Financial Accounting Standards Board

ORIGINAL PRONOUNCEMENTS

AS AMENDED

Statement of Financial Accounting Standards No. 106

Employers' Accounting for Postretirement Benefits Other Than Pensions

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Statement of Financial Accounting Standards No. 106 Employers' Accounting for Postretirement Benefits Other Than Pensions

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Amends APB 16, paragraph 88
Supersedes FAS 81
Amends FAS 87, paragraph 8
Deletes FAS 87, footnote 3
Supersedes FTB 87-1

Affected by: Paragraphs 22, 31, 46, 52, 53, 55, 56, 59, 60, and 62 amended by FAS 158, paragraphs D2(a), D2(b), and D2(e) through D2(l), respectively
Paragraphs 31A, 44A, and 44B added by FAS 158, paragraphs D2(c) and D2(d), respectively
Paragraph 65 amended by FAS 135, paragraph 4(r); FAS 149, paragraph 34; effectively amended by FAS 132(R), paragraph 4; and amended by FAS 157, paragraph E13(a)
Paragraphs 72, 73, 88, 92, 93, 97, and 98 amended by FAS 158, paragraphs D2(n) through D2(t), respectively
Paragraphs 74, 77, 78, 82, and 106 replaced by FAS 132, paragraphs 14(a), 14(b), 14(b), 14(c), and 14(d), respectively, and FAS 132(R), paragraph 18
Paragraph 86 amended by FAS 141, paragraph E14(a), and FAS 141(R), paragraph E21(a)
Paragraphs 87 and 88 deleted by FAS 141(R), paragraphs E21(b) and E21(k), respectively
Paragraph 96(a) amended by FAS 144, paragraph C12(a)
Paragraphs 103 and 392 amended by FAS 135, paragraph 4(r)
Paragraph 103 deleted by FAS 144, paragraph C12(b)
Paragraphs 103A through 103D added by FAS 158, paragraph D2(u)
Paragraphs 107, 417, and 461 amended by FAS 135, paragraph 4(r), and effectively amended by FAS 132(R), paragraph 4
Paragraph 391A added by FAS 158, paragraph D2(v)
Paragraph 391A effectively deleted by FSP FAS 158-1, paragraph 7
Paragraphs 394 through 396, 417, 420, 421, 423, 424, 426, 427, 429, 449 through 456, 458 through 470, 473, 474, 476, 477, 484 through 506, and 508 through 511 amended by FSP FAS 158-1, paragraph 7
Paragraphs 418, 419, 422, 425, 428, 430 through 448, and 457 deleted by FSP FAS 158-1, paragraph 7
Paragraph 444 amended by FAS 141, paragraph E14(b)
Paragraphs 464 and 467 replaced by FAS 135, paragraph 4(r)
Paragraph 471 and footnote 23 deleted by FAS 135, paragraph 4(r)
Paragraphs 479 through 483 replaced by FAS 132, paragraphs 61 through 64, and FAS 132(R), paragraphs C1 through C5
Paragraph 518 amended by FAS 157, paragraph E13(b), and FAS 158, paragraph D2(w)
Paragraphs F1 through F64 added by FSP FAS 158-1, paragraph 10
Paragraphs F39, F45, and F51 through F64 deleted by FSP FAS 158-1, paragraph 10
Footnote 6 amended by FSP FAS 158-1, paragraph 12
Footnotes 18, 25, 26, and 28 amended by FAS 158, paragraphs D2(e), D2(r), and D2(s), respectively
Footnote 20a added by FAS 149, paragraph 34, and deleted by FAS 157, paragraph E13(a)
Footnote 21 amended by FAS 157, paragraph E13(a)
Footnote 38 added by FAS 158, paragraph D2(v), and effectively deleted by FSP FAS 158-1, paragraph 7

Other Interpretive Releases: FASB Special Report, *A Guide to Implementation of Statement 106 on Employers' Accounting for Postretirement Benefits Other Than Pensions: Questions and Answers* (Superseded by FSP FAS 158-1) **Note:** This Special Report has been included in FAS 106 as Appendix F by FSP FAS 158-1.
FASB Special Report, *A Guide to Implementation of Statement 87 on Employers' Accounting for Pensions: Questions and Answers* (Superseded by FSP FAS 158-1) **Note:** This Special Report has been included in FAS 87 as Appendix E by FSP FAS 158-1.
FASB Special Report, *A Guide to Implementation of Statement 88 on Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits: Questions and Answers* (Superseded by FSP FAS 158-1) **Note:** This Special Report has been included in FAS 88 as Appendix C by FSP FAS 158-1.
FASB Staff Positions FAS 106-1 (Superseded by FSP FAS 106-2) and FAS 106-2
FASB Staff Position FAS 158-1

AICPA Accounting Standards Executive Committee (AcSEC)

Related Pronouncement: SOP 94-6

Issues Discussed by FASB Emerging Issues Task Force (EITF)

Affects: Nullifies EITF Issue No. 86-20
Partially resolves EITF Issue No. 84-35
Resolves EITF Issue No. 86-19

Interpreted by: Paragraph 105 interpreted by EITF Issue No. 86-27
Paragraph 186 interpreted by EITF Topic No. D-36
Paragraphs 308 and 518 interpreted by EITF Issue No. 93-3

Related Issues: EITF Issues No. 88-23, 92-12, 92-13, 96-5, 06-4, and 06-10 and Topic No. D-27

SUMMARY

This Statement establishes accounting standards for employers' accounting for postretirement benefits other than pensions (hereinafter referred to as postretirement benefits). Although it applies to all forms of postretirement benefits, this Statement focuses principally on postretirement health care benefits. It will significantly change the prevalent current practice of accounting for postretirement benefits on a pay-as-you-go (cash) basis by requiring accrual, during the years that the employee renders the necessary service, of the expected cost of providing those benefits to an employee and the employee's beneficiaries and covered dependents.

The Board's conclusions in this Statement result from the view that a defined postretirement benefit plan sets forth the terms of an exchange between the employer and the employee. In exchange for the current services provided by the employee, the employer promises to provide, in addition to current wages and other benefits, health and other welfare benefits after the employee retires. It follows from that view that postretirement benefits are not gratuities but are part of an employee's compensation for services rendered. Since payment is deferred, the benefits are a type of deferred compensation. The employer's obligation for that compensation is incurred as employees render the services necessary to earn their postretirement benefits.

The ability to measure the obligation for postretirement health care benefits and the recognition of that obligation have been the subject of controversy. The Board believes that measurement of the obligation and accrual of the cost based on best estimates are superior to implying, by a failure to accrue, that no obligation exists prior to the payment of benefits. The Board believes that failure to recognize an obligation prior to its payment impairs the usefulness and integrity of the employer's financial statements.

The Board's objectives in issuing this Statement are to improve employers' financial reporting for postretirement benefits in the following manner:

a. To enhance the relevance and representational faithfulness of the employer's reported results of operations by recognizing net periodic postretirement benefit cost as employees render the services necessary to earn their postretirement benefits
b. To enhance the relevance and representational faithfulness of the employer's statement of financial position by including a measure of the obligation to provide postretirement benefits based on a mutual understanding between the employer and its employees of the terms of the underlying plan
c. To enhance the ability of users of the employer's financial statements to understand the extent and effects of the employer's undertaking to provide postretirement benefits to its employees by disclosing relevant information about the obligation and cost of the postretirement benefit plan and how those amounts are measured
d. To improve the understandability and comparability of amounts reported by requiring employers with similar plans to use the same method to measure their accumulated postretirement benefit obligations and the related costs of the postretirement benefits.

Similarity to Pension Accounting

The provisions of this Statement are similar, in many respects, to those in FASB Statements No. 87, *Employers' Accounting for Pensions,* and No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits.* To the extent the promise to provide pension benefits and the promise to provide postretirement benefits are similar, the provisions of this Statement are similar to those prescribed by Statements 87 and 88; different accounting treatment is prescribed only when the Board has concluded that there is a compelling reason for different treatment. Appendix B identifies the major similarities and differences between this Statement and employers' accounting for pensions.

Basic Tenets

This Statement relies on a basic premise of generally accepted accounting principles that accrual accounting provides more relevant and useful information than does cash basis accounting. The importance of information about cash flows or the funding of the postretirement benefit plan is not ignored. Amounts funded or paid are given accounting recognition as uses of cash, but the Board believes that information about cash flows alone is insufficient. Accrual accounting goes beyond cash transactions and attempts to recognize the financial effects of noncash transactions and events as they occur. Recognition and measurement of the accrued obligation to provide postretirement benefits will provide users of financial statements with the opportunity to assess the financial consequences of employers' compensation decisions.

In applying accrual accounting to postretirement benefits, this Statement adopts three fundamental aspects of pension accounting: delayed recognition of certain events, reporting net cost, and offsetting liabilities and related assets.

Delayed recognition means that certain changes in the obligation for postretirement benefits, including those changes arising as a result of a plan initiation or amendment, and certain changes in the value of plan assets set aside to meet that obligation are not recognized as they occur. Rather, those changes are recognized systematically over future periods. All changes in the obligation and plan assets ultimately are recognized unless they are first reduced by other changes. The changes that have been identified and quantified but not yet recognized in the employer's financial statements as components of net periodic postretirement benefit cost and as a liability or asset are disclosed.

Net cost means that the recognized consequences of events and transactions affecting a postretirement benefit plan are reported as a single amount in the employer's financial statements. That single amount includes at least three types of events or transactions that might otherwise be reported separately. Those events or transactions—exchanging a promise of deferred compensation in the form of postretirement benefits for employee service, the interest cost arising from the passage of time until those benefits are paid, and the returns from the investment of plan assets—are disclosed separately as components of net periodic postretirement benefit cost.

Offsetting means that plan assets restricted for the payment of postretirement benefits offset the accumulated postretirement benefit obligation in determining amounts recognized in the employer's statement of financial position and that the return on those plan assets offsets postretirement benefit cost in the employer's statement of income. That offsetting is reflected even though the obligation has not been settled, the investment of the plan assets may be largely controlled by the employer, and substantial risks and rewards associated with both the obligation and the plan assets are borne by the employer.

Recognition and Measurement

The Board is sensitive to concerns about the reliability of measurements of the postretirement health care benefit obligation. The Board recognizes that limited historical data about per capita claims costs are available and that actuarial practice in this area is still developing. The Board has taken those factors into consideration in its decisions to delay the effective date for this Statement, to emphasize disclosure, and to permit employers to phase in recognition of the transition obligation in their statements of financial position. However, the Board believes that those factors are insufficient reason not to use accrual accounting for postretirement benefits in financial reporting. With increased experience, the reliability of measures of the obligation and cost should improve.

An objective of this Statement is that the accounting reflect the terms of the exchange transaction that takes place between an employer that provides postretirement benefits and the employees who render services in exchange for those benefits. Generally the extant written plan provides the best evidence of that exchange transaction. However, in some situations, an employer's cost-sharing policy, as evidenced by past practice or by communication of intended changes to a plan's cost-sharing provisions, or a past practice of regular increases in certain monetary benefits may indicate that the substantive plan—the plan as understood by the parties to the exchange transaction—differs from the extant written plan. The substantive plan is the basis for the accounting.

This Statement requires that an employer's obligation for postretirement benefits expected to be provided to or for an employee be fully accrued by the date that employee attains full eligibility for all of the benefits expected to be received by that employee, any beneficiaries, and covered dependents (the full eligibility date), even if the employee is expected to render additional service beyond that date. That accounting reflects the fact that at the full eligibility date the employee has provided all of the service necessary to earn the right to receive all of the benefits that employee is expected to receive under the plan.

The beginning of the attribution (accrual) period is the employee's date of hire unless the plan only grants credit for service from a later date, in which case benefits are generally attributed from the beginning of that credited service period. An equal amount of the expected postretirement benefit obligation is attributed to each year of service in the attribution period unless the plan attributes a disproportionate share of the expected benefits to employees' early years of service. The Board concluded that, like accounting for other deferred compensation agreements, accounting for postretirement benefits should reflect the explicit or implicit contract between the employer and its employees.

Single Method

The Board believes that understandability, comparability, and usefulness of financial information are improved by narrowing the use of alternative accounting methods that do not reflect different facts and circumstances. The Board has been unable to identify circumstances that would make it appropriate for different employers to use fundamentally different accounting methods or measurement techniques for similar postretirement benefit plans or for a single employer to use fundamentally different methods or measurement techniques for different plans. As a result, a single method is prescribed for measuring and recognizing an employer's accumulated postretirement benefit obligation.

Amendment to Opinion 12

An employer's practice of providing postretirement benefits to selected employees under individual contracts, with specific terms determined on an individual-by-individual basis, does not constitute a postretirement benefit *plan* under this Statement. This Statement amends APB Opinion No. 12, *Omnibus Opinion—1967,* to explicitly require that an employer's obligation under deferred compensation contracts be accrued following the terms of the individual contract over the required service periods to the date the employee is fully eligible for the benefits.

Transition

Unlike the effects of most other accounting changes, a transition obligation for postretirement benefits generally reflects, to a considerable extent, the failure to accrue the accumulated postretirement benefit obligation in earlier periods as it arose rather than the effects of a change from one acceptable accrual method of accounting to another. The Board believes that accounting for transition from one method of accounting to another is a practical matter and that a major objective of that accounting is to minimize the cost and mitigate the disruption to the extent possible without unduly compromising the ability of financial statements to provide useful information.

This Statement measures the transition obligation as the unfunded and unrecognized accumulated postretirement benefit obligation for all plan participants. Two options are provided for recognizing that transition obligation. An employer can choose to immediately recognize the transition obligation as the effect of an accounting change, subject to certain limitations. Alternatively, an employer can choose to recognize the transition obligation in the statement of financial position and statement of income on a delayed basis over the plan participants' future service periods, with disclosure of the unrecognized amount. However, that delayed recognition cannot result in less rapid recognition than accounting for the transition obligation on a pay-as-you-go basis.

Effective Dates

This Statement generally is effective for fiscal years beginning after December 15, 1992, except that the application of this Statement to plans outside the United States and certain small, nonpublic employers is delayed to fiscal years beginning after December 15, 1994. The amendment of Opinion 12 is effective for fiscal years beginning after March 15, 1991.

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The Board appreciates the contributions of the many people and organizations that assisted the Board in its research on this project.

Statement of Financial Accounting Standards No. 106

Employers' Accounting for Postretirement Benefits Other Than Pensions

CONTENTS

	Paragraph Numbers
Introduction	1– 5
Standards of Financial Accounting and Reporting:	
Scope	6– 12
Amendment to Opinion 12	13
Amendment to Statement 87	14
Use of Reasonable Approximations	15
Single-Employer Defined Benefit Postretirement Plans	16– 78
Basic Elements of Accounting for Postretirement Benefits	19– 22
Measurement of Cost and Obligations	23– 44
Accounting for the Substantive Plan	23– 28
Assumptions	29– 33
Assumptions Unique to Postretirement Health Care Benefits	34– 42
Attribution	43– 44
Recognition of Net Periodic Postretirement Benefit Cost	45– 62
Service Cost	47
Interest Cost	48
Actual Return on Plan Assets	49
Prior Service Cost	50– 55
Gains and Losses	56– 62
Measurement of Plan Assets	63– 66
Insurance Contracts	67– 71
Measurement Date	72– 73
Disclosures	74
Employers with Two or More Plans	75– 78
Multiemployer Plans	79– 83
Multiple-Employer Plans	84
Postretirement Benefit Plans outside the United States	85
Business Combinations	86– 89
Amendment to Opinion 16	89
Accounting for Settlement of a Postretirement Benefit Obligation	90– 95
Accounting for a Plan Curtailment	96– 99
Relationship of Settlements and Curtailments to Other Events	100
Measurement of the Effects of Termination Benefits	101–102
Disposal of a Segment [Deleted]	
Defined Contribution Plans	104–107
Effective Dates and Transition	108–115
Effective Date and Transition—Amendment to Opinion 12	114
Rescission of Technical Bulletin 87-1	115
Appendix A: Basis for Conclusions	116–389
Appendix B: Comparison of Employers' Accounting for Other Postretirement Benefits with Employers' Accounting for Pensions	390
Appendix C: Illustrations	391–511
Appendix D: Background Information	512–517
Appendix E: Glossary	518

INTRODUCTION

1. This Statement establishes standards of financial accounting and reporting for an employer that offers **postretirement benefits other than pensions**[1] (hereinafter referred to as **postretirement benefits**) to its employees.[2] The Board added a project on postemployment **benefits** other than pensions to its agenda in 1979 as part of its project on accounting for pensions and other postemployment benefits. In 1984, the subject of accounting for postemployment benefits other than pensions was identified as a separate project. As interim measures, FASB Statement No. 81, *Disclosure of Postretirement Health Care and Life Insurance Benefits,* was issued in November 1984, and FASB Technical Bulletin No. 87-1, *Accounting for a Change in Method of Accounting for Certain Postretirement Benefits,* was issued in April 1987.

2. Most employers have accounted for postretirement benefits on a pay-as-you-go (cash) basis. As the prevalence and magnitude of employers' promises to provide those benefits have increased, there has been increased concern about the failure of financial reporting to identify the financial effects of those promises.

3. The Board views a **postretirement benefit plan** as a deferred compensation arrangement whereby an employer promises to exchange future benefits for employees' current services. Because the obligation to provide benefits arises as employees render the services necessary to earn the benefits pursuant to the terms of the **plan,** the Board believes that the cost of providing the benefits should be recognized over those employee service periods.

4. This Statement addresses, for the first time, the accounting issues related to measuring and recognizing the exchange that takes place between an employer that provides postretirement benefits and the employees who render services in exchange for those benefits. The Board believes the accounting recognition required by this Statement should result in more useful and representationally faithful financial statements. However, this Statement is not likely to be the final step in the evolution of more useful accounting for postretirement benefit arrangements.

5. The Board's objectives in issuing this Statement are to improve employers' financial reporting for postretirement benefits in the following manner:

a. To enhance the relevance and representational faithfulness of the employer's reported results of operations by recognizing **net periodic postretirement benefit cost**[3] as employees render the services necessary to earn their postretirement benefits
b. To enhance the relevance and representational faithfulness of the employer's statement of financial position by including a measure of the obligation to provide postretirement benefits based on a mutual understanding between the employer and its employees of the terms of the underlying plan
c. To enhance the ability of users of the employer's financial statements to understand the extent and effects of the employer's undertaking to provide postretirement benefits to its employees by disclosing relevant information about the obligation and cost of the postretirement benefit plan and how those amounts are measured
d. To improve the understandability and comparability of amounts reported by requiring employers with similar plans to use the same method to measure their **accumulated postretirement benefit obligations** and the related costs of the postretirement benefits.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Scope

6. This Statement applies to *all* postretirement benefits expected to be provided by an employer to current and former employees (including **retirees,** dis-

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[1]Words that appear in the glossary are set in **boldface type** the first time they appear.

[2]The accounting for benefits paid after employment but before retirement (for example, layoff benefits) is a separate phase of the Board's project on accounting for postemployment benefits other than pensions. The fact that this Statement does not apply to those benefits should not be construed as discouraging the use of accrual accounting for those benefits.

[3]This Statement uses the term *net periodic postretirement benefit cost* rather than *net postretirement benefit 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.

abled employees,[4] and other former employees who are expected to receive postretirement benefits), their beneficiaries, and covered dependents, pursuant to the terms of an employer's undertaking to provide those benefits. Postretirement benefits include, but are not limited to, postretirement health care;[5] life insurance provided outside a pension plan to retirees; and other welfare benefits such as tuition assistance, day care, legal services, and housing subsidies provided after retirement. Often those benefits are in the form of a reimbursement to plan participants or direct payment to providers for the cost of specified services as the need for those services arises, but they may also include benefits payable as a lump sum, such as death benefits. This Statement also applies to **settlement** of all or a part of an employer's accumulated postretirement benefit obligation or **curtailment** of a postretirement benefit plan and to an employer that provides postretirement benefits as part of a special **termination benefits** offer.

7. For the purposes of this Statement, a postretirement benefit plan is an arrangement that is mutually understood by an employer and its employees, whereby an employer undertakes to provide its current and former employees with benefits after they retire in exchange for the employees' services over a specified period of time, upon attaining a specified age while in service, or both. Benefits may commence immediately upon termination of service or may be deferred until retired employees attain a specified age.

8. An employer's practice of providing postretirement benefits may take a variety of forms and the obligation may or may not be funded. This Statement applies to any arrangement that is in substance a postretirement benefit plan, regardless of its form or the means or timing of its funding. This Statement applies both to written plans and to unwritten plans whose existence is discernible either from a practice of paying postretirement benefits or from oral representations made to current or former employees. Absent evidence to the contrary, it shall be presumed that an employer that has provided postretirement benefits in the past or is currently promising those benefits to employees will continue to provide those future benefits.

9. This Statement applies to deferred compensation contracts with individual employees if those contracts, taken together, are equivalent to a plan that provides postretirement benefits. It does not apply to an employer's practice of providing postretirement benefits to selected employees under individual contracts with specific terms determined on an individual-by-individual basis. Those contracts shall be accounted for individually, following the terms of the contract. To the extent the contract does not attribute the benefits to individual years of service, the expected future benefits should be accrued over the period of service required to be rendered in exchange for the benefits. (Refer to paragraph 13.)

10. A postretirement benefit plan may be part of a larger plan or arrangement that provides benefits currently to active employees as well as to retirees. In those circumstances, the promise to provide benefits to present and future retirees under the plan shall be segregated from the promise to provide benefits currently to active employees and shall be accounted for in accordance with the provisions of this Statement.

11. This Statement does not apply to pension or life insurance benefits provided through a pension plan. The accounting for those benefits is set forth in FASB Statements No. 87, *Employers' Accounting for Pensions,* and No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits.*[6]

12. This Statement supersedes FASB Statement No. 81, *Disclosure of Postretirement Health Care and Life Insurance Benefits.* Paragraphs 13 and 114 of this Statement amend APB Opinion No. 12, *Omnibus Opinion—1967;* paragraph 14 amends Statement 87; and paragraph 89 amends APB Opinion

[4]The determination of disability benefits to be accrued pursuant to this Statement is based on the terms of the postretirement benefit plan defining when a disabled employee is entitled to postretirement benefits.

[5]Postretirement health care benefits are likely to be the most significant in terms of cost and prevalence, and certain of the issues that arise in measuring those benefits are unique. Therefore, much of the language of this Statement focuses on postretirement health care plans. Nevertheless, this Statement applies equally to all postretirement benefits.

[6]Appendix E of Statement 87 and Appendix C of Statement 88 provide accounting guidance on implementation questions raised in connection with those Statements. Many of the provisions in this Statement are the same as or are similar to the provisions of Statements 87 and 88. Consequently, the guidance provided in those appendixes should be useful in understanding and implementing many of the provisions of this Statement.

No. 16, *Business Combinations.* Paragraph 115 rescinds FASB Technical Bulletin No. 87-1, *Accounting for a Change in Method of Accounting for Certain Postretirement Benefits.*

Amendment to Opinion 12

13. The following paragraphs and footnote replace the first four sentences and footnote of paragraph 6 of Opinion 12:

> FASB Statement No. 87, *Employers' Accounting for Pensions,* or Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions,* applies to deferred compensation contracts with individual employees if those contracts, taken together, are equivalent to a postretirement income plan or a postretirement health or welfare benefit plan, respectively. Other deferred compensation contracts shall be accounted for individually on an accrual basis in accordance with the terms of the underlying contract.
>
> To the extent the terms of the contract attribute all or a portion of the expected future benefits to an individual year of the employee's service, the cost of those benefits shall be recognized in that year. To the extent the terms of the contract attribute all or a portion of the expected future benefits to a period of service greater than one year, the cost of those benefits shall be accrued over that period of the employee's service in a systematic and rational manner. At the end of that period the aggregate amount accrued shall equal the then present value of the benefits expected to be provided to the employee, any beneficiaries, and covered dependents in exchange for the employee's service to that date.*
>
> *The amounts to be accrued periodically shall result in an accrued amount at the full eligibility date (as defined in Statement 106) equal to the then present value of all of the future benefits expected to be paid. Paragraphs 413–416 of Statement 106 illustrate application of this paragraph.

