase in volatility of balance sheet entries



## FASB Project – What Next?

- Can't materially change the initial impact
  - Employers with non-calendar do still have as much as a full year to implementation, so further asset changes and measurement changes could significantly change initial liability
  - Freeze would have relatively little effect – Would alter PBO basis to ABO basis, but most of financial effect and potential volatility would remain intact



# FASB Project – What Next?

- Possible actions to deal with volatility
  - Liabilities –
    - Consider conversion to less volatile benefit formula type
    - Annuitization of retiree liabilities
  - Assets
    - Liability-driven investments