Amendment to Statement 87

14. The following sentences replace the first two sentences and footnote of paragraph 8 of Statement 87:

> This Statement does not apply to life insurance benefits provided outside a pension plan or to other postretirement health and welfare benefits. The accounting for those benefits is set forth in FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions.*

Use of Reasonable Approximations

15. This Statement is intended to specify accounting objectives and results rather than 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 Postretirement Plans

16. This Statement primarily focuses on an employer's accounting for a **single-employer plan** that defines the postretirement benefits to be provided to retirees. For purposes of this Statement, a **defined benefit postretirement plan** is one that defines the postretirement benefits in terms of (a) monetary amounts (for example, $100,000 of life insurance) or (b) benefit coverage to be provided (for example, up to $200 per day for hospitalization, 80 percent of the cost of specified surgical procedures, and so forth). (Specified monetary amounts and benefit coverage are hereinafter collectively referred to as *benefits.*)

17. In some cases, an employer may limit its obligation through an individual or an aggregate "cap" on the employer's cost or benefit obligation. For example, an employer may elect to limit its annual postretirement benefit obligation for each retired plan participant to a maximum of $5,000. Or, an employer may elect to limit its share of the aggregate cost of covered postretirement health care benefits for a period to an amount determined based on an average per capita cost per retired plan participant. Plans of that nature are considered to be defined benefit postretirement plans. Paragraphs 472–478 illustrate measurement considerations for defined-dollar capped plans.

18. A postretirement benefit is part of the compensation paid to an employee for services rendered. In a defined benefit plan, the employer promises to provide, in addition to current wages and benefits, future benefits during retirement. Generally, the amount of those benefits depends on the **benefit formula** (which may include factors such as the number of years of service rendered or the employee's compensation before retirement or termination), the longevity of the retiree and any beneficiaries and covered

dependents, and the incidence of events requiring benefit payments (for example, illnesses affecting the amount of health care required). In most cases, services are rendered over a number of years before an employee retires and begins to receive benefits or is entitled to receive benefits as a need arises. Even though the services rendered by the employee are complete and the employee has retired, the total amount of benefits the employer has promised and the cost to the employer of the services rendered are not precisely determinable but can be estimated using the plan's benefit formula and estimates of the effects of relevant future events.

Basic Elements of Accounting for Postretirement Benefits

19. Any method of accounting that recognizes the cost of postretirement benefits over employee service periods (before the payment of benefits to retirees) must deal with two factors that stem from the nature of the arrangement. First, estimates or **assumptions** must be made about the future events that will determine the amount and timing of the benefit payments. Second, an **attribution** approach that assigns benefits and the cost of those benefits to individual years of service must be selected.

20. The **expected postretirement benefit obligation** for an employee is the **actuarial present value** as of a particular date of the postretirement benefits expected to be paid by the employer's plan to or for the employee, the employee's beneficiaries, and any covered dependents pursuant to the terms of the plan. Measurement of the expected postretirement benefit obligation is based on the expected amount and timing of future benefits, taking into consideration the expected future cost of providing the benefits and the extent to which those costs are shared by the employer, the employee (including consideration of contributions required during the employee's active service period and following retirement, deductibles, coinsurance provisions, and so forth), or others (such as through governmental programs).

21. The accumulated postretirement benefit obligation[7] as of a particular date is the actuarial present value of all future benefits attributed to an employee's service rendered to that date pursuant to paragraphs 43 and 44 and 52–55, assuming the plan continues in effect and that all assumptions about future events are fulfilled. Prior to the date on which an employee attains **full eligibility** for the benefits that employee is expected to earn under the terms of the postretirement benefit plan (the **full eligibility date**), the accumulated postretirement benefit obligation for an employee is a portion of the expected postretirement benefit obligation. On and after the full eligibility date, the accumulated postretirement benefit obligation and the expected postretirement benefit obligation for an employee are the same. Determination of the full eligibility date is affected by plan terms that provide incremental benefits expected to be received by or on behalf of an employee for additional years of service, unless those incremental benefits are trivial. Determination of the full eligibility date is not affected by plan terms that define when benefit payments commence or by an employee's current **dependency status.** (Paragraphs 397–408 illustrate determination of the full eligibility date.)

22. Net periodic postretirement benefit cost comprises several components that reflect different aspects of the employer's financial arrangements. The **service cost** component of net periodic postretirement benefit cost is the actuarial present value of benefits attributed to services rendered by employees during the period (the portion of the expected postretirement benefit obligation attributed to service in the period). The service cost component is the same for an unfunded plan, a plan with minimal funding, and a well-funded plan. The other components of net periodic postretirement benefit cost are **interest cost**[8] (interest on the accumulated postretirement benefit obligation, which is a discounted amount), **actual return on plan assets, amortization** of any **prior service cost** or credit included in accumulated other comprehensive income, amortization of the **transition obligation** or **transition asset,** and the **gain or loss component,** which includes, to the extent recognized, amortization of the net gain or loss included in accumulated other comprehensive income.

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[7]The accumulated postretirement benefit obligation generally reflects a ratable allocation of expected future benefits to employee service already rendered in the attribution period; the accumulated benefit obligation under Statement 87 generally reflects the future benefits allocated to employee service in accordance with the benefit formula. In addition, unlike Statement 87, this Statement implicitly considers salary progression in the measurement of the accumulated postretirement benefit obligation of a pay-related plan.

[8]The interest cost component of postretirement benefit cost shall not be considered interest for purposes of applying FASB Statement No. 34, *Capitalization of Interest Cost.*

Measurement of Cost and Obligations

Accounting for the substantive plan

23. An objective of this Statement is that the accounting reflect the terms of the exchange transaction that takes place between an employer that provides postretirement benefits and the employees who render services in exchange for those benefits, as those terms are understood by both parties to the transaction. Generally, the extant written plan provides the best evidence of the terms of that exchange transaction. However, in some situations, an employer's **cost-sharing** policy, as evidenced by past practice or by communication of intended changes to a plan's cost-sharing provisions (paragraphs 24 and 25), or a past practice of regular increases in certain monetary benefits (paragraph 26) may indicate that the **substantive plan**—the plan as understood by the parties to the exchange transaction—differs from the extant written plan. The substantive plan shall be the basis for the accounting.

24. Except as provided in paragraph 25, an employer's cost-sharing policy, as evidenced by the following past practice or communication, shall constitute the cost-sharing provisions of the substantive plan if either of the following conditions exist. Otherwise, the extant written plan shall be considered to be the substantive plan.

a. The employer has a past practice of (1) maintaining a consistent level of cost sharing between the employer and its retirees through changes in deductibles, coinsurance provisions, retiree contributions, or some combination of those changes or (2) consistently increasing or reducing the employer's share of the cost of the covered benefits through changes in retired or **active plan participants'** contributions toward their retiree health care benefits, deductibles, coinsurance provisions, out-of-pocket limitations, and so forth, in accordance with the employer's established cost-sharing policy

b. The employer has the ability, and has communicated to affected **plan participants** its intent, to institute different cost-sharing provisions at a specified time or when certain conditions exist (for example, when health care cost increases exceed a certain level).

25. An employer's past practice of maintaining a consistent level of cost sharing with its retirees or consistently increasing or reducing its share of the cost of providing the covered benefits shall not constitute provisions of the substantive plan if accompanied by identifiable offsetting changes in other benefits or compensation[9] or if the employer incurred significant costs, such as work stoppages, to effect that cost-sharing policy.[10] Similarly, an employer's communication of its intent to institute cost-sharing provisions that differ from the extant written plan or the past cost-sharing practice shall not constitute provisions of the substantive plan (a) if the plan participants would be unwilling to accept the change without adverse consequences to the employer's operations or (b) if other modifications of the plan, such as the level of benefit coverage, or providing offsetting changes in other benefits, such as pension benefits, would be required to gain plan participants' acceptance of the change to the cost-sharing arrangement.

26. A past practice of regular increases in postretirement benefits defined in terms of monetary amounts may indicate that the employer has a present commitment to make future *improvements* to the plan and that the plan will provide monetary benefits attributable to prior service that are greater than the monetary benefits defined by the extant written plan. In those situations, the substantive commitment to increase those benefits shall be the basis for the accounting. Changes in the benefits, other than benefits defined in terms of monetary amounts, covered by a postretirement health care plan or by other postretirement benefit plans shall not be anticipated.

[9]For example, a past practice of increasing retiree contributions annually based on a specified index or formula may appear to indicate that the substantive plan includes a determinable indexing of the retirees' annual contributions to the plan. However, if that past practice of increasing retiree contributions is accompanied by identifiable offsetting changes in other benefits or compensation, those offsetting changes would indicate that the substantive plan incorporates only the *current* cost-sharing provisions. Therefore, future increases or reductions of those cost-sharing provisions should not be incorporated in measuring the expected postretirement benefit obligation.

[10]By definition, an employer does not have the unilateral right to change a collectively bargained plan. Therefore, if the postretirement benefits are the subject of collective bargaining, the extant written plan shall be the substantive plan unless the employer can demonstrate its ability to maintain (a) a consistent level of cost sharing or (b) a consistent practice of increasing or reducing its share of the cost of the covered benefits in past negotiations without making offsetting changes in other benefits or compensation of the affected plan participants or by incurring other significant costs to maintain that cost-sharing arrangement.

27. Contributions expected to be received from active employees toward the cost of their postretirement benefits and from retired plan participants are treated similarly for purposes of measuring an employer's expected postretirement benefit obligation. That obligation is measured as the actuarial present value of the benefits expected to be provided under the plan, reduced by the actuarial present value of contributions expected to be received from the plan participants during their remaining active service and postretirement periods. In determining the amount of the contributions expected to be received from those participants toward the cost of their postretirement benefits, consideration is given to any related substantive plan provisions, such as an employer's past practice of consistently increasing or reducing the contribution rates as described in paragraphs 24 and 25. An obligation to return contributions received from employees who do not attain eligibility for postretirement benefits and, if applicable, any interest accrued on those contributions shall be recognized as a component of an employer's postretirement benefit obligation.

28. Automatic benefit changes[11] specified by the plan that are expected to occur shall be included in measurements of the expected and accumulated postretirement benefit obligations and the service cost component of net periodic postretirement benefit cost. Also, **plan amendments** shall be included in the computation of the expected and accumulated postretirement 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 different benefit level for employees retiring after a future date, that increased or reduced benefit level shall be included in current-period measurements for employees expected to retire after that date.

Assumptions

29. The Board believes that measuring the net periodic postretirement benefit cost and accumulated postretirement benefit obligation based on best estimates is superior to implying, by a failure to accrue, that no cost or obligation exists prior to the payment of benefits. This Statement requires the use of **explicit assumptions,** each of which individually represents the best estimate of a particular future event, to measure the expected postretirement benefit obligation. A portion of that expected postretirement benefit obligation is attributed to each period of an employee's service associated with earning the postretirement benefits, and that amount is accrued as service cost for that period.

30. The service cost component of postretirement benefit cost, any prior service cost, and the accumulated postretirement benefit obligation are measured using actuarial assumptions and present value techniques to calculate the actuarial present value of the expected future benefits attributed to periods of employee service. Each 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. Principal actuarial assumptions include the time value of money (**discount rates**); participation rates (for **contributory plans**); retirement age; factors affecting the amount and timing of future benefit payments, which for **postretirement health care benefits** consider past and present **per capita claims cost by age, health care cost trend rates, Medicare reimbursement rates,** and so forth; salary progression (for **pay-related plans**); and the probability of payment (turnover, dependency status, mortality, and so forth).

31. Assumed discount rates shall reflect the time value of money as of the measurement date in determining the present value of future cash outflows currently expected to be required to satisfy the postretirement benefit obligation. In making that assumption, employers shall look to rates of return on high-quality fixed-income investments currently available whose cash flows match the timing and amount of expected benefit payments. If settlement of the obligation with third-party insurers is possible (for example, the purchase of nonparticipating life insurance contracts to provide death benefits), the interest rates inherent in the amount at which the postretirement benefit obligation could be settled are relevant in determining the assumed discount rates. Assumed discount rates are used in measurements of the expected and accumulated postretirement benefit

[11]For purposes of this Statement, a plan that promises to provide retirees a benefit in kind, such as health care benefits, rather than a defined dollar amount of benefit, is considered to be a plan that specifies automatic benefit changes. (The assumed rate of change in the future cost of providing health care benefits, the assumed health care cost trend rate, is discussed in paragraph 39.) Because automatic benefit changes are not conditional on employees rendering additional years of service, the full eligibility date is not affected by those changes. A benefit in kind includes the direct rendering of services, the payment directly to others who provide the services, or the reimbursement of the retiree's payment for those services.

obligations and the service cost and interest cost components of net periodic postretirement benefit cost.

31A. Pursuant to paragraph 31, an employer shall look to rates of return on high-quality fixed-income investments in determining assumed discount rates. The objective of selecting assumed discount rates using that method is to measure the single amount that, if invested at the measurement date in a portfolio of high-quality debt instruments, would provide the necessary future cash flows to pay the postretirement benefits when due. Notionally, that single amount, the accumulated postretirement benefit obligation, would equal the current market value of a portfolio of high-quality zero coupon bonds whose maturity dates and amounts would be the same as the timing and amount of the expected future benefit payments. Because cash inflows would equal cash outflows in timing and amount, there would be no reinvestment risk in the yields to maturity of the portfolio. However, in other than a zero coupon portfolio, such as a portfolio of long-term debt instruments that pay semiannual interest payments or whose maturities do not extend far enough into the future to meet expected benefit payments, the assumed discount rates (the yield to maturity) need to incorporate expected reinvestment rates available in the future. Those rates shall be extrapolated from the existing yield curve at the measurement date. The determination of the assumed discount rate is separate from the determination of the expected rate of return on plan assets whenever the actual portfolio differs from the hypothetical portfolio described above. Assumed discount rates shall be reevaluated at each measurement date. If the general level of interest rates rises or declines, the assumed discount rates shall change in a similar manner.

32. The **expected long-term rate of return on plan assets** shall reflect the average rate of earnings expected on the existing assets that qualify as **plan assets** and contributions to the plan expected to be made during the period. In estimating that rate, appropriate consideration should be given to the returns being earned on the plan assets currently invested and the rates of return expected to be available for reinvestment. If the return on plan assets is taxable to the trust or other fund under the plan, the expected long-term rate of return shall be reduced to reflect the related income taxes expected to be paid under existing law. The expected long-term rate of return on plan assets is used with the **market-related value of plan assets** to compute the **expected return on plan assets.** (Refer to paragraph 57.) There is no assumption of an expected long-term rate of return on plan assets for plans that are unfunded or that have no assets that qualify as plan assets pursuant to this Statement.

33. The service cost component of net periodic postretirement benefit cost and the expected and accumulated postretirement benefit obligations shall reflect future compensation levels to the extent the postretirement benefit formula defines the benefits wholly or partially as a function of future compensation levels.[12] For pay-related plans, assumed compensation levels shall reflect the best 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 about the same future economic conditions, such as future rates of inflation. Measuring service cost and the expected and accumulated postretirement benefit obligations based on estimated future compensation levels entails considering any indirect effects, such as benefit limitations, that would affect benefits provided by the plan.[13]

Assumptions unique to postretirement health care benefits

34. Measurement of an employer's postretirement health care obligation requires the use of several assumptions unique to health care benefits. Most significantly, it includes several assumptions about factors that will affect the amount and timing of future benefit payments for postretirement health care. Those factors include consideration of historical per capita claims cost by age, health care cost trend rates (for plans that provide a benefit in kind), and medical

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[12]For pay-related plans, salary progression is included in measuring the expected postretirement benefit obligation. For example, a postretirement health care plan may define the deductible amount or copayment, or a postretirement life insurance plan may define the amount of death benefit, based on the employee's average or final level of annual compensation.

[13]For example, a plan may define the maximum benefit to be provided under the plan (a fixed cap). In measuring the expected postretirement benefit obligation under that plan, the projected benefit payments would be limited to that cap. For a plan that automatically adjusts the maximum benefit to be provided under the plan for the effects of inflation (an adjustable cap), the expected postretirement benefit obligation would be measured based on adjustments to that cap consistent with the assumed inflation rate reflected in other inflation-related assumptions.

coverage to be paid by governmental authorities and other providers of health care benefits.

35. In principle, an employer's share of the expected future postretirement health care cost for a plan participant is developed by reducing the **assumed per capita claims cost** at each age at which the plan participant is expected to receive benefits under the plan by (a) the effects of coverage by Medicare and other providers of health care benefits, and (b) the effects of the cost-sharing provisions of the plan (deductibles, copayment provisions, out-of-pocket limitations, caps on the limits of the employer-provided payments, and retiree contributions).[14] The resulting amount represents the assumed **net incurred claims cost** at each age at which the plan participant is expected to receive benefits under the plan. If contributions are required to be paid by active plan participants toward their postretirement health care benefits, the actuarial present value of the plan participants' future contributions reduces the actuarial present value of the aggregate assumed net incurred claims costs.

36. The assumed per capita claims cost by age is the annual per capita cost, for periods after the measurement date, of providing the postretirement health care benefits covered by the plan from the earliest age at which an individual could begin to receive benefits under the plan through the remainder of the individual's life or the covered period, if shorter. The assumed per capita claims cost shall be the best estimate of the expected future cost of the benefits covered by the plan.[15] It may be appropriate to consider other factors in addition to age, such as sex and geographical location, in developing the assumed per capita claims cost.

37. Past and present claims data for the plan, such as a historical pattern of gross claims by age (claims curve), should be used in developing the current per capita claims cost to the extent that those data are considered to be indicative of the current cost of providing the benefits covered by the plan. Those current claims data shall be adjusted by the assumed health care cost trend rate. The resulting assumed per capita claims cost by age, together with the **plan demographics,** determines the amount and timing of expected future **gross eligible charges.**

38. In the absence of sufficiently reliable plan data about the current cost of the benefits covered by the plan, the current per capita claims cost should be based, entirely or in part, on the claims information of other employers to the extent those costs are indicative of the current cost of providing the benefits covered by the plan. For example, the current per capita claims cost may be based on the claims experience of other employers derived from information in data files developed by insurance companies, actuarial firms, or employee benefits consulting firms. The current per capita claims cost developed on those bases shall be adjusted to best reflect the terms of the employer's plan and the plan demographics. For example, the information should be adjusted, as necessary, for differing demographics, such as the age and sex of plan participants, health care utilization patterns by men and women at various ages, and the expected geographical location of retirees and their dependents, and for significant differences between the nature and types of benefits covered by the employer's plan and those encompassed by the underlying data.

39. The assumption about health care cost trend rates represents the expected annual rates of change in the cost of health care benefits currently provided by the postretirement benefit plan, due to factors other than changes in the demographics of the plan participants, for each year from the measurement date until the end of the period in which benefits are expected to be paid. Past and current health care cost trends shall be used in developing an employer's assumed health care cost trend rates, which implicitly consider estimates of health care inflation, changes in health care utilization or delivery patterns, technological advances, and changes in the health status of

[14]In some cases, retiree contributions are established based on the average per capita cost of benefit coverage under an employer's health care plan that provides coverage to both active employees and retirees. However, the medical cost of the retirees may cause the average per capita cost of benefit coverage under the plan to be higher than it would be if only active employees were covered by the plan. In that case, the employer has a postretirement benefit obligation for the portion of the expected future cost of the retiree health care benefits that are not recovered through retiree contributions, Medicare, or other providers of health care benefits.

[15]If significant, the internal and external costs directly associated with administering the postretirement benefit plan also should be accrued as a component of assumed per capita claims cost.

plan participants.[16] Differing services, such as hospital care and dental care, may require the use of different health care cost trend rates. It is appropriate for that assumption to reflect changes in health care cost trend rates over time. For example, the health care cost trend rates may be assumed to continue at the present level for the near term, or increase for a period of time, and then grade down over time to an estimated health care cost trend rate ultimately expected to prevail.

40. Certain medical claims may be covered by governmental programs under existing law or by other providers of health care benefits.[17] Benefit coverage by those governmental programs shall be assumed to continue as provided by the present law and by other providers pursuant to their present plans. Presently enacted changes in the law or amendments of the plans of other health care providers that take effect in future periods and that will affect the future level of their benefit coverage shall be considered in current-period measurements for benefits expected to be provided in those future periods. Future changes in laws concerning medical costs covered by governmental programs and future changes in the plans of other providers shall not be anticipated.

41. In some cases, determining the assumed per capita claims cost by age as described in paragraphs 36–38 may not be practical because credible historical information about the gross per capita cost of covered benefits may not be available or determinable to satisfy the stated measurement approach. However, credible historical information about **incurred claims costs** may be available. In those cases, an alternative method of developing the assumed per capita claims cost may be used provided the method results in a measure that is the best estimate of the expected future cost of the benefits covered by the plan. For example, the assumed health care cost trend rates may be determined by adjusting the expected change in the employer's share of per capita incurred claims cost by age by a factor that reflects the effects of the plan's cost-sharing provisions. However, an approach that projects net incurred claims costs using unadjusted assumed health care cost trend rates would implicitly assume changes in the plan's cost-sharing provisions at those assumed rates and, therefore, is not acceptable unless the plan's cost-sharing provisions are indexed in that manner or the substantive plan (paragraphs 24–26) operates in that manner.

42. Assumed discount rates include an inflationary element that reflects the expected general rate of inflation. Assumed compensation levels include consideration of future changes attributable to general price levels. Similarly, assumed health care cost trend rates include an element that reflects expected general rates of inflation for the economy overall and an element that reflects price changes of health care costs in particular. To the extent that those assumptions consider similar inflationary effects, the assumptions about those effects shall be consistent.

Attribution

43. An equal amount of the expected postretirement benefit obligation for an employee generally shall be attributed to each year of service in the **attribution period** (a benefit/years-of-service approach). However, some plans may have benefit formulas that attribute a disproportionate share of the expected postretirement benefit obligation to employees' early years of service. For that type of plan, the expected postretirement benefit obligation shall be attributed in accordance with the plan's benefit formula.

44. The beginning of the attribution period generally shall be the date of hire. However, if the plan's benefit formula grants credit only for service from a later date and that **credited service period** is not nominal in relation to employees' total years of service prior to their full eligibility dates, the expected postretirement benefit obligation shall be attributed from the beginning of that credited service period. In all cases, the end of the attribution period shall be the full eligibility date. (Paragraphs 409–412 illustrate the attribution provisions of this Statement.)

Recognition of Liabilities and Assets

44A. An employer that sponsors one or more single-employer defined benefit postretirement plans other than pensions shall recognize in its statement of financial position the funded statuses of those plans. The status for each plan shall be measured as the difference between the fair value of plan assets and the

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[16]An assumption about changes in the health status of plan participants considers, for example, the probability that certain claims costs will be incurred based on expectations of future events, such as the likelihood that some retirees will incur claims requiring technology currently being developed or that historical claims experience for certain medical needs may be reduced as a result of participation in a wellness program.

[17]For example, a retiree's spouse also may be covered by the spouse's present (or former) employer's health care plan. In that case, the spouse's employer (or former employer) may provide either primary or secondary postretirement health care benefits to the retiree's spouse or dependents.

accumulated postretirement benefit obligation as it is defined in this Statement.

44B. The employer shall aggregate the statuses of all overfunded plans and recognize that amount as an asset in its statement of financial position. It also shall aggregate the statuses of all underfunded plans and recognize that amount as a liability in its statement of financial position. An employer that presents a classified statement of financial position shall classify the liability for an underfunded plan as a current liability, a noncurrent liability, or a combination of both. The current portion (determined on a plan-by-plan basis) is the amount by which the actuarial present value of benefits included in the benefit obligation payable in the next 12 months, or operating cycle if longer, exceeds the fair value of plan assets. The asset for an overfunded plan shall be classified as a noncurrent asset in a classified statement of financial position.

Recognition of Net Periodic Postretirement Benefit Cost

45. As with other forms of deferred compensation, the cost of providing postretirement benefits shall be attributed to the periods of employee service rendered in exchange for those future benefits pursuant to the terms of the plan. That cost notionally represents the change in the **unfunded accumulated postretirement benefit obligation** for the period, ignoring employer contributions to the plan, plan settlements, and payments made by the employer directly to retirees. However, changes in that unfunded obligation that arise from experience gains and losses and the effects of changes in assumptions may be recognized as a component of net periodic postretirement benefit cost on a delayed basis. In addition, the effects of a plan initiation or amendment generally are recognized on a delayed basis.

46. The following components shall be included in the net postretirement benefit cost recognized for a period by an employer sponsoring a defined benefit postretirement plan:

a. Service cost (paragraph 47)
b. Interest cost (paragraph 48)
c. Actual return on plan assets, if any (paragraph 49)
d. Amortization of any prior service cost or credit included in accumulated other comprehensive income to the extent required by paragraphs 50–55
e. **Gain or loss** (including the effects of changes in assumptions) to the extent recognized (paragraphs 56–62)
f. Amortization of any obligation or asset existing at the date of initial application of this Statement, hereinafter referred to as the transition obligation[18] or transition asset remaining in accumulated other comprehensive income (paragraphs 110 and 112).

Service cost

47. The service cost component recognized in a period shall be determined as the portion of the expected postretirement benefit obligation attributed to employee service during that period. The measurement of the service cost component requires identification of the substantive plan and the use of assumptions and an attribution method, which are discussed in paragraphs 23–44.

Interest cost

48. The interest cost component recognized in a period shall be determined as the increase in the accumulated postretirement benefit obligation to recognize the effects of the passage of time. Measuring the accumulated postretirement 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

49. For a funded plan, the actual return on plan assets shall be determined based on the fair value of plan assets (refer to paragraphs 65 and 66) at the beginning and end of the period, adjusted for contributions and benefit payments. If the fund holding the plan assets is a taxable entity, the actual return on plan assets shall reflect the tax expense or benefit for the period determined in accordance with generally accepted accounting principles. Otherwise, no provision for taxes shall be included in the actual return on plan assets.

[18]Amortization of the transition obligation or asset will be adjusted prospectively to recognize the effects of (a) a negative plan amendment pursuant to paragraph 55, (b) a constraint on immediate recognition of a net gain or loss pursuant to paragraph 60, (c) settlement accounting pursuant to paragraphs 92 and 93, (d) plan curtailment accounting pursuant to paragraphs 97–99, and (e) a constraint on delayed amortization of the transition obligation pursuant to paragraph 112.

Prior service cost

50. Plan amendments (including initiation of a plan) may include provisions that attribute the increase or reduction in benefits to employee service rendered in prior periods or only to employee service to be rendered in future periods. For purposes of measuring the accumulated postretirement benefit obligation, the effect of a plan amendment on a plan participant's expected postretirement benefit obligation shall be attributed to each year of service in that plan participant's attribution period, including years of service already rendered by that plan participant, in accordance with the attribution of the expected postretirement benefit obligation to years of service as discussed in paragraphs 43 and 44. If a plan is initiated that grants benefits solely in exchange for employee service after the date of the plan initiation or a future date, no portion of the expected postretirement benefit obligation is attributed to prior service periods because, in that case, the credited service period for the current employees who are expected to receive benefits under the plan begins at the date of the plan initiation or the future date.

51. Plan amendments that improve benefits are granted with the expectation that the employer will realize economic benefits in future periods. Consequently, except as discussed in paragraph 54, this Statement does not permit the cost of benefit improvements (that is, prior service cost) to be included in net periodic postretirement benefit cost entirely in the year of the amendment. Rather, paragraph 52 provides for recognition of prior service cost arising from benefit improvements during the remaining years of service to the full eligibility dates of those plan participants active at the date of the plan amendment. (Refer to paragraph 55 for plan amendments that reduce benefits.)

52. A plan amendment that retroactively increases benefits (including benefits that are granted to **fully eligible plan participants**) increases the accumulated postretirement benefit obligation. The cost of the benefit improvement shall be recognized as a charge to other comprehensive income at the date of the amendment. Except as specified in the next sentence and in paragraphs 53 and 54, that prior service cost shall be amortized as a component of net periodic postretirement benefit cost by assigning an equal amount to each remaining year of service to the full eligibility date of each plan participant active at the date of the amendment who was not yet fully eligible for benefits at that date. If all or almost all of a plan's participants are fully eligible for benefits, the prior service cost shall be amortized based on the remaining life expectancy of those plan participants rather than on the remaining years of service to the full eligibility dates of the active plan participants. Other comprehensive income is adjusted as a result of amortizing prior service cost.

53. To reduce the complexity and detail of the computations required, consistent use of an alternative approach that more rapidly amortizes the prior service cost recognized in accumulated other comprehensive income is permitted. For example, a straight-line amortization of the cost over the average remaining years of service to full eligibility for benefits of the active plan participants is acceptable.

54. 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 that grants increased benefits is shorter than the remaining years of service to full eligibility for benefits of the active plan participants. Identification of those situations requires an assessment of the individual circumstances of the particular plan. 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.

55. A plan amendment that retroactively reduces, rather than increases, benefits decreases the accumulated postretirement benefit obligation. The reduction in benefits shall be recognized as a corresponding credit (prior service credit) to other comprehensive income that shall be used first to reduce any remaining prior service cost included in accumulated other comprehensive income, then to reduce any transition obligation remaining in accumulated other comprehensive income. The excess, if any, shall be amortized as a component of net periodic postretirement benefit cost on the same basis as specified in paragraph 52 for prior service cost. Immediate recognition of the excess is not permitted.

Gains and losses

56. Gains and losses are changes in the amount of either the accumulated postretirement benefit obligation or plan assets resulting from experience different from that assumed or from changes in assumptions. This Statement generally does not distinguish between those sources of gains and losses. Gains and

losses include amounts that have been realized, for example, by the 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 postretirement benefit cost in the period in which they arise, except as described in paragraph 61. Gains and losses that are not recognized immediately as a component of net periodic postretirement benefit cost shall be recognized as increases or decreases in other comprehensive income as they arise. (Gain and loss recognition in accounting for settlements and curtailments is addressed in paragraphs 90–99.)

57. The expected return on plan assets shall be determined based on the expected long-term rate of return on plan assets (refer to paragraph 32) 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 methods 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 class of plan assets.

58. Plan asset gains and losses are differences between the actual return on plan assets during a period and the expected return on plan assets for that period. Plan asset gains and losses include both (a) changes reflected in the market-related value of plan assets and (b) changes not yet reflected in the market-related value of plan assets (that is, the difference between the fair value and the market-related value of plan assets). Plan asset gains and losses not yet reflected in market-related value are not required to be amortized under paragraphs 59 and 60.

59. As a minimum, amortization of a net gain or loss included in accumulated other comprehensive income (excluding plan asset gains and losses not yet reflected in market-related value) shall be included as a component of net periodic postretirement benefit cost for a year if, as of the beginning of the year, that net gain or loss exceeds 10 percent of the greater of the accumulated postretirement benefit obligation or the market-related value of plan assets. If amortization is required, the minimum amortization[19] shall be that excess divided by the average remaining service period of active plan participants. 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 the average remaining service period.

60. Any systematic method of amortizing gains and losses included in accumulated other comprehensive income may be used in place of the minimum amortization specified in paragraph 59 provided that (a) the minimum amortization is recognized in any period in which it is greater (reduces the net gain or loss balance by more) than the amount that would be recognized under the method used, (b) the method is applied consistently, (c) the method is applied similarly to both gains and losses, and (d) the method used is disclosed. If an enterprise uses a method of consistently recognizing gains and losses immediately, any gain that does not offset a loss previously recognized in income pursuant to this paragraph shall first offset any transition obligation remaining in accumulated other comprehensive income; any loss that does not offset a gain previously recognized in income pursuant to this paragraph shall first offset any transition asset remaining in accumulated other comprehensive income.

61. In some situations, an employer may forgive a retrospective adjustment of the current or past years' cost-sharing provisions of the plan as they relate to benefit costs *already incurred* by retirees[20] or may otherwise deviate from the provisions of the substantive plan to increase or decrease the employer's share of the benefit costs *incurred in the current or past periods.* The effect of a decision to temporarily deviate

[19]The amortization must always reduce the beginning-of-the-year balance included in accumulated other comprehensive income. Amortization of a net gain included in accumulated other comprehensive income results in a decrease in net periodic postretirement benefit cost; amortization of a net loss included in accumulated other comprehensive income results in an increase in net periodic postretirement benefit cost.

[20]For example, the terms of a substantive postretirement health care plan may provide that any shortfall resulting from current year benefit payments in excess of the employer's stated share of incurred claims cost and retiree contributions for that year is to be recovered from increased retiree contributions in the subsequent year. The employer may subsequently determine that increasing retiree contributions for the shortfall in the prior year would be onerous and make a decision to bear the cost of the shortfall for that year. The employer's decision to bear the shortfall represents a change in intent and the resulting loss shall be recognized immediately. Future decisions by the employer to continue to bear the shortfall suggest an amendment of the substantive plan that should be accounted for as described in paragraphs 50–55.

from the substantive plan shall be immediately recognized as a loss or gain.

62. The gain or loss component of net periodic postretirement benefit cost shall consist of (a) the difference between the actual return on plan assets and the expected return on plan assets, (b) any gain or loss immediately recognized or the amortization of the net gain or loss included in accumulated other comprehensive income, and (c) any amount immediately recognized as a gain or loss pursuant to paragraph 61.

Measurement of Plan Assets

63. Plan assets are assets—usually stocks, bonds, and other investments (except certain **insurance contracts** as noted in paragraph 67)—that have been segregated and restricted (usually in a trust) to be used for postretirement benefits. The amount of plan assets includes amounts contributed by the employer, and by plan participants for a contributory plan, and amounts earned from investing the contributions, less benefits, income taxes, and other expenses incurred. 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. Securities of the employer held by the plan are includable in plan assets provided they are transferable.

64. 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 the employer may intend that those assets be used to provide postretirement benefits. Those assets shall be accounted for in the same manner as other employer assets of a similar nature and with similar restrictions. Amounts accrued by the employer but not yet paid to the plan are not plan assets for purposes of this Statement.

Editor's note: After adoption of FASB Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans,* and prior to adoption of FASB Statement No. 157, *Fair Value Measurements,* paragraph 65 and related footnotes should read as follows:

65. For purposes of the disclosures required by paragraphs 5 and 8 of FASB Statement No. 132 (revised 2003), *Employers' Disclosures about Pensions and Other Postretirement Benefits,* 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 an active 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[20a] may aid in estimating fair value, provided the expected cash flows are discounted at a current rate commensurate with the risk involved.[21] (Refer to paragraph 71.)

[20a]This pronouncement was issued prior to FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements,* and therefore the term *expected cash flows* does not necessarily have the same meaning as that term in Concepts Statement 7.

[21]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.

Editor's note: After adoption of both Statements 158 and 157, paragraph 65 and related footnotes should read as follows:

65. For purposes of the disclosures required by paragraphs 5 and 8 of FASB Statement No. 132 (revised 2003), *Employers' Disclosures about Pensions and Other Postretirement Benefits,* plan investments, whether equity or debt securities, real estate, or other, shall be measured at their fair value as of the measurement date.[21] (Refer to paragraph 71.)

[20a][This footnote has been deleted. See Status page.]

[21]The fair value of an investment shall be reduced by brokerage commissions and other costs normally incurred in a sale if those costs are significant (similar to fair value less cost to sell).

66. 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.

Insurance Contracts

67. For purposes of this Statement, an insurance contract is defined as a contract in which an insurance company unconditionally undertakes a legal obligation to provide specified benefits to specific individuals in return for a fixed consideration or

premium; an insurance contract is irrevocable and involves the transfer of significant risk from the employer (or the plan) to the insurance company.[22] Benefits covered by insurance contracts shall be excluded from the accumulated postretirement benefit obligation. Insurance contracts shall be excluded from plan assets, except as provided in paragraph 69 for the cost of **participation rights.**

68. Some insurance contracts (**participating insurance 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. If the participating insurance contract causes the employer to remain subject to all or most of the risks and rewards associated with the benefit obligation covered or the assets transferred to the insurance company, that contract is not an insurance contract for purposes of this Statement, and the purchase of that contract does not constitute a settlement pursuant to paragraphs 90–95.

69. The purchase price of a participating insurance contract ordinarily is higher than the price of an equivalent contract without a participation right. 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.

70. To the extent that insurance contracts are purchased during the period to cover postretirement benefits attributed to service in the current period (such as life insurance benefits), the cost of those benefits shall be the cost of purchasing the coverage under the contracts, except as provided in paragraph 69 for the cost of a participation right. If all the postretirement benefits attributed to service in the current period are covered by **nonparticipating insurance contracts** purchased during that period, the cost of the contracts determines the service cost component of net postretirement benefit cost for that period. Benefits attributed to current service in excess of benefits provided by nonparticipating insurance contracts purchased during the current period shall be accounted for according to the provisions of this Statement applicable to plans not involving insurance contracts.

71. Other contracts with insurance companies may not meet the definition of an insurance contract because the insurance company does not unconditionally undertake a legal obligation to provide specified benefits to specified individuals. Those contracts shall be accounted for as investments and measured at fair value. If a contract has a determinable cash surrender value or conversion value, that is presumed to be its fair value. For some contracts, the best available estimate of fair value may be contract value.

Measurement Date

72. The measurements of *plan assets and benefit obligations* required by this Statement shall be as of the date of the employer's fiscal year-end statement of financial position, unless (a) the plan is sponsored by a subsidiary that is consolidated using a fiscal period that differs from its parent's, as permitted by ARB No. 51, *Consolidated Financial Statements,* or (b) the plan is sponsored by an investee that is accounted for using the equity method of accounting under APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock,* using financial statements of the investee for a fiscal period that is different from the investor's, as permitted by Opinion 18. In those cases, the employer shall measure the subsidiary's plan assets and benefit obligations as of the date used to consolidate the subsidiary's statement of financial position and shall measure the investee's plan assets and benefit obligations as of the date of the investee's financial statements used to apply the equity method. Even though the postretirement benefit measurements are required as of a particular date, all procedures are not required to 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).

73. Measurements of *net periodic postretirement benefit cost* for both interim and annual financial statements generally shall be based on the assumptions at the beginning of the year (assumptions used

[22]If the insurance company providing the contract 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 insurance contract for purposes of this Statement.

for the previous year-end measurements of plan assets and obligations) unless more recent measurements of both plan assets and the accumulated postretirement benefit obligation are available. For example, if a significant event occurs, such as a plan amendment, settlement, or curtailment, that ordinarily would call for remeasurement, the assumptions used for those later measurements shall be used to remeasure net periodic postretirement benefit cost from the date of the event to the year-end measurement date. Unless an employer remeasures both its plan assets and benefit obligations during the fiscal year, the funded status it reports in its interim-period statement of financial position shall be the same asset or liability recognized in the previous year-end statement of financial position adjusted for (a) subsequent accruals of net periodic postretirement benefit cost that exclude the amortization of amounts previously recognized in other comprehensive income (for example, subsequent accruals of service cost, interest cost, and return on plan assets) and (b) contributions to a funded plan, or benefit payments. Upon remeasurement, a business entity shall adjust its statement of financial position in a subsequent interim period (on a delayed basis if the measurement date provisions of FASB Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans,* have not yet been implemented) to reflect the overfunded or underfunded status of the plan consistent with that measurement date.

Disclosures

74. Refer to paragraphs 5 and 8 of Statement 132(R).

Employers with Two or More Plans

75. Postretirement benefits offered by an employer may vary in nature and may be provided to different groups of employees. As discussed in paragraph 76, in some cases an employer may aggregate data from unfunded plans for measurement purposes in lieu of performing separate measurements for each unfunded plan (including plans whose designated assets are not appropriately segregated and restricted and thus have no plan assets as that term is used in this Statement). Net periodic postretirement benefit cost, the accumulated postretirement benefit obligation, and plan assets shall be determined for each separately measured plan or aggregation of plans by applying the provisions of this Statement to each such plan or aggregation of plans.

76. The data from all unfunded postretirement health care plans may be aggregated for measurement purposes if (a) those plans provide different benefits to the same group of employees or (b) those plans provide the same benefits to different groups of employees. Data from other unfunded postretirement welfare benefit plans may be aggregated for measurement purposes in similar circumstances, such as when an employer has a variety of welfare benefit plans that provide benefits to the same group of employees. However, a plan that has plan assets (as defined herein) shall not be aggregated with other plans but shall be measured separately.

77–78. Refer to paragraphs 6 and 7 of Statement 132(R).

Multiemployer Plans

79. For purposes of this Statement, a **multiemployer plan** is a postretirement benefit 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.

80. 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.

81. An employer participating in a multiemployer plan shall recognize as net postretirement benefit cost the required contribution for the period, which shall include both cash and the fair market value of noncash contributions, and shall recognize as a liability any unpaid contributions required for the period.

[23][This footnote has been deleted. See Status page.]

82. Refer to paragraph 10 of Statement 132(R).

83. In some situations, withdrawal from a multiemployer plan may result in an employer's having an obligation to the plan for a portion of the plan's unfunded accumulated postretirement benefit obligation. If it is either probable or reasonably possible that (a) an employer would withdraw from the plan under circumstances that would give rise to an obligation or (b) an employer's contribution to the fund would be increased during the remainder of the contract period to make up a shortfall in the funds necessary to maintain the negotiated level of benefit coverage (a "maintenance of benefits" clause), the employer shall apply the provisions of FASB Statement No. 5, *Accounting for Contingencies.*

Multiple-Employer Plans

84. Some postretirement benefit plans to which two or more unrelated employers contribute are not multiemployer plans. Rather, those **multiple-employer plans** are in substance aggregations of single-employer plans, combined to allow participating employers to pool plan assets for investment purposes or 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. Those 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.

Postretirement Benefit Plans outside the United States

85. Except for its effective date (paragraph 108), this Statement includes no special provisions applicable to postretirement benefit arrangements outside the United States. Those arrangements 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 applicability of this Statement to those arrangements 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.

Business Combinations

[Note: Prior to the adoption of FASB Statement No. 141 (revised 2007), ***Business Combinations*** **(effective for business combinations with an acquisition date on or after the beginning of the first annual reporting period beginning on or after 12/15/08), paragraph 86 should read as follows:]**

86. When an employer is acquired in a business combination and that employer sponsors a single-employer defined benefit postretirement plan, the assignment of the purchase price to individual assets acquired and liabilities assumed shall include a liability for the accumulated postretirement benefit obligation in excess of the fair value of the plan assets or an asset for the fair value of the plan assets in excess of the accumulated postretirement benefit obligation. The accumulated postretirement benefit obligation assumed shall be measured based on the benefits attributed by the acquired entity to employee service prior to the date the business combination is consummated, adjusted to reflect (a) any changes in assumptions based on the purchaser's assessment of relevant future events (as discussed in paragraphs 23–42) and (b) the terms of the substantive plan (as discussed in paragraphs 23–28) to be provided by the purchaser to the extent they differ from the terms of the acquired entity's substantive plan.

[Note: After the adoption of Statement 141(R) by business entities or the adoption of FASB Statement No. 164, ***Not-for-Profit Entities: Mergers and Acquisitions*** **(effective prospectively in the first set of initial or annual financial statements for a reporting period beginning on or after December 15, 2009) by not-for-profit entities, paragraph 86 should read as follows:]**

86. If an acquiree sponsors a single-employer defined benefit postretirement plan, the acquirer shall recognize as part of the business combination an asset or a liability representing the funded status of the plan (paragraph 44A). In determining that funded status, the acquirer shall exclude the effects of expected plan amendments, terminations, or curtailments that at the acquisition date it has no obligation to make. The accumulated postretirement benefit obligation assumed shall reflect any other necessary changes in assumptions based on the acquirer's assessment of relevant future events. If an acquiree participates in a multiemployer plan and it is probable as of the acquisition date that the acquirer will withdraw from that plan, the acquirer shall recognize as part of

the business combination a withdrawal liability in accordance with Statement 5.

[Note: After the adoption of Statement 141(R) (effective for business combinations with an acquisition date on or after the beginning of the first annual reporting period beginning on or after 12/15/08), paragraphs 87 and 88 are deleted.]

87. If the postretirement benefit plan of the acquired entity is amended as a condition of the business combination (for example, if the change is required by the seller as part of the consummation of the acquisition), the effects of any improvements attributed to services rendered by the participants of the acquired entity's plan prior to the date of the business combination shall be accounted for as part of the accumulated postretirement benefit obligation of the acquired entity. Otherwise, if improvements to the postretirement benefit plan of the acquired entity are not a condition of the business combination, credit granted for prior service shall be recognized as a plan amendment as discussed in paragraphs 50–55. If it is expected that the plan will be terminated or curtailed, the effects of those actions shall be considered in measuring the accumulated postretirement benefit obligation. Otherwise, no future changes to the plan shall be anticipated.

88. As a result of applying the provisions of paragraphs 86 and 87, any previously existing net gain or loss, prior service cost or credit, or transition obligation or transition asset remaining in accumulated other comprehensive income is eliminated for the acquired employer's plan.

Amendment to Opinion 16

89. The following footnote is added to the end of the last sentence of paragraph 88 of Opinion 16:

> *Paragraphs 86–88 of FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions,* specify how the general guidelines of this paragraph shall be applied to assets and liabilities related to plans that provide postretirement benefits other than pensions.

Accounting for Settlement of a Postretirement Benefit Obligation

90. For purposes of this Statement, a settlement is defined as a transaction that (a) is an irrevocable action, (b) relieves the employer (or the plan) of primary responsibility for a postretirement benefit obligation, and (c) eliminates significant risks related to the obligation and the assets used to effect the settlement.[24] Examples of transactions that constitute a settlement include making lump-sum cash payments to plan participants in exchange for their rights to receive specified postretirement benefits and purchasing long-term nonparticipating insurance contracts for the accumulated postretirement benefit obligation for some or all of the plan participants.

91. A transaction that does not meet the three criteria of paragraph 90 does not constitute a settlement for purposes of this Statement. For example, investing in a portfolio of high-quality fixed-income securities with principal and interest payment dates similar to the estimated payment dates of benefits may avoid or minimize certain risks. However, that investment decision does not constitute a settlement because that decision can be reversed, and investing in that portfolio does not relieve the employer (or the plan) of primary responsibility for a postretirement benefit obligation nor does it eliminate significant risks related to that obligation.

92. For purposes of this Statement, the maximum gain or loss subject to recognition in income when a postretirement benefit obligation is settled is the net gain or loss included in accumulated other comprehensive income defined in paragraphs 56–60 plus any transition asset remaining in accumulated other comprehensive income. That maximum gain or loss includes any gain or loss resulting from remeasurements of plan assets and the accumulated postretirement benefit obligation at the time of settlement.

93. If the entire accumulated postretirement benefit obligation is settled and the maximum amount subject to recognition is a gain, the settlement gain shall

[24]If an insurance contract is purchased from an insurance company controlled by the employer, the purchase of the contract does not constitute a settlement.

first reduce any transition obligation remaining in accumulated other comprehensive income;[25] any excess gain shall be recognized in income.[26] If the entire accumulated postretirement benefit obligation is settled and the maximum amount subject to recognition is a loss, the maximum settlement loss shall be recognized in income. If only part of the accumulated postretirement benefit obligation is settled, the employer shall recognize in income the excess of the pro rata portion (equal to the percentage reduction in the accumulated postretirement benefit obligation) of the maximum settlement gain over any remaining transition obligation or a pro rata portion of the maximum settlement loss.

94. If the purchase of a participating insurance contract constitutes a settlement (refer to paragraphs 67 and 90), the maximum gain (but not the maximum loss) shall be reduced by the cost of the participation right before determining the amount to be recognized in income.

95. If the cost of all settlements[27] in a year is less than or equal to the sum of the service cost and interest cost components of net postretirement benefit cost for the plan for the year, gain or loss recognition is permitted but not required for those settlements. However, the accounting policy adopted shall be applied consistently from year to year.

Accounting for a Plan Curtailment

96. For purposes of this Statement, a curtailment is an event that significantly reduces the expected years of future service of active plan participants or eliminates the accrual of defined benefits for some or all of the future services of a significant number of active plan participants. Curtailments include:

a. Termination of employees' services earlier than expected, which may or may not involve closing a facility or discontinuing a component of an entity
b. Termination or suspension of a plan so that employees do not earn additional benefits for future service. In the latter situation, future service may be counted toward eligibility for benefits accumulated based on past service.

97. The prior service cost included in accumulated other comprehensive income associated with the portion of the future years of service that had been expected to be rendered, but as a result of a curtailment are no longer expected to be rendered, is a loss. For purposes of measuring the effect of a curtailment, prior service cost includes the cost of plan amendments and any remaining transition obligation. For example, a curtailment may result from the termination of a significant number of employees who were plan participants at the date of a prior plan amendment.[28] The loss associated with that curtailment is measured as the portion of the remaining prior service cost included in accumulated other comprehensive income related to that (and any prior) plan amendment attributable to the previously expected remaining future years of service of the employees who were terminated and the portion of the remaining transition obligation attributable to the previously expected remaining future years of service of the terminated employees who were plan participants at the date of transition.

98. The accumulated postretirement benefit obligation may be decreased (a gain) or increased (a loss)

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[25]As discussed in paragraph 112, in measuring the gain or loss subject to recognition in income when a postretirement benefit obligation is settled, it shall first be determined whether amortization of an additional amount of any transition obligation is required.

[26]Because the plan is the unit of accounting, the determination of the effects of a settlement considers only the net gain or loss and transition obligation or asset included in accumulated other comprehensive income related to the plan for which all or a portion of the accumulated postretirement benefit obligation is being settled.

[27]For the following types of settlements, the cost of the settlement is:

a. For a cash settlement, the amount of cash paid to plan participants
b. For a settlement using nonparticipating insurance contracts, the cost of the contracts
c. For a settlement using participating insurance contracts, the cost of the contracts less the amount attributed to participation rights. (Refer to paragraphs 68 and 69.)

[28]A curtailment also may result from terminating the accrual of additional benefits for the future services of a significant number of employees. The loss in that situation is (a) a proportionate amount of the remaining prior service cost included in accumulated other comprehensive income based on the portion of the remaining expected years of service in the amortization period that originally was attributable to those employees who were plan participants at the date of the plan amendment and whose future accrual of benefits has been terminated and (b) a proportionate amount of the transition obligation remaining in accumulated other comprehensive income based on the portion of the remaining years of service of all participants active at the date of transition that originally was attributable to the remaining expected future years of service of the employees whose future accrual of benefits has been terminated.

by a curtailment.[29] That (gain) loss shall reduce any net loss (gain) included in accumulated other comprehensive income.

a. To the extent that such a gain exceeds any net loss included in accumulated other comprehensive income (or the entire gain, if a net gain exists), it is a curtailment gain.
b. To the extent that such a loss exceeds any net gain included in accumulated other comprehensive income (or the entire loss, if a net loss exists), it is a curtailment loss.

For purposes of applying the provisions of this paragraph, any transition asset remaining in accumulated other comprehensive income shall be treated as a net gain and shall be combined with the net gain or loss arising subsequent to transition to this Statement.

99. If the sum of the effects identified in paragraphs 97 and 98 is a net loss, it shall be recognized in income when it is probable that a curtailment will occur and the net effect is reasonably estimable. If the sum of those effects is a net gain, it shall be recognized in income when the related employees terminate or the plan suspension or amendment is adopted.

Relationship of Settlements and Curtailments to Other Events

100. A settlement and a curtailment may occur separately or together. If benefits expected to be paid in future periods are eliminated for some plan participants (for example, because a significant portion of the work force is dismissed or a plant is closed) but the plan remains in existence and continues to pay benefits, to invest assets, and to receive contributions, a curtailment has occurred but not a settlement. If an employer purchases nonparticipating insurance contracts for the accumulated postretirement benefit obligation and continues to provide defined benefits for future service, either in the same plan or in a successor plan, a settlement has occurred but not a curtailment. If a **plan termination** occurs (that is, the obligation is settled and the plan ceases to exist) and the plan is not replaced by a successor defined benefit plan, both a settlement and a curtailment have occurred (whether or not the employees continue to work for the employer).

Measurement of the Effects of Termination Benefits

101. Postretirement benefits offered as special or contractual termination benefits shall be recognized in accordance with paragraph 15 of Statement 88. That is, an employer that offers special termination benefits to employees shall recognize a liability and a loss when the employees accept the offer and the amount can be reasonably estimated. An employer that provides contractual termination benefits shall recognize a liability and a loss when it is probable that employees will be entitled to benefits and the amount can be reasonably estimated. A situation involving special or contractual termination benefits may also result in a curtailment to be accounted for under paragraphs 96–99 of this Statement.

102. The liability and loss recognized for employees who accept an offer of special termination benefits to be provided by a postretirement benefit plan shall be the difference between (a) the accumulated postretirement benefit obligation for those employees, assuming that those employees (active plan participants) not yet fully eligible for benefits would terminate at their full eligibility date and that fully eligible plan participants would retire immediately, without considering any special termination benefits and (b) the accumulated postretirement benefit obligation as measured in (a) adjusted to reflect the special termination benefits.

103. [This paragraph has been deleted. See Status page.]

Not-for-Profit Organizations and Other Entities That Do Not Report Other Comprehensive Income

103A. A not-for-profit employer shall recognize as a separate line item or items within changes in unrestricted net assets, apart from expenses, the gains or losses and the prior service costs or credits that would be recognized in other comprehensive income pursuant to paragraphs 52, 55, and 56 of this Statement. Consistent with the provisions of FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations,* this Statement does not prescribe whether the separate line item or items shall be included within or outside an intermediate measure of operations or performance indicator, if one is presented. The AICPA Audit and Accounting Guide,

[29]Increases in the accumulated postretirement benefit obligation that reflect termination benefits are excluded from the scope of this paragraph. (Refer to paragraphs 101 and 102.)

Health Care Organizations, requires a not-for-profit organization within its scope to report items of other comprehensive income outside the performance indicator.

103B. A not-for-profit employer shall reclassify to net periodic postretirement benefit cost a portion of the net gain or loss and prior service costs or credits previously recognized in a separate line item or items and a portion of the transition asset or obligation remaining from the initial application of this Statement, pursuant to the recognition and amortization provisions of paragraphs 50–62, 112, and 113. The contra adjustment or adjustments shall be reported in the same line item or items within changes in unrestricted net assets, apart from expenses, as the initially recognized amounts. Net periodic postretirement benefit cost shall be reported by functional classification pursuant to paragraph 26 of Statement 117.

103C. In applying the provisions of this Statement to not-for-profit employers, the references to accumulated other comprehensive income in paragraphs 22, 46(d), 46(f), 53, 55, 59 (and its related footnote 19), 60, 62, 88, 92, 93 (and its related footnote 26), 97 (and its related footnote 28), 98, and 518, and the references to amounts previously recognized in other comprehensive income in paragraphs 73 and 518, shall instead be to the gains or losses, prior service costs or credits, and transition obligation or asset that have been recognized as changes in unrestricted net assets arising from a postretirement benefit plan but not yet reclassified as components of net periodic postretirement benefit cost.

103D. An employer other than a not-for-profit employer that does not report other comprehensive income pursuant to FASB Statement No. 130, *Reporting Comprehensive Income,* shall apply the provisions of paragraphs 103A–103C in an analogous manner that is appropriate for its method of reporting financial performance and financial position.

Defined Contribution Plans

104. For purposes of this Statement, a **defined contribution postretirement plan** is a plan that provides postretirement 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 postretirement benefits the individual is to receive.[30] Under a defined contribution plan, the postretirement benefits a plan participant will receive are limited to the amount contributed to the plan participant's account, the returns earned on investments of those contributions, and forfeitures of other plan participants' benefits that may be allocated to the plan participant's account.

105. To the extent a plan's defined contributions to an individual's account are to be made for periods in which that individual renders services, the net postretirement benefit 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.

106. Refer to paragraph 11 of Statement 132(R).

107. A postretirement benefit 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 requirements shall be determined in accordance with the provisions of this Statement applicable to a defined benefit plan and the disclosure requirements shall be determined in accordance with the provisions of paragraphs 5 and 8 of Statement 132(R).

Effective Dates and Transition

108. Except as noted in the following sentences of this paragraph and in paragraphs 114 and 115, this Statement shall be effective for fiscal years beginning after December 15, 1992. For plans outside the United States and for defined benefit plans of employers that (a) are **nonpublic enterprises** and (b) sponsor defined benefit postretirement plan(s) with no more than 500 plan participants in the aggregate, this Statement shall be effective for fiscal years beginning after December 15, 1994. Earlier application is encouraged. Restatement of previously issued annual financial statements is not permitted. If a decision is made in other than the first interim period of

[30]For example, an employer may establish individual postretirement health care accounts for each employee, each year contributing a specified amount to each active employee's account. The balance in each employee's account may be used by that employee after the employee's retirement to purchase health care insurance or for other health care benefits. Rather than providing for defined health care benefits, the employer is providing a defined amount of money that may be used by retirees toward the payment of their health care costs.

an employer's fiscal year to apply this Statement early, previous interim periods of that year shall be restated.

109. If at the transition date an employer has excluded assets in a **postretirement benefit fund** from its statement of financial position and some or all of the assets in that fund do not qualify as plan assets as defined herein, the employer shall recognize in the statement of financial position the fair value of those nonqualifying assets as the employer's assets (not prepaid postretirement benefit cost) and an equal amount as an accrued postretirement benefit obligation pursuant to the transition to this Statement and before applying paragraph 110. Thereafter, those assets shall be accounted for in accordance with generally accepted accounting principles applicable to those types of assets, including their presentation in the employer's statement of financial position based on any restrictions on their use. The fair value of those assets at the transition date shall be used as their cost.

110. For a defined benefit plan, an employer shall determine as of the measurement date (paragraph 72) for the beginning of the fiscal year in which this Statement is first applied (the transition date), the amounts of (a) the accumulated postretirement benefit obligation and (b) the fair value of plan assets plus any recognized accrued postretirement benefit cost or less any recognized prepaid postretirement benefit cost. The difference between those two amounts, whether it represents a transition obligation or a transition asset, may be recognized either immediately in net income of the period of the change (paragraph 111) as the effect of a change in accounting principle,[31] or on a delayed basis (paragraph 112) as a component of net periodic postretirement benefit cost. Any transition obligation related to a defined contribution plan shall be recognized in the same manner. A single method of transition shall be elected at the date this Statement is initially applied for all defined benefit and defined contribution postretirement plans.

111. If immediate recognition of the transition obligation or asset is elected, the amount attributable to the effects of a plan initiation or any benefit improvements adopted after December 21, 1990 shall be treated as unrecognized prior service cost and excluded from the transition amount immediately recognized. In addition, an employer who chooses to immediately recognize the transition obligation or asset shall, at the date of transition, adjust as necessary the accounting for purchase business combinations consummated subsequent to December 21, 1990 to include in the assignment of the purchase price to assets acquired and liabilities assumed, recognition of the difference between the accumulated postretirement benefit obligation and the fair value of the plan assets, as described in paragraphs 87 and 88. If reliable information on which to base measurement of the assumed postretirement benefit obligation as of the date the business combination is consummated is not available, the purchaser shall retroactively adjust the purchase price allocation to recognize the obligation assumed or the asset acquired, using the best information available at the date of transition to this Statement. The cumulative effect on prior periods' income of that retroactive adjustment of the purchase price allocation, for example, increased amortization of goodwill associated with the business combination, and the amortization of prior service cost related to a plan initiation or amendment adopted after December 21, 1990, shall be recognized as part of the effect of the accounting change to adopt this Statement.

112. If delayed recognition is elected, the transition obligation or asset shall be amortized on a straight-line basis over the average remaining service period of active plan participants, except that (a) if the average remaining service period is less than 20 years, the employer may elect to use a 20-year period, and (b) if all or almost all of the plan participants are inactive, the employer shall use the average remaining life expectancy period of those plan participants. However, amortization of the transition obligation shall be accelerated if the cumulative benefit payments subsequent to the transition date to all plan participants exceed the cumulative postretirement benefit cost accrued subsequent to the transition date. In that situation, an additional amount of the unrecognized transition obligation shall be recognized equal to the excess cumulative benefit payments. For purposes of applying this provision, cumulative benefit payments shall be reduced by any plan assets or any recognized accrued postretirement benefit obligation at the transition date. Payments made pursuant to a settlement, as discussed in paragraphs 90–94, shall be included

[31]The effect of the accounting change and the related income tax effect shall be presented in the statement of income between the captions "extraordinary items" and "net income." The per share information presented on the statement of income shall include the per share effect of the accounting change.

in the determination of cumulative benefit payments made subsequent to the transition date.

113. If at the measurement date for the beginning of an employer's fiscal year it is expected that additional recognition of any remaining unrecognized transition obligation will be required pursuant to paragraph 112, amortization of the transition obligation for interim reporting purposes shall be based on the amount expected to be amortized for the year, except for the effects of applying paragraph 112 for any settlement required to be accounted for pursuant to paragraphs 90–94. Those effects shall be recognized when the related settlement is recognized. The effects of changes during the year in the initial assessment of whether additional recognition of the unrecognized transition obligation will be required for the year shall be recognized over the remainder of the year. The amount of the unrecognized transition obligation to be recognized for a year shall be finally determined at the measurement date for the end of the year based on the constraints on delayed recognition discussed in paragraph 112; any difference between the amortization of the transition obligation recognized during interim periods and the amount required to be recognized for the year shall be recognized immediately.

Effective Date and Transition—Amendment to Opinion 12

114. Paragraph 6 and the related footnote of APB Opinion No. 12, *Omnibus Opinion—1967,* are amended effective for fiscal years beginning after March 15, 1991. The effect of the amendment on existing individual deferred compensation contracts, other than those providing postretirement health or welfare benefits, shall be recognized as the effect of a change in accounting principle in accordance with paragraphs 17–21 of APB Opinion No. 20, *Accounting Changes.* Individual deferred compensation contracts that provide postretirement health or welfare benefits shall be subject to the general transition provisions and effective dates of this Statement.

Rescission of Technical Bulletin 87-1

115. Effective with the issuance of this Statement, FASB Technical Bulletin No. 87-1, *Accounting for a Change in Method of Accounting for Certain Postretirement Benefits,* is rescinded. If a change in method of accounting for postretirement benefits is adopted subsequent to the issuance of this Statement, the new method shall comply with the provisions of this Statement.

The provisions of this Statement need not be applied to immaterial items.

This Statement was adopted by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Dennis R. Beresford, *Chairman*
Victor H. Brown
Raymond C. Lauver
James J. Leisenring
C. Arthur Northrop
A. Clarence Sampson
Robert J. Swieringa

Appendix A

BASIS FOR CONCLUSIONS

CONTENTS

	Paragraph Numbers
Introduction	116–117
Benefits and Costs	118–132
Scope	133–139
Evolutionary Changes in Accounting Principles	140–141
Improvements in Financial Reporting	142–145
Conclusions on Basic Issues—Single-Employer Defined Benefit Postretirement Plans	146–272
The Exchange	146–147
Funding and Accrual Accounting	148–150
The Principal Issues	151–267
The Liability	152–165
Criteria for Recognition	159–163
Recognition versus Disclosure	164–165
Measurement of Cost and Obligations	166–246
Accounting for the Substantive Plan	172–176
Contributory Plans	177–178
Assumptions	179–196
Assumptions Unique to Postretirement Health Care Benefits	197–199
Attribution Method	200–218
Attribution Period	219–239
Amount Attributed	240–244
Attribution Pattern	245–246
Transition	247–267
Components of Net Periodic Postretirement Benefit Cost	268–272
Conclusions on Other Issues—Single-Employer Defined Benefit Postretirement Plans	273–364
Fundamentals of Postretirement Benefit Accounting	273–276
Recognition and Measurement of a Plan Initiation or Amendment	277–290
Recognition of Prior Service Cost	285–289
Recognition of the Effect of a Plan Amendment That Reduces Benefits (Negative Plan Amendment)	290

	Paragraph Numbers
Delayed Recognition of Gains and Losses	291–302
Minimum Liability	303–307
Measurement of Plan Assets	308–311
Measurement Date	312–314
Settlements and Curtailments	315–332
Settlement of the Obligation	319–325
Curtailment of the Plan	326–332
Measurement of Special Termination Benefits	333–338
Disclosure	339–356
General Considerations	339–341
Specific Disclosure Requirements	342–356
Descriptive Information	342–343
Net Periodic Postretirement Benefit Cost Information	344
Information about Obligations and Assets	345–349
Information about Assumptions	350–356
Two or More Plans	357–358
Different Accounting for Certain Small Employers	359–363
Different Accounting for Certain Industries	364
Other Situations and Types of Plans	365–387
Contracts with Insurance Companies	365–374
Insurance Contracts Used in Settlements	372–374
Multiemployer Plans	375–378
Multiple-Employer Plans	379
Postretirement Benefit Plans outside the United States	380–381
Defined Contribution Plans	382
Business Combinations	383–387
Effective Dates	388–389

Appendix A

BASIS FOR CONCLUSIONS

Introduction

116. 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 approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

117. This Statement addresses the accounting issues related to measuring and recognizing the exchange that takes place between an employer that promises to provide postretirement health care or other welfare benefits (postretirement benefits) and the employees who render services in exchange for those benefits. The Board's conclusion to recognize postretirement benefit promises on an accrual basis over employee service periods is not a new notion; rather, it is fundamental to accounting for all deferred compensation contracts.

Benefits and Costs

118. The mission of the FASB is to "establish and improve standards of financial accounting and reporting for the guidance and education of the public, including issuers, auditors, and users of financial statements" (FASB *Rules of Procedure,* page 2). In fulfilling that mission the Board follows certain precepts, including the precept to promulgate standards only when the expected benefits of the resulting information exceed the perceived costs. The Board strives to determine that a proposed standard will fill a significant need and that the costs imposed to meet that standard, as compared with other alternatives, are justified in relation to the overall benefits of the resulting information.

119. The objective, and implicit benefit, of issuing an accounting standard is the increased credibility and representational faithfulness of financial reporting as a result of the new or revised accounting. However, the value of that incremental improvement to financial reporting is impossible to quantify. Consequently, the Board's assessment of the benefit to preparers, creditors, investors, and other users of issuing an accounting standard is, unavoidably, subjective. Like the incremental benefit of issuing an accounting standard, the incremental costs imposed by a new accounting standard are diffuse. They are borne by users and attesters as well as preparers of financial statements. Some of those costs can be quantified, albeit imprecisely and with difficulty; but, most of the benefits and many of the costs of adopting a new accounting standard cannot be quantified. How does one measure the benefit of improved financial reporting? Or stated another way, how does one assess the cost of the failure to accrue an obligation?

120. FASB Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information,* discusses the benefits and costs of accounting information. It states:

> The costs and benefits of a standard are both direct and indirect, immediate and deferred. They may be affected by change in circumstances not foreseen when the standard was promulgated. There are wide variations in the estimates that different people make about the dollar values involved and the rate of discount to be used in reducing them to a present value. . . . [It has been observed that] "the merits of any Standard, or of the Standards as a whole, can be decided finally only by judgments that are largely subjective. They cannot be decided by scientific test." [paragraph 142]

The Board believes those observations remain pertinent and accurately describe its process of considering benefits and costs.

121. An assessment of the benefits and costs of issuing an accounting standard is integral to the Board's decision-making process. Consideration of each individual issue includes the subjective weighing of the incremental improvement in financial reporting against the incremental cost of implementing the identified alternatives. At the end of that process, the Board considers the accounting provisions in the aggregate and must conclude that issuance of the standard is a sufficient improvement in financial reporting to justify the perceived costs. Paragraphs 122–132 address the Board's overall assessment of possible benefits and costs. Various benefits and costs that were deemed significant in reaching the conclusions in this Statement are described in later paragraphs of this basis for conclusions.

122. The Board believes that this Statement will fill a significant need for information about the financial

effects of postretirement benefits that have been exchanged for employee service. Those financial effects are currently omitted from most general-purpose financial statements. Pay-as-you-go (cash) basis accounting delays the recognition and measurement of those effects until postretirement benefits are paid; as a result, costs incurred currently are not recognized until future periods.

123. General-purpose financial statements imply completeness of information within the bounds of what is material and feasible. A material omission can rob financial statements of their credibility. Continuation of the present accounting practice for postretirement benefits would represent a material omission from the financial statements of many employers. That practice led some respondents to the February 1989 Exposure Draft, *Employers' Accounting for Postretirement Benefits Other Than Pensions,* to suggest immediate recognition of the currently existing obligation as the correction of an error.

124. This Statement fulfills a significant need for information by requiring the use of accrual accounting for postretirement benefits. Accrual accounting will more appropriately reflect the financial effects of an employer's existing promise to provide those benefits and the events that affect that promise in financial statements, as those events occur. That accounting will subject the employer's estimates and assumptions about the future events that will determine the amount and timing of future benefit payments to the discipline of accounting recognition and measurement, and to the independent review of auditors and others, thereby enhancing the utility of the information provided.

125. This Statement also fills the need for information by requiring descriptive disclosures about the postretirement benefit plan, current measures of the plan assets, obligations, and costs, and the effect on the employer's financial statements of the provisions for delayed recognition of certain events affecting those measures. Fulfilling the significant need for information comes at a cost—namely, the incremental cost of developing, implementing, and maintaining a measurement and reporting system to support the required accrual accounting and disclosures and the cost of learning how to use the new information.

126. Many employers have not monitored and managed their postretirement benefit obligations and costs. Consequently, a significant portion of the incremental systems cost reflects costs that a prudent employer would incur in monitoring and managing the consequences of its postretirement benefit arrangement. The Board believes that those costs should be associated with the existence of those arrangements, rather than with the requirements of this Statement. The Board also believes that there will be relatively little incremental systems cost incurred to satisfy the disclosure requirements of this Statement because the necessary information already will be developed in order to meet the basic recognition and measurement requirements.

127. The incremental cost of the accounting and disclosure requirements of this Statement has been reduced by following, to a significant extent, the precedents in Statement 87 for pension accounting. Moreover, the general approach is similar in many respects to that used by consulting actuaries who have estimated postretirement benefit costs and obligations as part of special health care cost containment studies, employee termination incentive programs, restructurings, and mergers and business combinations.

128. The incremental cost of implementing the requirements of this Statement has been increased by alternative approaches that provide for the delayed recognition of employers' transition obligations and the effects of subsequent plan amendments and gains and losses. Those provisions generally increase the complexity of the requirements, reduce understandability and comparability, and create the need for additional disclosures. However, those provisions enhance the acceptability of this Statement to the extent they reflect the views of some constituents and minimize disruption.

129. This Statement provides both general objectives and provisions and detailed guidance and illustrations. Some respondents indicated that providing detailed guidance might increase the incremental cost of the requirements of this Statement. However, a lack of detailed guidance can result in incremental costs being incurred by employers, auditors, regulators, and others by implicitly requiring that they define issues, identify and debate alternatives, assess possible effects, and select and implement solutions. Those costs are often not readily apparent but, nevertheless, are significant. Moreover, if different employers select different solutions in similar situations, with effects that are materially different, the resulting information lacks comparability, thereby reducing the benefits to investors and other users. Inevitably,

critics, regulators, and other users demand elimination of alternatives, and additional costs would be incurred as those actions are taken.

130. Some believe that employers will change the designs of postretirement benefit plans or the way those plans are financed as a result of the new information about the financial effects of postretirement benefits. In addition, some believe that the new information may provide an additional impetus to federal legislation covering employers' obligations for those plans or the deductibility of employers' advance funding of those plans. Those actions, if taken, are not the direct result of a requirement to accrue postretirement benefits, but rather, may result from more relevant and useful information on which to base decisions.

131. The Board is sensitive to the consequences that are likely to occur as a result of the new information. However, the nature and extent of those consequences are highly uncertain and are difficult to isolate from the effects of other events that will occur independent of that new information. For example, the costs of providing health care benefits are significant and are increasing. Expected future changes in those costs are likely to affect the design and funding of postretirement benefit plans and federal legislation covering those plans, regardless of the issuance of this Statement.

132. Even if the Board could isolate the likely consequences of the information provided pursuant to this Statement from other events that produce change, enhancing or diminishing the possibility of those consequences is not the Board's objective. The information provided by general-purpose financial statements is a public good. That information is shared by many interested parties with disparate interests and forms the basis for contracts and for monitoring contract performance. Both the benefits and costs of the information provided pursuant to this Statement will be recognized over time and will affect many parties differently. Those parties and the contracts they enter into will benefit from more relevant and reliable information about the incidence of postretirement benefit costs. But improved financial information comes at a cost, and while some of those parties may not pay directly for the benefits they derive from that information, they are likely to bear indirectly some of its cost.

Scope

133. In considering the scope of the project, the Board discussed various benefits provided after retirement, such as postretirement health care benefits, and benefits offered after employment but before retirement, such as temporary benefits after a layoff. Postemployment benefits provided to nonretirees may have many of the same characteristics as postretirement benefits—they may be defined in kind rather than in fixed amounts and their legal status may be uncertain. However, while most postretirement benefits are provided for the lifetime of an eligible retiree and for some covered dependents, many nonretiree postemployment benefits are provided for a specified period of time, often based on years of service. But the most important difference may lie in the fundamentally different nature of the employer's promise. Nonretiree postemployment benefits are generally more like termination compensation—a payment for not working—than deferred compensation—a delayed payment of compensation for working.

134. The Board concluded that postretirement benefits, because of their prevalence and magnitude, should be addressed in the initial stages of the project. Upon completion of this first phase, the Board will consider the need to provide guidance for accounting for other benefits offered after employment but not pursuant to retirement.

135. This Statement covers all benefits, other than cash benefits and life insurance benefits paid by pension plans, provided to current or former employees, their beneficiaries, and covered dependents during the period following the employees' retirement. Benefits encompassed include, but are not limited to, postretirement health care; life insurance provided outside a pension plan; and other welfare benefits such as tuition assistance, day care, legal services, and housing subsidies provided after retirement. The Board's conclusion about accrual of an obligation over the period of employee service rendered in exchange for that benefit is applicable to all forms of compensation.

136. Health and other welfare benefits expected to be provided to employees deemed to be on a disability retirement are within the scope of this Statement. In many cases those employees will have permanently ceased active employment because of their disabilities and retired under the disability provisions of a postretirement benefit (pension) plan. In other

cases those employees may have ceased permanent active employment because of their disabilities but not yet gone through formal "retirement" procedures and are carried on nonretired status under the disability provisions of the plan solely to continue earning additional postretirement benefits such as pensions.

137. The determination of disability benefits to be accrued pursuant to this Statement is based on the terms of the postretirement benefit plan that define when a disabled employee is entitled to postretirement benefits. For example, the provisions of the postretirement health care plan may provide postretirement health care coverage after a disabled employee attains a specified number of years of credited service (which may include credit for periods after the employee is disabled), with a separate disability plan that provides health benefits prior to that date.[32] Or, the postretirement health care plan may have special provisions for disabled employees that entitle them to benefit coverage under the postretirement benefit plan at a date earlier than that coverage would commence for other employees who are not disabled. Including disability health and other welfare benefits provided to employees on a disability retirement within the scope of this Statement is consistent with past practice, most notably in the pension area. Disability benefits offered through a pension plan are covered by Statement 87 and FASB Statement No. 35, *Accounting and Reporting by Defined Benefit Pension Plans.*

138. The Board concluded that all promises to provide postretirement benefits should be accrued whether they are provided through a plan or through individual contracts. For purposes of this Statement, the Board has defined a plan as an arrangement whereby an employer undertakes to provide its employees with benefits after they retire (terminate their service after meeting specified age, service, or age and service requirements defined by the postretirement benefit plan) in exchange for their services over a specified period of time, upon attaining a specified age, or both. The amount of the benefits can be determined or estimated in advance from the provisions of a document or documents or from the employer's current and past practices. The plan may be written or unwritten. An employer's practice of providing postretirement benefits pursuant to informal guidelines is considered to be a plan for purposes of this Statement.

139. This Statement applies to deferred compensation contracts with individual employees if those contracts, taken together, are equivalent to a postretirement benefit plan. However, an employer's practice of providing postretirement benefits to selected employees under individual contracts, with specific terms determined on an individual-by-individual basis, does not constitute a postretirement benefit plan under this Statement. This Statement amends Opinion 12 to explicitly require that the employer's obligation under those contracts be accrued following the terms of the individual contract.

Evolutionary Changes in Accounting Principles

140. The Board concluded that the changes required by this Statement represent a significant improvement in financial reporting. Paragraph 2 of FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises,* states 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 may have to be slower in some areas than in others.

141. Some Board members believe that it would be conceptually appropriate and preferable to (a) recognize an obligation for postretirement benefits that would not be less than the vested benefit obligation,[33] (b) immediately recognize the effects of plan initiations and amendments that are retroactive, and (c) immediately recognize gains and losses, perhaps with gains and losses reported currently in comprehensive income but not in earnings. However, the Board concluded that those alternatives should not be

[32]For example, an employer may promise to provide postretirement health care coverage to all employees who render 30 or more years of service. The employer may carry active employees who become disabled on active status so a disabled employee continues to accumulate credit toward postretirement benefits. Measurement of the expected postretirement benefit obligation should include an assumption that some employees who are expected to receive benefits under the postretirement benefit plan will become disabled and cease working prior to the date at which they otherwise would have been eligible for postretirement health care benefits. The measurement of the postretirement benefits expected to be paid to disabled employees would encompass only those benefits expected to be paid during the period following what otherwise would have been their full eligibility date; in this case, the date at which the employee would have completed 30 years of service. That amount is attributed to an employee's service to the date the disability is assumed to occur.

[33]As used herein, *vested postretirement benefit obligation* refers to the actuarial present value as of a particular date of the benefits expected to be paid to or for retirees, former employees, and active employees assuming they terminated immediately, including benefits expected to be paid to or for beneficiaries and any covered dependents of those plan participants.

adopted at this time. Those alternatives would be a major change from current practice and from the standards adopted by the Board for employers' accounting for pensions.

Improvements in Financial Reporting

142. This Statement represents the first authoritative accounting pronouncement that requires current recognition of the exchange transaction between an employer that promises to provide postretirement benefits and the employees who render service in exchange for the benefits promised. Employers have generally recognized the obligation and related costs arising from the exchange as the obligation was satisfied rather than when it was incurred. The Board concluded that the recognition required by this Statement should result in a more meaningful representation of the employer's financial position and results of operations at any point in time.

143. Certain aspects of the delayed recognition features of this Statement cause the obligation that is recognized to differ from the current measure of the unfunded obligation attributed to service in the current and prior years. However, that current measure of the obligation and the effect of delayed recognition in deriving the amount of that obligation that has been recognized are required to be disclosed.

144. This Statement requires recognition of a service cost component of net periodic postretirement benefit cost based on the actuarial present value of the portion of the expected postretirement benefit obligation attributed to service during the period. This Statement also requires disclosure of the other compensatory and financial components of postretirement benefit cost for the period in order to reflect the employer's net cost of the benefit promise. The Board concluded that disclosure of the components should 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.

145. Some respondents argued that the uncertainties inherent in quantifying the obligation for postretirement benefits lead to the conclusion that the measurements are not sufficiently reliable for recognition in financial statements. They would prefer to disclose rather than recognize that obligation and the related cost. The Board does not find those arguments persuasive. The Board concluded that it is possible for employers to produce an estimate of that obligation that is sufficiently reliable and relevant to justify recognition in financial statements. The Board expects that with experience, the reliability of the measurement will be enhanced. The Board concluded that employers' current practice of not recognizing their postretirement benefit obligations and the related costs results in less reliable financial statements and impairs the usefulness and integrity of those financial statements.

Conclusions on Basic Issues—Single-Employer Defined Benefit Postretirement Plans

The Exchange

146. The Board's conclusions in this Statement derive from the view that a defined postretirement benefit is part of 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 current and deferred benefits (such as a pension), health care and other welfare benefits during the employee's retirement period. Postretirement benefits are not gratuities but instead are part of an employee's compensation for services rendered. Since payment is deferred, the benefit is a type of deferred compensation. The employer's obligation for that compensation is incurred when the services exchanged for that benefit are rendered, not when an employee terminates or when a retiree receives benefits.

147. Postretirement benefits are a form of pension benefits in kind. Unlike traditional cash pension benefits, the employer promises to provide defined benefits or services as the need for those benefits or services arises or on the occurrence of a specified event. Typically, those postretirement benefits supplement cash benefits paid after retirement. Regardless of the form of the benefit—in cash or in kind—the underlying promise is the same. In exchange for service over a specified period, the employer will provide the employee and any covered dependents or beneficiaries with the defined postretirement benefits.

Funding and Accrual Accounting

148. This Statement relies on a basic premise of generally accepted accounting principles that accrual accounting provides more relevant and useful information than cash basis accounting. Accrual accounting goes beyond cash transactions and recognizes the financial effects on an entity of transactions and other events and circumstances that have future cash consequences as those events and transactions occur,

rather than only when cash is received or paid by the entity. In particular, accrual accounting provides a link between an entity's operations (and other transactions, events, and circumstances that affect it) and its cash receipts and outlays. It provides information about an entity's assets and liabilities and changes in those amounts that cannot be obtained from information produced by accounting only for cash receipts and outlays. Because the Board views the event obligating the employer as the rendering of employee service in exchange for future (postretirement) benefits, this Statement rejects terminal accrual (accrual at retirement) and cash basis accounting. The Board concluded that for postretirement benefits, as in other areas, the information resulting from accrual accounting is more representationally faithful and more relevant to financial statement users than accounting information prepared solely on the basis of cash transactions.

149. This Statement reaffirms Board decisions that funding should not be used as the basis for accounting recognition of cost. However, the Board's conclusion that accounting information on an accrual basis is needed does not mean that accounting information and funding decisions are unrelated. Measurement and recognition of the accrued obligation to provide postretirement benefits will provide management and other users of financial statements with better information to assess the financial consequences of management's actions. That information about the postretirement benefit obligation will be a factor in determining the amount and timing of future contributions to the plan.

150. The decision of how or when to fund the obligation is not an accounting issue. It is a financing decision that is properly influenced by many factors (such as tax considerations and the availability of attractive investment alternatives) that are unrelated to how or when the postretirement benefit obligation is incurred. The amount funded (however determined) is, of course, given accounting recognition as a use of cash, but the Board concluded that this is one of many areas in which information about cash flows alone is not sufficient.

The Principal Issues

151. Among the many issues considered by the Board in this project, three stand out as central to the Board's extensive deliberations and to public debate. Those issues are (a) whether a postretirement benefit plan results in an obligation that meets the definition of a liability, (b) how and when the obligation and related cost should be measured and recognized, and (c) how and when any net obligation or net asset that exists when this Statement is first applied should be measured and recognized.

The liability

152. Liabilities are defined in paragraph 35 of FASB Concepts Statement No. 6, *Elements of Financial Statements,* as "probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events" (footnote references omitted). Liabilities reflect the residual of certain transactions or events affecting an entity. For example, a liability for postretirement benefits reflects the interrelationship of the cumulative cost to an employer of an exchange transaction and the ultimate payment of benefits to the [former] employees—the other party to the exchange transaction.

153. The first characteristic of a liability is that it "embodies a present duty or responsibility to one or more entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand" (Concepts Statement 6, paragraph 36). The employer has a duty or requirement to sacrifice assets in the future—the essence of the first characteristic of a liability. That duty exists even though a benefit obligation may be satisfied by providing goods and services rather than cash and the amount and timing of the benefit payments are estimated.

154. An employer that promises to provide postretirement benefits almost certainly has assumed a responsibility to make future payments because at least some of the present employees will receive those benefits in the future. Measurement of the postretirement benefit obligation considers the likelihood that some employees will work to or beyond the date eligibility for some or all of the postretirement benefits is attained, while others will terminate prior to that date and forego any right to postretirement benefits.

155. The second characteristic of a liability is that "the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice" (Concepts Statement 6, paragraph 36). Paragraph 36 also states that ". . . although most liabilities rest generally on a foundation of legal rights and duties, existence of a legally enforceable claim is

not a prerequisite for an obligation to qualify as a liability if for other reasons the entity has the duty or responsibility to pay cash, to transfer other assets, or to provide services to another entity." Some respondents indicated that postretirement benefits do not meet this characteristic of a liability and consequently, in their view, need not be recognized. Some of those respondents argued that only legally enforceable claims should be reported as liabilities. Others noted that most employers have retained the right to terminate or amend their postretirement benefit promises and therefore believe those employers can avoid the obligation at their discretion.

156. Case law has not been unequivocal about the legal enforceability or lack thereof of promises to provide postretirement benefits, although legal enforceability of certain claims has been demonstrated. However, in accordance with Concepts Statement 6, the Board has looked beyond the legal status of the promise to consider whether the liability is effectively binding on the employer because of past practices, social or moral sanctions, or customs.

157. An entity is not obligated to sacrifice assets in the future if it can avoid the future sacrifice at its discretion without significant penalty. The penalty to the employer need not be in the form of another liability but could be in the form of a reduction in the value of assets. Concepts Statement 6, paragraph 203, illustrates that notion as follows: "The example of an entity that binds itself to pay employees vacation pay or year-end bonuses by paying them every year even though it is not contractually bound to do so and has not announced a policy to do so has already been noted. . . . It could refuse to pay only by risking substantial employee-relations problems." As a practical matter, it is unlikely that an employer could terminate its existing obligations under a postretirement benefit plan without incurring some cost. Therefore, the Board concluded that in the absence of evidence to the contrary, an employer is presumed to have accepted responsibility to provide the promised benefits. Consequently, the accounting for postretirement benefit arrangements generally is based on the presumption that the plan will continue and that the benefits promised by the employer will be provided.

158. The third characteristic of a liability is that "the transaction or other event obligating the entity has already happened" (Concepts Statement 6, paragraph 36). This characteristic is met when the employee renders service in exchange for the future benefits. The Board concluded that, conceptually, compensation cost should be recognized in the period in which it is earned under the plan—that is, when the employee renders the required service, not when the need for the benefit arises (which is factored into measurement of the obligation). An objective of this Statement is to recognize the compensation cost of an employee's postretirement benefits over the employee's credited service period, even though the complexity of the postretirement benefit arrangement and the uncertainty of the amount and timing of the future payments may preclude complete recognition of the precise postretirement benefit cost and obligation over that period.

Criteria for recognition

159. Paragraph 63 of Concepts Statement 5, states that an item should be recognized when four fundamental recognition criteria are met:

> *Definitions*—The item meets the definition of an element of financial statements.
> *Measurability*—It has a relevant attribute measurable with sufficient reliability.
> *Relevance*—The information about it is capable of making a difference in user decisions.
> *Reliability*—The information is representationally faithful, verifiable, and neutral.

160. Most respondents indicated that employee service pursuant to a postretirement benefit plan creates an obligation that meets the definition of a liability. Some of those respondents expressed concerns about an employer's ability to measure its obligation with sufficient reliability, while others questioned whether the costs outweigh the benefits of recognizing the liability and the related cost in the financial statements. However, a majority of the respondents supported recognizing an obligation for postretirement benefits. They indicated that reasonable estimates of the measure of an employer's postretirement benefit obligation can be developed and that recognition of a liability based on that best estimate is preferable to no recognition or to footnote disclosure in lieu of recognition.

161. Paragraph 46 of Concepts Statement 6 acknowledges that the effects of economic events are often uncertain and that the existence and amount of items need not be certain for them to qualify as assets and liabilities. Estimates and approximations are commonplace in financial statements. Paragraph 74 of Concepts Statement 5 states that "relevance should

be evaluated in the context of the principal objective of financial reporting: providing information that is useful in making rational investment, credit, and similar decisions." Paragraph 59 of Concepts Statement 2 states that the reliability of a measurement of accounting information is dependent on the extent to which users can depend on it to represent the economic conditions or events that it purports to represent. That concepts Statement acknowledges that that is seldom a clear choice; rather, the issue is whether the accounting information is so relevant that some allowance ought to be made for some lack of reliability because the information provides a better representation of economic conditions than would be portrayed without the information.

162. Reliability may affect the timing of recognition. Paragraphs 76 and 77 of Concepts Statement 5 state:

> Information about some items that meet a definition may never become sufficiently reliable at a justifiable cost to recognize the item. For other items, those uncertainties are reduced as time passes, and reliability is increased as additional information becomes available.
>
> . . . waiting for virtually complete reliability or minimum cost may make the information so untimely that it loses its relevance. At some intermediate point, uncertainty may be reduced at a justifiable cost to a level tolerable in view of the perceived relevance of the information.

163. The Board concluded that the obligation to provide postretirement benefits meets the definition of a liability (paragraphs 152–158), is representationally faithful, is relevant to financial statement users, and can be measured with sufficient reliability at a justifiable cost. To imply by a failure to accrue that no obligation exists prior to the payment of benefits is not a faithful representation of what the financial statements purport to represent. The Board concluded that failure to recognize the existence of the obligation significantly impairs the usefulness and credibility of the employer's financial statements.

Recognition versus disclosure

164. Some respondents agreed that better information about the cost of and obligation for postretirement benefits is needed but argued that the information would be just as useful if it were disclosed in the footnotes. In the Board's view, it is important that elements that qualify 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. The usefulness and integrity of financial statements are impaired by each omission of an element that qualifies for recognition. The incremental systems cost of recognition is insignificant. All of the costs of measuring the postretirement benefit obligation would be incurred to provide useful disclosures.

165. If disclosures and recognition are equally useful, then any asset or liability, or revenue or expense, could be reported with equal effect in either manner. Few would argue that disclosure is an alternative to recognition when discussing an entity's trade payables or cost of sales. If one accepts the view that an employer has a liability and cost for postretirement benefits exchanged for employees' current and past services, there is no substantive difference between postretirement benefits and other costs and liabilities other than the difficulty of measurement and the longer period of time over which the liability is paid. Although the "equal usefulness" argument may be valid for some sophisticated users, it may not hold for all or even most users. Those who assert that footnote disclosure or recognition would be equally useful, but argue only for disclosure, must believe that recognition and disclosure have different consequences.

Measurement of cost and obligations

166. The Board believes that the understandability, comparability, and usefulness of financial information are improved by narrowing the use of alternative accounting methods that do not reflect different facts and circumstances. Consequently, the Board has attempted to improve financial reporting by accounting for similar transactions similarly and by measuring enterprises' resources and claims to or interest in those resources on similar bases. Any method of accounting for postretirement benefits that recognizes the expected future cost during the service period must deal with two problems that stem from the nature of the arrangement. First, estimates or assumptions must be made about the future events that will determine the amount and timing of the benefit payments. Second, an approach must be selected for attributing the cost of those benefits to individual years of service.

167. 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 and timing of future benefits, such as retirement date and life expectancy, can be more reliably estimated on a group basis. However, that uncertainty does not change the nature of the promise. Actuarial computations consider that some existing or future retirees will live longer than others and that some individuals will terminate employment before becoming eligible for the benefits or die before receiving any benefits. Those factors are appropriately considered in measuring the probable future sacrifice that will result from the present existing promise of benefits to former and current employees.

168. This Statement uses the term *expected postretirement benefit obligation* (a term not used in Statement 87) to describe the obligation for benefits expected to be received by plan participants. The expected postretirement benefit obligation is used as the basis for determining the benefit cost to be attributed to credited years of service. The term *accumulated postretirement benefit obligation* is used to describe the portion of the expected postretirement benefit obligation attributed to service to a measurement date. Since measurement of the expected postretirement benefit obligation includes an assumed salary progression for a pay-related plan, salary progression is, by definition, included in the accumulated benefit obligation for a pay-related postretirement benefit plan. Thus, the accumulated postretirement benefit obligation disclosed pursuant to this Statement is defined in terms notionally more comparable to the projected benefit obligation under Statement 87.

169. Since the accumulated benefit obligation defined by Statement 87 excludes assumed salary progression, the accumulated benefit obligation for a pay-related pension plan has no counterpart in this Statement. The Board concluded that it would be more confusing to define an additional measure of a benefit obligation, in addition to the expected and accumulated postretirement benefit obligations, under this Statement to compare with the accumulated benefit obligation for pay-related plans under Statement 87 than to measure the accumulated benefit obligation for those plans differently under the two Statements.

170. Despite that difference in the definition of the accumulated benefit obligation for a postretirement benefit plan and for a pension plan, service cost and interest cost are defined and measured in a similar fashion under both this Statement and Statement 87. Service cost under both Statements is the actuarial present value of benefits attributed to services rendered by plan participants during the period and includes consideration of salary progression for pay-related plans. Interest cost under this Statement is defined as the increase in the *accumulated* postretirement benefit obligation to recognize the effects of the passage of time; under Statement 87 interest cost is defined as the increase in the *projected* benefit obligation to recognize the effects of the passage of time.

171. In considering postretirement benefit plans, neither respondents nor the Board was able to identify fundamentally different circumstances that would make it appropriate for different employers to adopt different accounting methods or measurement techniques for similar plans or for a single employer to adopt different methods or measurement techniques for different plans. As a result, a single method is prescribed for measuring and recognizing an employer's obligation and the related net periodic cost. That method attributes the expected postretirement benefit obligation to employee service rendered to the date full eligibility for the postretirement benefits is attained. The method is intended to improve comparability and understandability of employers' financial statements in reporting the financial consequences of providing postretirement benefits. It generally is also consistent with accounting for other forms of deferred compensation earned by employees that are paid during retirement, such as pensions.

Accounting for the substantive plan

172. Many respondents to the Exposure Draft observed that employers' postretirement benefit promises (particularly for health care benefits) are evolving. They stated that employers will change their promises in reaction to expected future health care costs. They believe that because future costs are considered in postretirement benefit measurements, employers should be permitted to anticipate the changes to the plan that the employer would be likely to make in reaction to the expected future cost of the benefits currently covered by the plan. Some respondents suggested that a designated health care cost trend rate, such as the general inflation rate, be used to consider implicitly the future actions employers might take to control their postretirement health care costs. Other respondents suggested the use of more explicit approaches that would anticipate future plan amendments if certain conditions were met.

173. In response to those suggestions, the Board considered whether there are situations in which future plan changes should be anticipated for measurement purposes. Board members generally believed that when an employer has a present commitment to amend the plan, the extant written plan, amended to reflect that commitment, should be the basis for the accounting. The Board believed that evidence of an employer's commitment to amend the plan should include an employer's past practices of amending the plan, identification of strategies to effect future changes, and the assessment of the feasibility and likelihood of making those changes in light of the expected economic and social costs. Because the transaction that is the basis for the accounting is the result of an exchange between an employer and its employees, Board members believed that the substantive plan that is the basis for the accounting should be communicated to and understood by the plan participants as representing that exchange agreement.

174. Some Board members supported permitting the anticipation of changes, including changes in a plan's covered benefits, if certain conditions were met. The Board noted, however, that unlike changes in cost-sharing provisions, there would be no past practice of changing covered benefits that could be considered representative of the substantive plan. Once a benefit is eliminated, it cannot be eliminated again. In addition, given a choice of benefit changes that might occur, it is unlikely that employers could determine which would be most likely to occur. And, since different health care benefits may have different assumed health care cost trend rates, the inability to determine the most likely change in the covered benefits would affect an employer's ability to measure its expected postretirement benefit obligation. The Board noted that those measurement concerns do not arise when benefits are defined solely in terms of monetary amounts. The Board concluded that changes in in-kind benefits covered by a postretirement health care plan or by other postretirement benefit plans should not be anticipated. The Board noted, however, that if an employer amends the benefits to be provided by the plan, the effect of the amendment is recognized immediately in measuring the employer's expected and accumulated postretirement benefit obligations, even if the effective date of the change in benefits is delayed until a specified date in the future.

175. Some Board members do not favor anticipating any future plan changes for purposes of measuring and recognizing an employer's postretirement benefit obligations. They note that financial statements are intended to present the financial effects of events and transactions that have already happened. In their view, future actions that change the promise should be recognized when the change occurs; to anticipate future changes is not a representationally faithful portrayal of the employer's current obligation. Therefore, they believe the obligation and cost to provide postretirement benefits should be measured as defined by the plan at the measurement date. Further, they believe the criteria to limit those plan changes that may be anticipated will prove to be unworkable, just as other attempts to account for management's intent have been unworkable. Other Board members believe that a plan's existing terms do not necessarily establish the substance of the current or past exchange transaction and therefore may not always provide the best basis for measuring an employer's current obligation.

176. The Board concluded that measures of an employer's postretirement benefit obligations should reflect the terms of the exchange transaction understood by an employer and its employees. To the extent that an employer has a past practice of maintaining a consistent level of cost sharing or consistently increasing or reducing the cost-sharing provisions of the plan that reflects the employer's cost-sharing policy, without offsetting identifiable changes in other benefits or compensation or other significant costs, that policy represents the substantive terms of the exchange transaction. Such a past practice would be indicated when the nature of the change and duration of the past practice are sufficient to warrant a presumption that it is understood by the plan participants. Similarly, if an employer has communicated its intent to institute different cost-sharing provisions of the plan at a specified time or when specified conditions are met and those changes are likely to occur without adverse consequences to the employer's operations or offsetting changes in the plan participants' other benefits, those changes should be anticipated. The Board notes, however, that in most cases collectively bargained plans will be unable to anticipate plan changes because the employer does not have the unilateral ability to amend the plan and would most likely be unable to demonstrate a consistent past practice of cost-sharing changes without offsetting changes in other benefits. For that reason, some Board members believe there should be no possibility of an exception.

Contributory plans

177. Some employers may require that active employees contribute toward the cost of their postretirement benefits. Those contributions may be adjusted throughout the service period and may vary depending on the number of an employee's dependents. In addition, postretirement benefit plans may have cost-sharing provisions that require retired employees to share a portion of the cost of the benefits through contributions, copayment provisions, or deductibles. Because an employer's postretirement benefit obligation is measured as of a defined measurement date, the Exposure Draft proposed that for purposes of measuring the expected postretirement benefit obligation, employee contributions or cost-sharing provisions should be assumed using the rates or provisions required by the current plan benefit formula. Unless an employer had a history of regular increases in benefits indicative of a commitment to make future improvements to the plan, anticipating future changes to the plan would have been precluded for purposes of measuring the expected postretirement benefit obligation and net periodic postretirement benefit cost.

178. Contributions expected to be received from active employees toward the cost of their postretirement benefits and from retired plan participants are treated similarly for purposes of measuring an employer's expected postretirement benefit obligation. An employer's obligation to return contributions received from employees who do not attain eligibility for postretirement benefits, and, if applicable, any interest accrued on those contributions, should be recognized as a component of an employer's postretirement benefit obligation. Thus, an employer's statement of financial position should reflect an accrued obligation for postretirement benefits that includes (a) the accrued obligation to provide benefits to plan participants who are eligible for benefits or are expected to become eligible for benefits under the postretirement benefit plan and (b) the obligation to return accumulated contributions, plus any interest thereon, to employees who are expected to terminate without attaining eligibility for the postretirement benefits.

Assumptions

179. Measurements of the actuarial present value of the expected and accumulated postretirement benefit obligations require actuarial assumptions. Those assumptions include discount rates, retirement age, the timing and amount of future benefits (which for postretirement health care benefits consider past and present per capita claims cost, health care cost trend rates, and medical coverage by governmental authorities and other providers of health care benefits), and the probability of payment (turnover, dependency status, mortality, and so forth). Measurement of the expected postretirement benefit obligation and the accumulated postretirement benefit obligation also considers salary progression when applicable. Many of the assumptions used in postretirement benefit measurements are similar to assumptions used in pension measurements.

180. This Statement requires that each significant assumption reflect the best estimate of the plan's future experience, solely with respect to that individual assumption (an "explicit" approach). All assumptions should assume that the plan will continue, absent compelling evidence to the contrary. The Board believes that an explicit approach results in more understandable and useful information about changes in the benefit obligation and the choice of significant assumptions used to determine the various measurements required by this Statement.

181. Some respondents argued that an implicit approach to assumptions, that combines the effect of two or more assumptions to approximate future experience, would improve comparability by reducing variability in employers' assumptions. Under an implicit approach, reliability of assumptions is judged in the aggregate, not individually. However, some respondents who supported an implicit approach seemed to favor uniformity of certain assumptions, such as the use of designated health care cost trend rates, rather than favoring the combination of two or more assumptions. Other respondents who supported an implicit approach seemed to support that approach because it would implicitly consider how the plan might be amended in the future to achieve a desired limit on cost increases. For example, some respondents supported measuring the employer's share of future incurred claims costs by projecting the increase in health care costs using the expected general inflation rate. They stated that applying the expected general inflation rate to the employer's share of per capita incurred claims costs (current cost) best reflects management's intent to control those costs in the future within that limit. However, the Board believes that such an approach cannot be characterized as measuring the current promise or as being generally representative of a trend to limit an employer's commitment. If an employer has historically

amended its plan to achieve a trend equal to the general inflation rate, the Board believes that that past practice is better considered explicitly in determining the substantive plan than implicitly through a surrogate health care cost trend rate.

182. The Board considered an implicit approach as an alternative for certain individual assumptions—for example, by measuring an employer's postretirement benefit obligation and cost using an assumed spread between the health care cost trend rate and the discount rate. An implicit approach was rejected because the Board concluded that users of financial statements are better able to make judgments about the measures presented if they are given the opportunity to compare employers' individual assessments of specific future events. Consequently, the Board concluded that employers should be required to measure their obligations using the best information and estimates available based on existing information and circumstances.

183. Measurement of an employer's postretirement benefit obligation is based on the current plan participants (a "closed group" approach) because it better recognizes the benefit obligation over the period in which employees render service in exchange for benefits. Accounting on the basis of an ongoing employee group (an "open group" approach) often defers recognition of part of the cost of employees' current service to later periods. That open group view provides no basis for recognizing the cost of benefits over the service periods related to the current work force and suggests by its application that employers have a cost and obligation for employees not yet hired.

184. The Board concluded that application of accrual accounting to postretirement benefit accounting requires that the cost of the benefits be recognized in the period in which the employer receives the associated economic benefits—as employee services are rendered. Employee compensation, whether paid currently or deferred, should be recognized when the services are rendered. The Board concluded that, in concept, the employer's obligation to an existing employee group is the sum of its obligations to individual employees, adjusted to reflect the present value of the amount of the obligation and the probability of payment (the actuarial present value).

185. Employers' postretirement benefit obligations will differ to the extent that their promises are different. For example, some employers may fully reimburse the cost of nursing home care, while others may not provide for that care. Or, some employers may carve out Medicare benefits and provide a low level of supplementary health care coverage, while others may provide a more generous plan that coordinates benefits with Medicare. No standard plan design or package of postretirement benefits or a static set of circumstances exists that would call for all employers to use the same assumptions. Different types of benefits may have differing trend rate assumptions, and different employers may have differing expectations about benefit utilization. Because of differences in plan design and employer circumstances, including the expected demographics of the plan population, measurement assumptions about the timing and amount of future benefits should represent an employer's best estimate with respect to the factors affecting its particular promise.

186. The objective of selecting assumed discount rates is to measure the single amount that, if invested at the measurement date in a portfolio of high-quality debt instruments, would provide the necessary future cash flows to pay the accumulated benefits when due. Notionally, that single amount, the accumulated postretirement benefit obligation, would equal the current market value of a portfolio of high-quality zero coupon bonds whose maturity dates and amounts would be the same as the timing and amount of the expected future benefit payments. Because cash inflows would equal cash outflows in timing and amount, there would be no reinvestment risk in the yields to maturity of the portfolio. However, in other than a zero coupon portfolio, such as a portfolio of long-term debt instruments that pay semiannual interest payments or whose maturities do not extend far enough into the future to meet expected benefit payments, the assumed discount rates (the yield to maturity) need to incorporate expected reinvestment rates available in the future. Those rates should be extrapolated from the existing yield curve at the measurement date. Assumed discount rates should be reevaluated at each measurement date. If the general level of interest rates rises or declines, the assumed discount rates should change in a similar manner.

187. The Board concluded that, conceptually, the basis for determining the assumed discount rates for measuring the present value of the postretirement benefit obligation and the service cost component should be the same as the basis for determining the assumed discount rates for pension measurements. That is, conceptually, the selection of assumed discount rates should be based on the single sum that, if

invested at the measurement date, would generate the necessary cash flows to pay the benefits when due.

188. Consistent with Statement 87, the Exposure Draft referred to "the interest rates inherent in the amount at which the postretirement benefit obligation could be effectively settled." Many respondents found that notion confusing because postretirement benefit obligations generally cannot be settled at the current time. However, as opposed to "settling" the obligation, which incorporates the insurer's risk factor, "effectively settling" the obligation focuses only on the time value of money and ignores the insurer's cost for assuming the risk of experience losses. Because of the misunderstanding of the meaning of "effectively settled," the Board concluded that reference to that phrase should be eliminated in order to clarify that the objective of the discount rate is to measure the time value of money. However, elimination of that phrase from this Statement is not intended to reflect a substantive difference between the requirements of Statement 87 and this Statement.

189. Some respondents to the Exposure Draft suggested that an indebtedness model approach that would consider the risk of default by an employer be used to discount an employer's postretirement benefit obligation. That approach suggests that the extent to which an employer chooses to fund its obligation in a trust or similar arrangement changes the value of the promise to retirees because the existence of the plan assets enhances the security of their benefit payments. Using that approach, two employers with identical postretirement benefit promises and plan demographics, but with different funding policies, would measure their expected postretirement benefit obligations differently.

190. The Board rejected the indebtedness model for postretirement benefit measurements. Measurement of pension obligations is not dependent on the level of plan assets, and the Board finds no reason for using different approaches to measure pension and postretirement benefit obligations. In addition, the Board notes that acceptance of the indebtedness model for discounting those obligations raises a broader issue that is beyond the scope of this Statement. The Board currently has a project on its agenda on present-value-based measurements; consideration of an indebtedness model will be encompassed by that project.

191. Most respondents who disagreed with the proposed discount rate favored basing assumed discount rates on company-specific rates, such as an entity's cost of capital or internal rate of return on assets or on shareholders' equity or a financing rate such as its incremental borrowing rate, or on "normalized" long-term interest rates. Generally, those respondents stated that the source of assets that will be used to satisfy an obligation should determine the discount rate. Because most employers currently pay for postretirement benefits with cash generated from current operations or financing transactions, those respondents stated that the rate used to discount the obligation should be based on an employer's rate of return on shareholders' equity or its cost of financing. However, implementation of that approach would be difficult because there is no uniform method for determining a company's cost of capital and a negative rate of return on shareholders' equity would produce inexplicable results. Using a financing rate such as an entity's incremental borrowing rate for discounting purposes also would be difficult because the duration of existing debt is unlikely to be the period over which the postretirement benefits are expected to be paid.

192. Those respondents who advocated a "normalized" long-term rate stated that the use of a current rate for discounting introduces volatility into the measurement process that is unrelated to the postretirement benefit obligation. They recommended that some form of smoothing be used to reduce that volatility. However, the Board noted that smoothing only one assumption would not necessarily make the measurement less volatile because all of the other data and assumptions used in measuring an employer's postretirement benefit obligation and cost are updated annually and represent the best estimate of conditions at that point in time. Concerns about the volatility introduced by all assumptions are mitigated by the delayed recognition provisions provided for gains and losses, including the permitted use of a "corridor" to shield certain gains and losses from recognition. Furthermore, it is not the Board's intent to eliminate all volatility, particularly when it is representationally faithful of the phenomenon being reported.

193. The discounting approach prescribed by this Statement for employers' postretirement benefit obligations is consistent with the approach prescribed by Statement 87 for discounting employers' pension obligations. The Board's project on present-value-based measurements will consider alternative methods for discounting all of the obligations of an employer. In the interim, the approach required by this Statement should result in more comparable measures of the

accumulated postretirement benefit obligation and of the service and interest cost components among employers than the other discounting alternatives considered.

194. Many of the other assumptions used in postretirement benefit measurements also are similar to assumptions used in pension measurements, but the sensitivity of the measures to changes in the assumptions may be more significant. For example, the turnover assumption may have a more significant effect for postretirement benefits than for pension benefits because, in many cases, eligibility for postretirement benefits is an all-or-nothing proposition, while most pension plans provide reduced benefits for relatively short periods of service. The dependency status assumption also may have a more significant effect on postretirement benefit measurements than on pension measurements. Plan provisions that entitle an employee's spouse and other dependents to health care and other welfare benefits may substantially increase an employer's cost and obligation for postretirement benefits.

195. Postretirement benefit measurements are more sensitive to assumptions about retirement ages and the probability of retiring at each age than are pension measurements. For example, employer-provided postretirement health care benefits are significantly more expensive before Medicare coverage begins than after. Many pension arrangements provide for an actuarially reduced pension benefit for employees retiring before the normal retirement age; however, for an employee retiring early, there typically is no reduction in the postretirement benefit levels, and those benefits will be paid over a longer period of time and at a higher annual cost to the employer than if the employee retired at the normal retirement age. Similarly, postretirement benefit measurements are more sensitive than pension measurements to the life expectancy assumption. In particular, health care benefits are sensitive to that assumption because health care costs generally increase with age.

196. Postretirement health care and life insurance benefits may be based on an employee's final compensation. For example, an employer's postretirement health care plan may require retiree contributions based on the retiree's level of compensation at retirement, or a postretirement life insurance plan may provide a death benefit that is a multiple of final pay. As in employers' accounting for pensions, the Board concluded that assumed compensation levels should reflect the best estimate of participants' actual future compensation levels and should be consistent with assumed discount rates to the extent that both incorporate expectations about the same future economic conditions.

Assumptions unique to postretirement health care benefits

197. Measuring the expected postretirement benefit obligation for postretirement health care benefits includes making assumptions about the amount and timing of postretirement health care benefits expected to be paid in the future for current plan participants. Recent claims cost experience and the claims cost experience of other employers in the same industry or geographical location may provide useful information in developing the assumed per capita claims cost by age from the earliest age at which a plan participant could receive benefits under the plan to the longest life expectancy. Data files developed and maintained by insurers or benefits consultants about employers' claims costs for similar benefits programs and national or regional statistics about claims cost patterns also may provide information that may be used for developing the per capita claims cost by age.

198. The assumed health care cost trend rates consider the expected annual change in per capita claims costs due to all factors other than changes in the composition of the plan participants by age or dependency status. Changes in the cost of health care are influenced by numerous factors including changes in the cost of health care services, changes in the utilization pattern for health care services, changes in the nature and type of those services as medical practices change and new technology is developed, sociodemographic changes, and changes in public and private policy. Thus, in developing the assumed health care cost trend rates, the effects of medical care inflation, changes in medical care utilization or delivery patterns, technological advances, and changes in the health status of the covered population are all implicitly incorporated in the estimates. The effects of changes in enacted legislation are recognized as those changes occur.

199. Some respondents suggested that the health care cost trend rate would be more costly to develop than other estimates of future trends in costs, such as the general inflation rate. Consulting actuaries informed the Board that the health care cost trend rate per se is not significantly more costly to develop than

other estimates of future costs. The more potentially significant cost is in the accumulation of the claims cost data to which any trend rate would be applied for measuring an employer's postretirement health care obligation and cost. (The measurement provisions of this Statement take into account employers' data limitations and the cost of measuring the employer's obligation and cost as described in paragraphs 38 and 41.) Consulting actuaries noted that the application of health care cost trend rates to the claims cost data produces a more relevant and representationally faithful measure of an employer's expected future cash outflows for postretirement health care benefits than would the use of alternative rates, at little or no incremental cost.

Attribution method

200. In the context of this Statement, attribution is the process of assigning the expected cost of benefits to periods of employee service. The general objective is to assign to each year of service the cost of benefits earned or assumed to have been earned in that year. There are two broad groups, or families, of attribution methods—benefit approaches and cost approaches—and there are different attribution methods within those families.

201. Under Statement 87, pension benefits are attributed to employee service on the basis of the plan's benefit formula. A pension benefit formula is defined in paragraph 264 of that Statement as "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." For example, a benefit formula may be stated as: Y% × number of years of service × final pay. The benefit formula method assigns benefits to periods of employee service based on the terms of the plan that define the benefits an employee will receive; the cost is calculated as the actuarial present value of the benefits assigned.

202. The Board believes that, normally, the terms of a plan (benefit formula) provide the most relevant basis for relating benefits promised to services rendered. The Board also believes that a single attribution method, normally based on the terms of the plan, should be prescribed to enhance comparability and understandability of financial statements. However, the Board considered whether the measurement approach should differ for plans that do not have a benefit formula that defines benefits in terms of the specific periods of service that must be rendered in exchange for the benefits. Noting that a difference in method might be warranted for those plans, the Board considered a variety of measurement approaches.

203. Arguments for a particular attribution method are usually based on which approach is perceived to best represent the underlying exchange between the employer and employee. The benefit approaches view the cost of the plan in terms of the benefits being earned each year, generally based on the terms of the plan (benefit formula). A distinct unit of retirement benefit is associated with each year of credited service; that is, those approaches assign benefits directly to years of service. The obligation measured under the benefit approaches is the actuarial present value of the benefits attributed to past and current employees' service to the reporting date, generally based on the terms of the plan.

204. The cost approaches view measurement of the obligation and cost on an annual basis as less important than the pattern of cost recognition from one period to another. Proponents of the cost approaches generally take the view that an employer has career contracts with its employees. Thus, the cost of the plan is viewed in terms of the benefits expected to be earned over the entire working lives of the plan participants. That cost is allocated to years of service as a level amount that, if invested at the assumed discount rates, would equal the actuarial present value of those benefits at retirement, assuming no experience gains or losses. The costs assigned to each year may be level in dollar amounts or as a percentage of compensation. Proponents of cost approaches view the liability for an individual as measurable only at the date of hire or plan initiation (as zero) and at the retirement date (as the expected postretirement benefit obligation); at any interim date, only an arbitrary allocation is possible. The cost approaches produce an obligation for a group of employees with differing retirement dates that, at any point in time, can be described only as the result of the allocation that produced it. The accrued liability does not represent a measure of the benefits "earned" to date pursuant to the terms of the plan.

205. Because cost approaches assign a level amount of cost to each period, either as a percentage of compensation or in terms of dollars, they generally assign a greater percentage of the total cost of the benefit to earlier years of service in the attribution period than do benefit approaches. For postretirement benefit plans that have a level benefit formula, the benefit approaches assign a service cost to earlier periods of

service in the attribution period that, when discounted, is less than that assigned during later years of service. Consequently, for those plans the benefit approaches typically result in lower charges than the cost approaches in early service periods offset by higher charges in later periods, and, in the absence of plan amendments, they generally result in a lower accrued liability at any point prior to the end of the attribution period.

206. For postretirement benefit plans that have a variable benefit formula,[34] cost approaches and benefit approaches may account for the benefit cost differently. Cost approaches generally project the expected postretirement benefit obligation at retirement and allocate an amount to each service period that is level in terms of dollars or percentage of compensation and that, together with interest at the assumed discount rates, will accumulate to the expected postretirement benefit obligation. Benefit approaches generally attribute different costs to different service periods when the benefit formula assigns different benefits to different periods of service.

207. The Board considered six methods for attributing postretirement benefits that are undefined in terms of the specified period of service to be rendered in exchange for the benefits. Those methods are described in paragraphs 180–186 of the Exposure Draft. Four of the methods were traditional approaches that incorporate the use of present value techniques, while the other two methods allocate the total benefit or cost on an undiscounted basis. The latter approaches attribute the expected postretirement benefits or cost to periods of service either as a level amount of benefit or cost or as a level percentage of compensation. Undiscounted approaches produce identical results under the benefit and cost methods.

208. The Board rejected the undiscounted approaches. Because the obligation is to provide benefits in the future, not currently, the Board concluded that the present value of the obligation expected to be paid is the most relevant and reliable measure of the obligation and of the cost of the services received. Discounting explicitly recognizes that the present value of an obligation payable in the future is less than that of an equal obligation payable currently. The Board concluded that recording an obligation at its ultimate cost without discounting is overly conservative and does not provide the information most relevant for decision making.

209. The Board rejected attribution on the basis of compensation because it does not faithfully represent how the cost is incurred under the terms of the plan. In cases in which compensation levels are a factor, years of service generally are also a consideration in determining the benefits to be provided because an employee would not be eligible for the benefits unless some period of service had been provided.

210. The Board was unable to identify a basis for attributing postretirement benefits that would be more appropriate, in most cases, than measurement of the current benefit cost and accumulated postretirement benefit obligation based on years of service. Statement 87 prescribes the attribution of pension benefits on the basis of years of service; compensation is considered for measuring the amount of the benefit to be attributed to each year of service when compensation levels are a factor in determining the amount of the pension benefit. The Board found no compelling reason to prescribe a different basis for attributing postretirement benefits than the basis used for attributing pension benefits.

211. The Board's consideration therefore focused on two attribution approaches: a benefit/years-of-service approach and a cost/years-of-service approach. A benefit approach attributes benefits on the basis of individual plan participants; a cost approach may attribute either on an individual or on an aggregate basis. Of those alternative cost approaches, the Board focused on an aggregate approach. Since the objective of a cost method is the allocation of benefit costs, there is no reason to burden that method unnecessarily with complexities and computations that could not be supported as enhancing measurement of either the obligation at a point in time or the cost incurred for a period.

212. A benefit/years-of-service approach is viewed by the Board as more consistent with its conceptual framework's focus on measurement of assets and liabilities. An objective of a benefit approach is to fully accrue the expected postretirement benefit obligation for an employee by the end of the credited service period for that employee. Under an aggregate cost

[34]For example, the terms of the plan may state that retirees will receive an annual benefit that is equal to (a) 2.5 percent of covered benefits for each year of service through year 10, (b) 3.0 percent of covered benefits for each year of service in years 11–20, and (c) 3.5 percent of covered benefits for each year of service in years 21–30.

approach, cost is attributed based on the average remaining years of service of all active plan participants; consequently, the cost of the expected postretirement benefit obligation for an employee generally would be attributed to a period beyond the end of the credited service period for that employee.

213. The Board considers the benefit attribution pattern under a benefit approach to be more representative of how benefits are earned than the pattern under a cost approach. Assume, for example, that postretirement benefits are provided in exchange for 20 years of service. A benefit approach results in a level attribution of the *future* benefits, implying that the benefits are earned equally over the attribution period. An aggregate cost approach implicitly results in a declining *future* benefit attributed to years of service with the passing of time and approaching retirement, implying that proportionately more benefits are attributable to the early years of service than to the later years. Under both approaches, absent funding considerations, the cost of providing benefits rises with the passing of time as retirement is approached, although the increase is lower under the aggregate cost approach because the service cost component is a level amount or percentage.

214. When it began deliberations on the attribution method, the Board considered present plan designs as well as possible future plan designs. Because postretirement health care and other welfare benefits generally supplement pension benefits, the Board considered the likelihood that future postretirement benefit plan formulas will become more similar to pension plan formulas. That is, employers may promise postretirement benefits that vary based on individual years of service rather than promise the same benefits to all employees who become eligible for benefits. Since that time, various surveys have documented a trend in plan designs in that direction.

215. The Board noted that one particular aggregate cost approach is computationally less complex than a benefit approach because it does not attempt to differentiate between the causes of any unexpected changes in the unfunded accumulated benefit obligation; any unexpected change is recognized prospectively. The effects of plan amendments and gains and losses are incorporated into the unfunded expected postretirement benefit obligation for prospective recognition. However, the Board concluded that the computational advantages of that somewhat less complex aggregate cost approach did not outweigh the other considerations favoring a benefit/years-of-service approach.

216. A few respondents suggested that the Board not require the use of a single method of attributing the cost of postretirement benefits to periods of employee service but, rather, allow a choice among a number of acceptable actuarial methods. They 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.

217. The Board is not convinced that differences in circumstances among employers require different methods for measuring the service cost component of net periodic postretirement benefit cost. Similar arguments were made about employers' accounting for pensions. However, respondents were unable to identify, and the Board was unable to develop, any basis to support the use of different methods. Differences in circumstances require the use of different assumptions or different attribution periods that appropriately result in different patterns of recognizing the cost of providing postretirement benefits.

218. Most respondents preferred a single attribution method based on the terms of the plan, similar to the approach prescribed by Statement 87. They maintained that that method would be more understandable and more useful than a less familiar method and would be less costly to implement than a new method. The Board agreed and concluded that a benefit/years-of-service approach should be prescribed. When a benefit formula does not define the specific years of service to be rendered in exchange for the benefits, the Board acknowledges that an allocation of benefits to individual years of service in the attribution period has to be assumed. However, the Board believes that it would be inappropriate to develop an approach that is inconsistent with the benefit approach underlying Statement 87 unless that approach would significantly reduce implementation costs without unduly compromising the more conceptually appropriate approach, particularly since the Board views the promise for postretirement benefits to be similar to the promise for pension benefits.

Attribution period

219. A plan's benefit formula is the basis for determining the benefits to which plan participants may be entitled. The benefit formula specifies how plan participants attain eligibility for those benefits—the

years of service to be rendered, the age to be attained while in service, or a combination of those factors. Consequently, a plan's benefit formula provides the most relevant and reliable basis for measuring the expected postretirement benefit obligation and for determining the period over which those benefits should be accrued.

220. The Board concluded that if the expected postretirement benefits promised pursuant to a plan are similar to a deferred vested pension benefit,[35] the benefit obligation should not be attributed beyond the date an employee has rendered the required service for full eligibility for the future benefits expected to be received by that employee. Full eligibility is attained by meeting specified age, service, or age and service requirements of the plan. The full eligibility date is the date at which an employee attains eligibility for all of the benefits that are expected to be received by that employee, including any benefits expected to be received by any beneficiaries or covered dependents.

221. For example, if a plan provides a postretirement health care or life insurance benefit to an employee who renders 10 years of service, the actuarial present value of that benefit should be fully accrued at the end of 10 years of service. Similarly, if a plan provides a postretirement benefit to an employee who attains age 55 while in service, the actuarial present value of that benefit should be fully accrued when the employee attains age 55. Whether benefits commence immediately or in the future does not change the employee's eligibility for postretirement benefits. The Board concluded that postretirement benefits should not be attributed beyond the date *full* eligibility for those benefits is attained.

222. The Exposure Draft proposed that, consistent with Statement 87, determination of the full eligibility date not be affected by measurement assumptions such as when benefit payments commence, dependency status, salary progression, and so forth. During its redeliberations, the Board again considered whether the full eligibility date should be affected by certain measurement assumptions. For example, for pay-related plans that define the benefit earned as a fixed percentage of final pay, an incremental benefit is earned each year for the effect of the change in an employee's pay rate for that year. Similarly, for plans that provide an indexed benefit that is "capped" at the indexed amount of the benefit at an employee's retirement, an incremental benefit equal to the effect of the annual change in that index is earned for each year of service. Board members believed the attribution period should include all employee service periods for which a nontrivial incremental postretirement benefit is earned. The Board recognized that consideration of those measurement assumptions in determining the full eligibility date would be inconsistent with how Statement 87 applies to certain pension plans with maximum credited service periods. Those situations are limited.

223. The Board concluded that it is willing to accept that inconsistency because considering all years of service that provide an incremental benefit in determining an employee's full eligibility date is both more understandable and more consistent with the accounting for other deferred compensation contracts under Opinion 12. Consequently, the full eligibility date is determined by plan terms that provide incremental benefits for additional service, such as benefits based on final pay or benefits that are indexed through an employee's active service period, unless those incremental benefits are trivial. Determination of the full eligibility date is *not* affected by plan terms that define when benefit payments commence or by an employee's current dependency status. (Paragraphs 397–408 illustrate determination of the full eligibility date.)

224. Respondents to the Exposure Draft generally disagreed with ending the attribution period at an employee's full eligibility date. Those respondents supported attributing benefits to an employee's full service period—ending with the expected retirement date—whether or not the benefit formula defines the specific years of service to be rendered in exchange for the benefits. Many respondents indicated that, irrespective of the terms of the plan, attributing benefits to employees' full service periods reflects the employer's intent, asserting that the postretirement benefits promised to employees are substantially independent of their compensation levels or years of service. Other respondents indicated that attributing

[35] This Statement uses the term *vested benefits* in the accounting sense, not in the legal context. For accounting purposes, vesting refers to an employee's right to receive present or future benefits whether or not the employee remains in the service of the employer. The fact that the benefits do not commence until after the employee retires or that additional benefits may be earned by rendering additional service does not change the right to the benefits that have been earned and to which the employee would be entitled if the employee terminated.

postretirement benefits to an employee's expected retirement date is more consistent with the attribution period for most pension benefits.

225. In its redeliberation of the attribution period, the Board observed the results of the field test of the Exposure Draft. Those results suggested that, for many employers who elect delayed recognition of the transition obligation, the difference in net periodic cost that results from attributing the expected postretirement benefit obligation to an employee's full eligibility date rather than the employee's expected retirement date is minimal. That is because, in those situations, net periodic cost reflects the interplay of service cost, interest cost, and amortization of an employer's transition obligation. If the expected postretirement benefit obligation is attributed to an employee's full eligibility date, the transition obligation that is recognized on a delayed basis in future periods is greater than if the benefit obligation is attributed over a longer period. In addition, if the benefit obligation is attributed to an employee's full eligibility date, there is no service cost for fully eligible plan participants. As a result of those effects, and the relative magnitude of interest cost, regardless of the attribution period, the net periodic cost for most employers is not likely to be significantly affected by attributing the expected postretirement benefit obligation over service to employees' full eligibility dates rather than over service to employees' expected retirement dates.

226. The Board observes that the terms of most pension plans result in attributing the pension benefits to the years of service to an employee's expected retirement date. Because most pension plans provide an incremental benefit for each year of service, the full eligibility date and retirement date are the same. Recent surveys suggest a trend among employers to amend their postretirement benefit plans to define the amount of benefits employees will receive based on the length of their service, similar to most pension plans. If that trend continues, the full eligibility date for many or most postretirement benefit plans also may be the employee's retirement date.

227. For postretirement benefit plans that are not pay-related or otherwise indexed during an employee's service period (most existing postretirement health care plans), attributing the benefits to an employee's full eligibility date *is* consistent with the attribution period for pension benefits; what may make the periods appear to be different is different plan terms that define when the benefits are earned. For postretirement benefit plans that are pay-related or that otherwise index benefits during employees' service periods to their retirement date, the full eligibility date and retirement date generally will be the same. The attribution period for those benefits will differ from the attribution period for a similarly defined pension benefit with a capped credited service period. (Refer to discussion in paragraphs 222 and 223.)

228. Ending the attribution period at an employee's full eligibility date is consistent with the plan terms, which, in the Board's view, provide the best evidence of the exchange transaction. The accounting for an exchange transaction should reflect the understanding of both parties to the transaction. If an employer were to change the eligibility requirements for postretirement benefits from 10 years of service and attainment of age 55 while in service to a requirement of 15 years of service and attainment of age 62 while in service, that would be a fundamentally different promise with an economic consequence for the employer and at least some employees. The Board believes it would not be representationally faithful to ignore the difference between those promises in determining the attribution period.

229. The Board considered attributing benefits beyond the full eligibility date in some, but not all, cases. Several criteria were considered in defining the conditions under which that should occur, such as whether eligibility for benefits is attained gradually or all at once, whether the benefit formula unambiguously defines the specific years of service to be rendered, whether a specific age must be attained while in service, and whether retirement from the company is required.

230. The Board considered an approach that would require attribution of benefits beyond a plan participant's full eligibility date to the participant's expected retirement date if all eligible plan participants receive the same benefit and if eligibility for the benefits is attained all at once upon attaining a specified age while in service, upon rendering a specified number of years of service, or a combination of both. However, the Board rejected that approach because it was troubled by the arbitrary nature of the resulting attribution period. For example, if a plan provides 60 percent of the cost of postretirement health care benefit coverage to all employees who render 25 or more years of service, that approach would require attribution over a 30-year period for an employee expected to retire after 30 years of service. However, if a plan provides 40 percent of the cost of postretirement

health care benefit coverage to all employees who render 20 years of service and an additional benefit of 4 percent for service in each of the following 5 years, the expected postretirement benefit obligation for an employee expected to render 30 years of service would be attributed to that employee's first 25 years of service. The accounting would attribute the benefits over different periods even though, in both cases, the benefit promise would be vested after 25 years of service and service beyond 25 years would not result in an incremental benefit.

231. The Board also considered an approach that would require attribution of benefits beyond the full eligibility date for those benefits if a plan's benefit formula does not unambiguously define the specific period of service to be rendered in exchange for the benefits. The Board rejected that condition because of the inconsistent results that would occur. For example, if one plan provides 75 percent of the cost of postretirement health care coverage to employees who render 30 years of service and a different plan provides the same benefits to employees who attain age 55 while in service and render at least 10 years of service, benefits would be attributed beyond the full eligibility date in the latter case but not the former. For an employee hired at age 25 who is expected to render 40 years of service, the benefits under the first plan would be attributed to the employee's first 30 years of service and the benefits under the second plan would be attributed to the employee's full service period, even though the same benefit is earned upon meeting the age and service conditions of the respective plans.

232. The Board also considered an approach that would require attribution of benefits beyond the full eligibility date if a plan's benefit formula requires attaining a specified age while in service. In that case, the credited service period is not unambiguously defined. The Board noted that the approach creates anomalies and rejected it as arbitrary for the reasons discussed in paragraphs 230 and 231.

233. The Board also considered an approach that would require attribution of benefits beyond the full eligibility date if an employee must meet the employer's criteria for retirement before termination in order to receive the benefits.[36] Under that approach, the benefit promise is viewed as an exchange for service over an employee's career, and retirement is viewed as the recognizable event. The Board rejected that approach for several reasons. While meeting the employer's criteria for retirement may define when postretirement benefit coverage is expected to commence, the act of retirement in and of itself does not reflect the exchange that takes place between the employer and an employee. It is the required employee service that is exchanged for postretirement benefits. In addition, an approach that attributes benefits beyond the full eligibility date based on the act of retirement would be inconsistent with accruing other deferred compensation contracts, including pensions, to the full eligibility date.

234. The need to be "retired" in order to receive benefits is not unique to other postretirement benefit plans. At the full eligibility date the employee has completed the contractual requirements for eligibility for all the postretirement benefits that employee is expected to receive and can terminate with entitlement to those benefits when a specified event occurs or the need for those benefits arises. An objective of accounting for deferred compensation contracts is to measure the accrued liability defined by the contract as reliably as possible and, therefore, to recognize cost over the periods in which the benefits are earned and the exchange takes place. Although for some contracts it may not be possible to determine the portion of the expected future benefits earned by an employee before that employee attains full eligibility for the benefits, no uncertainty remains at the full eligibility date. The total expected postretirement benefits have been earned at that date.

235. Attribution of postretirement benefits beyond the date full eligibility for the benefits is attained would suggest that there is a difference between "fully vested" pension benefits and "full eligibility" for other postretirement benefits. At the full eligibility date, the *right* to the benefits is not contingent upon rendering future service. Both vesting in pension

[36]For example, an employer may promise to provide postretirement health care coverage to all employees who retire from the company (terminate after meeting the age or service requirements that entitle an employee to immediate pension benefits); under the terms of the retirement plan, an employee may retire from the company early with 30 years of service or at the normal retirement age with less than 30 years of service. Consequently, for an employee hired at age 25 who renders 30 years of consecutive service, the employer has promised to provide postretirement benefit coverage upon that employee's termination (retirement) on or after rendering 30 years of service. Although that employee will render service beyond age 55, eligibility for the benefits is not conditional upon rendering additional service, and no incremental benefit is provided for doing so.

benefits and attaining full eligibility for postretirement benefits are rights that are "earned" (exchanged) for meeting specified age, service, or age and service requirements. In both cases, an employee is not entitled to *receive* the benefits until after the employer-employee relationship is terminated. The Board saw no significant distinction between the two.

236. Paragraph 42(a) of Statement 87 states that "for benefits of a type includable in vested benefits,[9] [the benefits 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*" (emphasis added). Footnote 9 of Statement 87 describes a supplemental early retirement benefit that is vested after a stated number of years as an example of a benefit of a type includable in vested benefits. Paragraph 42(b) of Statement 87 states that "for benefits of a type not includable in vested benefits,[10] [the benefits shall be considered to accumulate] in proportion to the ratio of completed years of service to total projected years of service." Footnote 10 of Statement 87 describes a death or disability benefit that is payable only if death or disability occurs during active service as an example of a benefit of a type *not* includable in vested benefits. Most postretirement benefits are of a type includable in vested benefits.

237. The Board was unable to identify any approach that would, in its opinion, appropriately attribute benefits beyond the date full eligibility for those benefits is attained. Accordingly, the Board concluded that postretirement benefits should not be attributed to service beyond the date an employee attains full eligibility for those benefits. The Board also concluded that if the benefit formula defines the beginning of the credited service period, benefits generally should be attributed from that date. If the beginning of the credited service period is not defined, the beginning of the credited service period is deemed to be the date of hire, and benefits should be attributed from that date.

238. Some Board members disagree with ending the attribution period at the full eligibility date as defined in this Statement. They support attributing the expected postretirement benefit obligation from an employee's date of hire (or beginning of the credited service period, if later) to the date beyond which the employee's additional service will not change (neither increase nor decrease) the amount of benefits to which the employee will be entitled—usually the employee's retirement date. That approach would extend the attribution period to include any years of employee service during which the employer conceptually incurs a negative service cost because the employee, by electing to continue service after earning a vested postretirement benefit, gives back benefits that have been earned (refer to paragraphs 240–242). This Statement attributes the expected postretirement benefit obligation, rather than the vested postretirement benefit obligation, to years of credited service and assigns no service cost to the years of service beyond the full eligibility date. Those Board members would attribute the expected postretirement benefit obligation on a pro rata basis to *all* years of service that change the amount of benefits an employee is entitled to receive, *including* those years in the giveback period.

239. Those Board members recognize that, depending on a plan's terms, an employee's full eligibility date may be the same as the employee's retirement date. In those instances there is no period during which the employer conceptually incurs a negative service cost. But for many existing plans, an employee's full eligibility date and retirement date differ. Those Board members are concerned with those latter plans. They observe that many existing plans provide benefits to employees "upon retirement" or "upon retiring from the company" without defining the specific years of service to be rendered in exchange for the benefits. Those Board members believe that, for those plans, ending the attribution period at the expected retirement date more appropriately reflects the understanding that postretirement benefits are exchanged for *all* years of employee service. Those Board members believe that attributing benefits to the date beyond which an employee's service will not change the amount of benefits to be received by the employee is a preferable, practical, and understandable approach to attributing the expected postretirement benefit obligation to years of service.

Amount attributed

240. Implicit in the Board's conclusion is the view that at the full eligibility date the employer has a measurable obligation to provide benefits in the future. The Board considered whether measurement of that obligation for a plan that provides benefits immediately after retirement should be based on (a) benefits the employee is expected to receive given the employee's expected retirement date (the expected postretirement benefit obligation) or (b) benefits the employee would be eligible to receive were

the employee to retire (terminate) immediately (a vested postretirement benefit obligation). Under the latter approach, if the vested postretirement benefit obligation for an employee were attributed to service to the full eligibility date and that employee continued to render service rather than retire, a negative service cost would be recognized (for the reduction in the vested postretirement benefit obligation) during the subsequent service period as the employee foregoes a portion of the benefits that had been earned at the full eligibility date. Under either approach the same obligation—the expected postretirement benefit obligation—would be recognized at the employee's retirement date.

241. Attributing the vested postretirement benefit obligation to service to the full eligibility date is viewed as conceptually appropriate by some Board members. At that date, an obligation exists to provide postretirement benefits; that obligation is no longer contingent upon the employee rendering future service. Those Board members believe it is inconsistent to measure an obligation to which an employee is immediately eligible as the expected postretirement benefit obligation, which considers that benefits commence after additional future service, because no future service is required. They believe that a measurement based on rendering future service is not representationally faithful when a greater benefit has been earned that is not dependent upon the rendering of future service.

242. The ability to satisfy the benefit obligation at less than the "vested" amount is outside the control of an employer. Further, to attribute benefits on the basis of the expected postretirement benefit obligation anticipates an employee's election to remain in service and consequently give back a benefit. Certain Board members believe that, conceptually, that election should be accounted for as it is made. In their view, recognition of the vested postretirement benefit obligation at the full eligibility date and the subsequent giveback of benefits in the intervening period until retirement better reflects the exchange that has occurred. That is, the employer has promised to provide a specified level of benefit coverage in exchange for a minimum period of employee service or service to a specified attained age. During the service period subsequent to the full eligibility date, the economic benefit to the employee for continuing to work (and the employer's compensation cost) is the excess of the amount the employee receives for working over the amount the employee would have received had the employee not continued to work.

243. Despite the conceptual support that some Board members believe exists for attributing the vested postretirement benefit obligation over the service period to the full eligibility date, Board members recognized the difficulty of conveying to preparers and users of financial statements the notion of a negative service cost for some employees. Therefore, the Board concluded that the expected postretirement benefit obligation, rather than the vested postretirement benefit obligation, should be attributed to service to the full eligibility date.

244. The Board acknowledges that attribution of the expected postretirement benefit obligation to the full eligibility date may be viewed as being internally inconsistent because recognition and measurement are on different bases. Whereas recognition is based on service to the full eligibility date, measurement of the obligation considers service beyond that date because an employer must consider when benefit payments are likely to commence in order to measure the expected postretirement benefit obligation that is to be attributed to employees' service periods. The Board notes that although some future events do not provide a basis for recognition of elements of financial statements, they may affect the measurement of recognized past events. The Board concluded that, absent a reconsideration of fundamental measurement and recognition concepts, attribution of the expected postretirement benefit obligation, rather than the vested postretirement benefit obligation, to the full eligibility date is preferable given the evolutionary state of accounting for postretirement benefits.

Attribution pattern

245. The Exposure Draft proposed attributing the expected postretirement benefit obligation to employee service using the benefit formula. That is, if the benefit formula attributes certain benefits to individual years or groups of years of service in the credited service period, the benefit formula generally would have been followed for attribution purposes. Otherwise, an equal amount of the expected benefits would have been assigned to each year of service in the attribution period. The Board believed then and continues to believe that the benefit formula is the most relevant basis for attributing benefits to years of service. However, it is particularly difficult to attribute benefits to years of service in accordance with the present terms of many postretirement health care plans. Frequently, the plan terms are ambiguous and quite difficult to apply at interim dates. For example, a plan may define different benefits for different

years of service and have a separate age and service requirement that must be met to attain eligibility for any benefits.

246. Following a plan's benefit formula for attributing postretirement benefits to individual years of service in the attribution period adds a degree of complexity that the Board concluded was unnecessary. The Board believes that the primary objective of attribution is to have fully accrued the actuarial present value of the cost of the postretirement benefits expected to be provided to an employee pursuant to the terms of the contract (the expected postretirement benefit obligation) at the date the employee attains full eligibility for those benefits. Although following the benefit formula for attribution purposes would be more representationally faithful and consistent with Statement 87, the Board concluded that because postretirement benefits do not typically vest at interim dates during an employee's service period in the same manner as pension benefits, and because the terms of postretirement benefit plans generally are more complex than the terms of pension plans, the obligation accrued at an interim date is not as relevant and reliable as the obligation accrued at the full eligibility date. Consequently, in order to reduce complexity, the Board concluded that the expected postretirement benefit obligation should be recognized by assigning an equal amount to each year of service in the attribution period, unless the plan's benefit formula attributes a disproportionate share of the expected postretirement benefit obligation to employees' early years of service.

Transition

247. The issues of how and when the transition amount should be recognized are sensitive ones to employers who face, for the first time, the prospect of accruing the cost of postretirement benefits exchanged for current service as well as accounting for the cost of those benefits exchanged for prior service. Unlike the effects of most other accounting changes, a transition obligation for postretirement benefits generally reflects, to some extent, the failure to accrue the obligation in the earlier periods in which it arose rather than the effects of a change from one accrual method of accounting to another.

248. An employer changing from the cash basis of accounting for postretirement benefits to the accrual basis required by this Statement has not recognized any of the cost of the benefits for active plan participants and only some portion of the cost of the benefits for retired plan participants—amounts that would have been recognized as the service and interest cost components of net periodic postretirement benefit cost in earlier periods. In addition, an indeterminate portion of the transition obligation may represent unrecognized prior service cost arising from a plan initiation or amendment, an unrecognized net gain or loss, or an unrecognized obligation from a prior business combination.

249. Determining the portion of the transition obligation that represents unrecognized service cost and interest cost of prior periods would require retroactively measuring the amount of benefit obligation that would have been recognized for each prior period by the employer had this Statement always been applied. To do that, an employer would have to determine the historical data and assumptions about the economic environment that would have been made at the date of plan adoption and at each subsequent measurement date. It is unlikely that the data necessary to measure the obligation at those dates exist, and it would be difficult, if not impossible, to develop assumptions that ignore the benefit of hindsight.

250. The Board concluded that transition is, to a significant extent, a practical matter. A major objective of transition is to minimize implementation costs and to mitigate disruption to the extent possible without unduly compromising the ability of financial statements to provide useful information. The Board also concluded that it would be confusing, complex, and inconsistent to measure the transition obligation differently from other measurements in accounting for postretirement benefits. The transition obligation is measured as the unrecognized unfunded accumulated postretirement benefit obligation, which is based on the portion of the expected postretirement benefit obligation attributed to each year of service rendered prior to a plan participant's full eligibility date. That measurement is consistent with the attribution of benefits to years of service, measurement of the effects of a plan initiation that grants retroactive benefits or a plan amendment, and the measurement of a postretirement benefit obligation assumed in a business combination accounted for as a purchase.

251. Changes from cash basis to accrual basis accounting are usually made retroactively. If the components of the transition obligation (asset) could be separately determined, it would be consistent with other provisions of this Statement to treat the unrecognized current service and interest cost as the cumulative effect of an accounting change (that is, to immediately recognize those components when this

Statement is first applied), and retroactively remeasure prior purchase business combinations for postretirement benefit obligations assumed but not recognized. It also would be consistent to recognize at least some of the unrecognized prior service cost and unrecognized gain or loss prospectively, based on the delayed recognition afforded those components of postretirement benefit cost by this Statement. However, if the cumulative effect of the accounting change were required to be estimated, the cost of doing so could be prohibitive and the results questionable for the reasons discussed in paragraph 249.

252. Several alternatives to immediate recognition of the transition obligation or asset were considered. The Board believed that, conceptually, immediate recognition of the cumulative effect of the accounting change (as described in paragraph 251) would be most appropriate. The potential magnitude of the accumulated postretirement benefit obligation, particularly the obligation for postretirement health care benefits, suggests that any omission of that obligation would detract from the usefulness of the statement of financial position. However, the Board recognized that the magnitude of that obligation and the limited availability of historical data on which to base its measurement suggest the need for a more pragmatic approach. Those considerations led the Board to conclude in the Exposure Draft that the initial emphasis of this Statement should be on disclosure of the transition obligation and that the subsequent recognition of that amount in the statement of financial position and in the statement of income should be phased in over future periods.

253. Respondents generally favored a transition period longer than the 15-year period proposed in the Exposure Draft. Some maintained that the magnitude of employers' transition obligations argues for a longer transition period to minimize disruption of current practice. Others noted that a longer transition period would better reflect the average remaining service period of the employee work force that will be entitled to the benefits. Because most existing plans do not give employees postretirement health care benefits unless they meet the company's criteria for retirement with an immediate pension benefit, the remaining service periods of participants in a postretirement health care plan is typically longer than the remaining service periods of participants in a pension plan. Employees who are eligible for postretirement health care benefits are generally only long-service employees, while employees are often entitled to a deferred vested pension benefit if they terminate at younger ages with shorter service periods. For a majority of the companies that participated in the field test of the Exposure Draft, the average remaining service period of the active participants in their postretirement benefit plans was between 18 years and 21 years; previous surveys of employers' pension plans indicated an average remaining service period of those plan participants that is several years shorter.

254. The Board concluded that employers whose plan participants' average remaining years of service is less than 20 years could elect to recognize their transition obligation or asset over 20 years, reflecting the average remaining service periods for participants in many other employers' postretirement benefit plans. However, the Board also concluded that phasing in recognition of a transition obligation should not result in slower recognition of an employer's postretirement benefit obligation than would result from continuation of the pay-as-you-go (cash basis) method. The Exposure Draft proposed that amortization of the transition obligation be accelerated if (a) cumulative benefit payments subsequent to the transition date to fully eligible plan participants at the transition date exceeded the sum of (1) the cumulative amortization of the entire transition obligation and (2) the cumulative interest on the unpaid transition obligation or (b) cumulative benefit payments subsequent to the transition date to all plan participants exceeded the cumulative postretirement benefit cost accrued subsequent to the transition date. As a result of the complexity associated with applying the first of those constraints, the Board concluded that recognition of the transition obligation should be accelerated only if the second constraint applies.

255. Although respondents to the Exposure Draft supported delayed recognition of the transition obligation as a practical approach to transition, most of those respondents also favored permitting (but not requiring) immediate recognition of the transition obligation or asset. They noted that FASB Technical Bulletin No. 87-1, *Accounting for a Change in Method of Accounting for Certain Postretirement Benefits,* permitted immediate recognition of the transition obligation in certain circumstances. They also noted that immediate recognition provides the simplest method of recognition that would most significantly improve financial reporting. Because a significant portion of the transition obligation is likely to relate to service and interest costs for prior periods, they argued that the Board should permit an employer to

immediately recognize its transition obligation for postretirement benefits.

256. The Board's consideration of permitting immediate recognition of the transition obligation or asset focused on whether financial reporting would be enhanced by limiting alternatives, recognizing that in doing so, a conceptually defensible, and in some cases preferable, alternative might be eliminated. Some Board members believe that immediate recognition of the transition obligation or asset should not be permitted. They believe that the understandability and comparability of financial reporting, both in the year of adoption and in subsequent periods, would be improved by uniformly phasing in recognition of the transition obligation or asset for postretirement benefits for all employers. They also note that the actuarial techniques for measuring postretirement health care benefit obligations are still developing and should become more sophisticated and reliable with time and experience. They observe that near-term measures of the accumulated postretirement benefit obligation from which the transition obligation is derived will reflect the deficiencies of insufficient data collection in the past and the evolving actuarial practice in this area. They also note that subsequent adjustments to measures of the accumulated postretirement benefit obligation will be recognized in income through the gain or loss component of net periodic postretirement benefit cost.

257. Because an indeterminate portion of the transition obligation may relate to unrecognized prior service cost, an unrecognized net gain or loss, or the effects of a prior purchase business combination, immediate recognition of the transition obligation in its entirety would result in premature recognition of those amounts. Under the recognition provisions of this Statement, those effects are properly recognized in the results of operations for subsequent periods. Some Board members were troubled by that result. This Statement delays recognition of the effects of plan improvements, because they are granted with the expectation that the employer will realize economic benefits in the future, and of plan reductions and permits the delayed recognition of gains and losses. Opinion 16, as amended by this Statement, requires recognition of postretirement benefit obligations assumed in a purchase business combination in determining the cost of the assets acquired, including goodwill related to the purchase; that increase in the cost of the assets acquired is recognized as a charge against operations in future periods.

258. The Board concluded that an employer's transition obligation or asset may be recognized either on a delayed basis or immediately, subject to certain constraints. In reaching that conclusion, the Board recognized that complete comparability would not be achieved by proscribing immediate recognition of the transition obligation. A few companies have already adopted accrual accounting for postretirement benefits pursuant to Technical Bulletin 87-1 and have immediately recognized their transition obligations. Others would have the opportunity to do so before issuance of this Statement. Despite concerns about the availability and reliability of data on which to base measurement of an employer's accumulated postretirement benefit obligation, the Board believes that the delayed effective date of this Statement should provide for further development of actuarial techniques and the accumulation of more reliable data on which to base the measurements at the date of transition. The Board concluded that employers should not be precluded from recognizing their transition obligations in the manner that some believe most significantly improves financial reporting.

259. The Board considered limiting the immediate recognition of the postretirement benefit transition obligation to the amount in excess of any remaining unrecognized transition asset for pensions because the transition amounts result from similar standards for similar costs. Some Board members are concerned about the credibility of financial statements if income from the transition to one standard is included in income over time, while expense from the transition to a related standard is recognized all at once. Others believe that because the two standards relate to different subjects, credibility is not affected. The Board concluded that immediate recognition of the transition obligation for postretirement benefits should not be limited by any remaining transition asset for pensions. The Board observes that because transition is largely a practical matter, consideration should be given to the facts and circumstances surrounding the issues addressed by the standard. In the case of postretirement benefits other than pensions, some Board members believe that a change from cash basis to accrual accounting is a circumstance sufficiently different from a change from one accrual method to another to justify a unique transition provision. They also believe that the transition obligation for postretirement benefits reflects service cost and interest cost attributable to prior periods to a much greater degree than the transition obligation for pensions.

260. Immediate recognition of an employer's transition obligation or asset is permitted only at the date of initial application of this Statement. The Board concluded that to permit immediate recognition at any subsequent time would result in too much variability in financial reporting for a long period of time. That option also would be inconsistent with some of the arguments in favor of immediate recognition and would introduce additional complexities in determining the amount that could be subsequently recognized.

261. The effect of immediately recognizing a transition obligation or asset and any related tax effect are to be reported separately in the statement of income as the effect of a change in accounting. To more closely approximate the measure of the cumulative effect of the accounting change, the amount immediately recognized in income is required to exclude certain effects that should, more appropriately, be reflected in determining future periods' income. Thus, the amount immediately recognized in income as the effect of the change in accounting is required to exclude the effects of (a) any previously unrecognized postretirement benefit obligation assumed in a business combination accounted for as a purchase, (b) a plan initiation, and (c) any plan amendment that improved benefits, to the extent that those events occur after the issuance of this Statement.

262. The Board considered excluding from the amount immediately recognized in income any significant portion of the transition obligation attributable to obligations assumed in past purchase business combinations or the effects of past plan initiations or amendments that improved benefits, in order to more reliably measure the effect of the accounting change. However, the Board believes that the data on which those measurements would be based for those past events are generally not available and would be costly, if not impossible, to develop. Some Board members believe that, at a minimum, the amounts related to any of those events that are known or are readily available should be excluded from any transition obligation immediately recognized in income. For primarily practical reasons, the Board concluded that only the constraints identified in paragraph 261 should be applied.

263. The Board considered whether the effects of recognizing an employer's transition obligation or asset should be included in determining net income, as an adjustment of retained earnings, or as a component of comprehensive income, but not net income. Opinion 20 states that most changes in accounting should be recognized by including the cumulative effect of the change in accounting in net income of the period of change. The correction of an error and certain changes in accounting principles identified in that Opinion are recognized by restating prior periods, resulting in an adjustment of beginning retained earnings for the current period.

264. Some respondents favored recognizing the transition obligation (or asset) through a direct charge (or credit) to retained earnings because the amount relates primarily to past periods. However, recognition of the cumulative effect of an accounting change through income, as specified in Opinion 20, is a well-established principle. In addition, implementation issues would arise in recognizing the future effects of changes in the measure of the accumulated benefit obligation that is included in the transition obligation. One such issue would be how the effects of plan amendments that reduce benefits that existed at the transition date or the effects of settlements or curtailments and gains from experience different from that assumed should be reflected.

265. A few respondents supported a comprehensive income approach. Concepts Statement 5 discusses comprehensive income as a broad measure of the effects of all changes in an enterprise's equity for a period, other than from transactions resulting from investments by or distributions to owners. Earnings are described as a measure of performance for a period. Following a comprehensive income approach would include the effects of changes in accounting principles in comprehensive income but not in earnings. Respondents suggested establishing a separate, permanent component of equity to report the effect of recognizing the transition obligation either immediately or on a delayed basis. The suggested approach differs from certain existing separate components of equity (as described in FASB Statements No. 12, *Accounting for Marketable Securities,* and No. 52, *Foreign Currency Translation,* and Statement 87), that ultimately are reflected in determining net income of subsequent periods, if not offset by other events. The comprehensive income approach suggested by respondents would require separate Board consideration of how comprehensive income would be displayed, since Concepts Statement 5 does not address that issue. That consideration is beyond the scope of this Statement.

266. The Board concluded that, if an employer's transition obligation or asset is recognized immediately, the effect of that change in accounting should

be recognized in a manner consistent with recognition of the effects of other changes in accounting. The Board believes that recognition of the effects of an accounting change through income is widely understood and accepted. To immediately recognize the effects of adopting this Statement in a different manner would be inconsistent with how subsequent adjustments of the transition obligation are recognized and would diminish the understandability and usefulness of the financial statements. Therefore, the Board concluded that the effects of an employer's election to immediately recognize its transition obligation or asset for postretirement benefits should be reported as the effect of an accounting change; employers that elect delayed recognition of the transition obligation or asset should report the recognition of that amount as a component of net periodic postretirement benefit cost, consistent with the manner of reporting the transition effects of Statement 87.

267. The Board also concluded that for individual deferred compensation contracts, the effects of a change in the measurement and recognition of an employer's obligation at the date the change in accounting is adopted should be recognized in a manner consistent with the nature of the benefit provided by the contract. Consequently, the effect of the change in accounting for individual contracts that provide postretirement health or other welfare benefits, measured at the date of the change, is subject to the general transition provisions and effective dates of this Statement (paragraphs 108–114). However, the effect of a change in accounting for other individual deferred compensation contracts is to be recognized as the cumulative effect of a change in accounting in accordance with Opinion 20, effective for fiscal years beginning after March 15, 1991. The Board believed that that delay in the effective date for those contracts should provide sufficient time for communication of the amendment of Opinion 12 to affected employers.

Components of Net Periodic Postretirement Benefit Cost

268. The Board concluded that an understanding of postretirement benefit accounting is facilitated by separately considering the components of net periodic postretirement benefit cost. Those components are service cost, interest cost, actual return on plan assets, amortization of unrecognized prior service cost, gain or loss recognition, and amortization of the transition obligation or asset for employers who elect delayed recognition of the unrecognized obligation or asset existing at the date of initial application of this Statement.

269. A plan with no plan assets, no plan amendments, no gains or losses, and no unrecognized transition amount would have two components of cost—service cost and interest cost. As employees work during the year in exchange for promised benefits, a *service cost* (compensation cost) accrues. Measurement of that component is discussed in the section on measurement of cost and obligations (paragraphs 166–246). Since the service cost component and the related obligation are measured on a present value basis under this Statement, a second component—*interest cost*—also must be accounted for. Measurement of that component is straightforward once the discount rates are determined; selection of appropriate discount rates is discussed in paragraphs 186–193.

270. A third component of cost exists for a funded plan—the *return* (or possibly loss) *on plan assets.* That component ordinarily reduces net periodic postretirement benefit cost. The interest cost and return on plan assets components represent financial items rather than employee compensation cost and are affected by changes in the employer's financing arrangements. For example, an employer can increase the return on plan assets by making additional contributions to a fund that is segregated and restricted for the payment of the postretirement benefits. An employer can decrease interest cost (and return on plan assets) by using plan assets to purchase nonparticipating life insurance contracts to settle part of the accumulated postretirement benefit obligation of a postretirement life insurance plan.

271. The fourth component of cost is the *amortization of unrecognized prior service cost,* which reflects the increase or decrease in compensation cost as a result of granting, improving, or reducing postretirement benefits attributed, pursuant to this Statement, to periods prior to the plan initiation or amendment. The amortization of unrecognized prior service cost that results from a plan initiation that grants retroactive benefits will increase net periodic postretirement benefit cost; amortization of prior service cost that results from a plan amendment will increase or decrease the net periodic postretirement benefit cost depending on whether the amendment increases or reduces (a negative plan amendment) benefits.

272. The fifth component of cost is the *gain or loss component.* That component either decreases or increases postretirement benefit cost depending on

whether the net unrecognized amount is a gain or a loss, whether the actual return on plan assets for a particular period is less than or greater than the expected return on plan assets, and whether an employer makes a decision to temporarily deviate from the substantive plan. That component combines gains and losses of various types and therefore includes both compensation and financial items that are not readily separable.

Conclusions on Other Issues—Single-Employer Defined Benefit Postretirement Plans

Fundamentals of Postretirement Benefit Accounting

273. In applying accrual accounting to postretirement benefits, this Statement accepts three fundamental ideas that are common to pension accounting: delayed recognition of certain events, reporting net cost, and offsetting liabilities and related assets. Those three features of practice have shaped financial reporting for pensions for many years even though they conflict in some respects with accounting principles applied elsewhere.

274. Delayed recognition means that certain changes in the obligation for postretirement benefits, including those changes that result from a plan initiation or amendment, and certain changes in the value of plan assets set aside to meet that obligation are not recognized as they occur. Rather, those changes are recognized systematically over future periods. All changes in the obligation and plan assets are ultimately recognized unless they are first offset by future changes. The changes that have been quantified but not yet recognized in the employer's financial statements as components of net periodic postretirement benefit cost and as a liability or asset are disclosed.

275. Net cost means that the recognized consequences of events and transactions that affect a postretirement benefit plan are reported as a single amount in the employer's financial statements. That net cost comprises at least three types of events or transactions that might otherwise be reported separately. Those events or transactions—exchanging a promise of deferred compensation in the form of postretirement benefits for employee service, the interest cost arising from the passage of time until those benefits are paid, and the returns from the investment of plan assets—are disclosed separately as components of net periodic postretirement benefit cost.

276. Offsetting means that the postretirement benefit obligation recognized in the employer's statement of financial position is reported net of amounts contributed to a plan specifically for the payment of that obligation and that the return on plan assets is offset in the employer's statement of income against other components of net periodic postretirement benefit cost. That offsetting is reflected even though the obligation has not been settled, the investment of the plan assets may be largely controlled by the employer, and substantial risks and rewards associated with both the obligation and the plan assets are borne by the employer.

Recognition and Measurement of a Plan Initiation or Amendment

277. When a postretirement benefit plan is initiated or amended to increase benefits, credit may be explicitly granted for employee service rendered prior to the date of the plan initiation or amendment. However, a plan initiation or amendment may not explicitly grant prior service credit. Thus it may be unclear whether an obligation for prior service arises for all or some of the participants.

278. A plan initiation or amendment that provides benefits to current retirees can only grant the retirees credit for their prior service, since no future service can be required for them to be entitled to the new or amended benefits. Consequently, an obligation for prior service arises to the extent a plan initiation or amendment provides new or increased benefits to current retirees. A similar assessment can be made for a plan initiation or amendment that provides benefits to other plan participants who have rendered sufficient service to be fully eligible to receive the new or amended benefits. However, since some of those plan participants have not yet retired and are expected to render additional future service, some respondents argued that a plan initiation or amendment affecting active plan participants fully eligible for benefits may be viewed as prospective. That view acknowledges no obligation for prior service; any obligation would arise as the employees render future service in exchange for the benefits. As applied to active plan participants who are fully eligible for benefits, the latter argument appears to be consistent only with the use of an attribution period that would end at an active plan participant's retirement date, not with an attribution period ending at an active plan participant's full eligibility date.

279. When new or amended benefits are granted to active plan participants who are not yet fully eligible

for benefits, the determination of whether those benefits are granted in exchange for past or future service is unclear unless specified by the plan initiation or amendment. Some respondents argued that because eligibility for the new or amended benefits is contingent on rendering future service, the plan initiation or amendment should be viewed only as prospective. Others argued that, consistent with the attribution approach that allocates an equal amount of benefit to each year of service in the attribution period and assuming the plan's benefit formula does not specify the benefits earned for specific years of service, the granting of new or amended benefits should be viewed as partially retroactive, to the extent the benefits are attributable to prior service periods, and partially prospective.

280. The Board noted that if a plan initiation or amendment does not explicitly state whether the new or amended benefits are granted prospectively or retroactively, but affects retirees as well as active plan participants, the plan could be viewed as implicitly granting prior service credit to active plan participants expected to receive the new or amended benefits. Assigning new or amended benefits to prior periods acknowledges that benefits are provided in exchange for employee service over the total credited service period.

281. The Board considered whether a plan initiation should be given the same accounting treatment as a plan amendment. If a plan initiation is viewed as retroactive, presumably any subsequent plan amendment also should be viewed as retroactive unless the plan specifically ignores prior service in determining eligibility for the new or amended benefit. However, if a plan initiation is viewed as prospective, one could view a subsequent amendment to that plan either as retroactive to the date of plan initiation or as prospective.

282. In considering whether plan initiations and amendments should be viewed similarly (that is, both as retroactive or both as prospective), the Board acknowledged the potential difficulty in distinguishing between a plan initiation and plan amendment. For example, if an employer has a health care plan for retirees and decides to provide dental benefits to retirees, one can view the action as an amendment of the postretirement health care plan or as the initiation of a postretirement dental care plan. The Board also was concerned about accounting for other amendments that might be viewed as plan initiations. For example, if a plan providing nominal benefits was initiated on January 1 and then was amended a few months later to increase benefits, the amended plan could be viewed as the plan that was contemplated when initiated on January 1. The Board concluded that a plan initiation should be accounted for in a manner similar to a plan amendment, unless the plan specifically provides benefits solely in exchange for service after the date of the plan initiation or a future date.

283. The Board also considered whether the effects of a plan initiation or amendment on retirees and other fully eligible plan participants should be viewed as retroactive and the effects on other active plan participants as prospective. In granting new or amended benefits to retirees and other fully eligible plan participants, an employer is implicitly, if not explicitly, granting credit for prior service. However, for active plan participants who have not yet attained full eligibility for those benefits, the new or amended benefits could be provided in exchange for their remaining service to full eligibility for benefits. Some interested parties, particularly consulting actuaries, advised the Board of the difficulties in measuring the service cost component of net periodic postretirement benefit cost and gains and losses if plan amendments were viewed as prospective for some plan participants.

284. Under a prospective approach, the benefits granted at plan initiation and with each subsequent amendment would need to be layered, requiring a repricing of each layer at each measurement date to determine service cost and gains or losses. That repricing could be particularly difficult when the plan does not define the specific periods of service to be rendered in exchange for the benefits and the benefits are defined in kind, rather than in terms of a fixed value or amount of benefit. In addition to the concerns expressed with prospective treatment of a plan initiation or amendment that affects certain active plan participants, the Board noted that negative plan amendments cannot logically be viewed as prospective for those plan participants. Given those factors, and the decision to reduce complexity by attributing the expected postretirement benefit obligation ratably to employees' years of service in the attribution period, the Board concluded that all plan amendments should be viewed as retroactive for all plan participants. Similarly, plan initiations generally should be viewed as retroactive unless the plan initiation specifically disregards prior service in determining eligibility for the new benefits.

Recognition of prior service cost

285. When a plan is amended to increase benefits or a plan is initiated and grants credit for prior service, the accumulated postretirement benefit obligation, based on retroactive allocation of benefits to service in prior years, is greater than before the plan initiation or amendment. As a result, the incremental obligation created by a plan initiation or amendment is reflected immediately as an increase in the accumulated postretirement benefit obligation. Whether that increase should be recognized (a) immediately as postretirement benefit cost for the year of the plan initiation or amendment or (b) on a delayed basis as part of postretirement benefit cost for future periods is arguable, particularly when the plan's terms attribute the increase to employees' prior service.

286. Some Board members support immediate recognition of prior service cost as an expense, particularly the portion related to existing retirees. Although some intangible economic benefits of a plan initiation or amendment may be received in future periods from benefit improvements for active plan participants, they believe that those intangible benefits do not qualify for recognition as an asset. Therefore, they believe there is little basis for delaying recognition of the underlying prior service cost to future periods. Other Board members believe that a plan initiation or amendment is made with a view to benefiting the employer's future operations through reduced employee turnover, improved productivity, or reduced demands for increases in cash compensation.

287. In its deliberations on Statement 87, the Board concluded that it is reasonable to assume that a plan amendment is the result of an economic decision and that a future economic benefit to the employer exists when benefit increases are granted to active plan participants and retirees. They observed that amortizing the cost of acquiring a future economic benefit over future periods is consistent with accounting practice in other areas. The Board also concluded that a requirement to charge the cost of a retroactive plan initiation or amendment immediately to net periodic pension cost would be an unacceptable change from prior practice. Accordingly, the Board concluded that the increase in the obligation resulting from a pension plan initiation or amendment 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.

288. In considering postretirement benefits, the Board found no compelling reason to recognize the cost of a retroactive plan initiation or amendment in a manner fundamentally different from that required by Statement 87. Thus, this Statement requires recognizing an equal amount of the prior service cost in each remaining year of service to the full eligibility date of each plan participant active at the date of the plan initiation or amendment who is not yet fully eligible for benefits at that date. Other alternatives provided under Statement 87 that recognize the prior service cost more rapidly, such as over the average remaining years of service to full eligibility for benefits of the active plan participants, also are permitted.

289. The Board recognizes that treating any plan amendment as retroactive, even if the new or amended benefits are provided solely in exchange for future service, results in a measure of the accumulated postretirement benefit obligation and of unrecognized prior service cost that may exceed the measure that would result from following the plan terms. The effect of retroactive treatment, however, is consistent with the pattern of ratably attributing the expected postretirement benefit obligation to each year of service in the attribution period. The effects of a higher measure of the accumulated postretirement benefit obligation and unrecognized prior service cost in some cases, as a result of treating prospective changes as retroactive, are consequences that offset the benefits of the simpler methodology provided by a ratable attribution pattern. However, delayed recognition of prior service cost mitigates those effects and net periodic postretirement benefit cost is not expected to be significantly affected.

Recognition of the effect of a plan amendment that reduces benefits (negative plan amendment)

290. A plan amendment may reduce rather than increase benefits attributed to prior service. The Board concluded that, consistent with Statement 87, any decrement in the obligation for benefits attributable to prior service should first reduce any existing unrecognized prior service cost arising from the plan's initiation or subsequent benefit increases. Further, the Board concluded that any remaining effects of a negative plan amendment should next reduce any unrecognized transition obligation with any remaining credit generally recognized in a manner consistent with prior service cost; that is, over remaining years of service to full eligibility for benefits of the active plan participants. The Board concluded that those

constraints on recognition of the effects of a negative plan amendment are necessary because the effects of reducing a plan promise should not be recognized before the original promise, including the unrecognized transition obligation, is recognized. Immediate recognition of the effects of a negative plan amendment also is precluded because future periods may be affected by an employer's decision to reduce benefits provided under the plan.

Delayed Recognition of Gains and Losses

291. Gains and losses, sometimes called actuarial gains and losses, are changes in either the accumulated postretirement benefit obligation or the fair value of plan assets arising from changes in assumptions and from experience different from that incorporated in the assumptions. For example, gains and losses include the effects on measurement of the accumulated postretirement benefit obligation that result from changes in the assumed health care cost trend rates for postretirement health care plans and actual returns on plan assets greater than or less than the expected rates of return.

292. Some respondents expressed concern about the volatility of a measure of an unfunded postretirement benefit obligation and the practical effects of incorporating that volatility into financial statements. The Board does not believe that volatility in financial statements is necessarily undesirable. If a financial measure purports to represent a phenomenon that is volatile, that measure must reflect the volatility or it will not be representationally faithful.

293. The Board acknowledges that, in the case of the accumulated postretirement benefit obligation, reported volatility may not be entirely a faithful representation of changes in the status of the obligation (the phenomenon represented). It also may reflect an unavoidable inability to predict accurately the future events that are anticipated in making period-to-period measurements. That may be particularly true for postretirement health care plans in light of the current inexperience in measuring the accumulated postretirement benefit obligation for those plans. The difference in periodic measures of the accumulated benefit obligation for a postretirement health care plan, and therefore the funded status of the plan, results partly from the inability to predict accurately for a period, or over several periods, annual expected claims costs, future trends in the cost of health care, turnover rates, retirement dates, dependency status, life expectancy, and other pertinent events. As a result, actual experience often differs significantly from what was estimated, which leads to changes in the estimates for future measurements. Recognizing the effects of revisions in estimates in full in the period in which they occur may produce financial statements that portray more volatility than is inherent in the employer's obligation.

294. The Board considered those views and concluded that, similar to employers' accounting for pensions, gains and losses should not be required to be recognized immediately as a component of net periodic postretirement benefit cost. Accordingly, this Statement provides for delayed recognition of gains (losses) over future periods to the extent they are not reduced by subsequent losses (gains). 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 postretirement benefit cost, are recognized on a basis intended to reduce volatility. The method used was developed in Statement 87. Both the extent of reduction in volatility and the mechanism adopted to effect it are essentially practical decisions without conceptual basis. The Board believes that the market-related value of plan assets used in this Statement as a device to reduce the volatility of net periodic postretirement benefit cost is not as relevant as the fair value of those assets.

295. Unlike most pension plans, the return on postretirement benefit plan assets may be subject to income tax because of the lack of tax-exempt vehicles for funding those benefits. At present, even if postretirement benefit plan assets are restricted and segregated within a trust, the income generated by those assets generally is taxable. If the plan has taxable income, the assessed tax will reduce the returns available for payment of benefits or reinvestment. The Board concluded that when the trust or other entity holding the plan assets is taxed as a separate entity on the return on *plan assets* (as defined herein), the expected long-term rate of return should be determined by giving consideration to anticipated income taxes under enacted tax law. However, if the tax on income generated by plan assets is not a liability of the plan, but of the employer, the expected long-term rate of return should not anticipate a tax on those earnings, because that tax will be reflected in the employer's accounting for income taxes.

296. The Board had several reasons for adopting the approach required in this Statement for measuring and incorporating the return on plan assets into net periodic postretirement benefit cost. First, it is the

same as that used in Statement 87 and is similar, mechanically, to actuarial practices intended to reflect the return on plan assets. As a result, it should be easier for those familiar with pension accounting or actuarial practices to understand and apply. Second, the use of explicit estimates of the return on plan assets avoids the use of discount rates, which are primarily relevant for measuring the accumulated postretirement benefit obligation, as part of a calculation related to the return on plan assets. Therefore, it reflects more clearly the Board's basic conclusion that information about a deferred compensation plan is more understandable if asset-related or financial features of the arrangement are distinguished from the liability-related and compensation cost features.

297. 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 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 postretirement benefit plan. The Board concluded that some amortization, at least when the net unrecognized gain or loss becomes significant, should be required.

298. Consistent with Statement 87, this Statement uses a "corridor" approach as a minimum amortization approach. That approach allows a reasonable opportunity for gains and losses to offset each other without affecting net periodic postretirement benefit 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. The width of that corridor is related to the market-related value of plan assets and the amount of the accumulated postretirement benefit obligation because the gains and losses subject to amortization are changes in those two amounts. The Exposure Draft proposed that a net gain or loss equal to 10 percent of the greater of those two amounts should not be required to be amortized (and thus included in net periodic postretirement benefit cost). Thus, the width of the resulting corridor would be 20 percent (from 90 percent to 110 percent of the greater balance).

299. Respondents generally agreed with the proposal to shield from recognition gains and losses falling within a defined corridor. However, many of the respondents suggested a wider corridor. They stated that they believe there will be greater volatility of measurement of postretirement benefit obligations than of pension obligations. They suggested that that consideration and the inability to fund postretirement benefit plans (which they believed would provide offsetting asset-related gains and losses) warrant a wider corridor to further mitigate potential swings in net postretirement benefit cost from one period to the next.

300. The effects of widening the corridor to 20 percent of the greater of the accumulated postretirement benefit obligation or market-related value of plan assets were tested in a number of different scenarios. The results of that study showed that widening the corridor would have little effect on mitigating the volatility of net periodic postretirement benefit cost; the significant factor in mitigating that volatility is the period over which unrecognized gains or losses in excess of the corridor are recognized. The Board concluded that understandability and comparability would be enhanced by retaining the approach followed for pension accounting.

301. Gains and losses also may be recognized immediately or on a delayed basis using any systematic method of amortizing unrecognized gains and losses, provided the method is consistently followed and that it does not result in less rapid recognition of gains and losses than the minimum amortization discussed in paragraph 298. Amortization of unrecognized net gains or losses is based on beginning-of-year balances. If an employer elects to recognize gains and losses immediately, the amount of any net gain in excess of a net loss previously recognized in income shall first offset any unrecognized transition obligation, and the amount of any net loss in excess of a net gain previously recognized in income shall first offset any unrecognized transition asset. That constraint was added because Board members believe that gains (losses) should not be recognized before the underlying unfunded (overfunded) accumulated postretirement benefit obligation is recognized.

302. In some cases an employer may assume a benefit obligation for current and past benefit payments that differs from the substance of the employer's commitment. For example, on the basis of the mutually understood terms of the substantive plan, an employer may anticipate for accounting purposes that any shortfall resulting from current year benefit payments in excess of the employer's substantive plan

cost and participant contributions for the year will be recovered from increased participant contributions in the subsequent year. However, the employer may subsequently determine that increasing participant contributions for the prior year's shortfall is onerous and make a decision to bear the cost of the shortfall for that year. That is, an employer may make a decision not to retrospectively adjust participants' contributions to recover the shortfall. The Board concluded that the gain or loss from such a temporary deviation from the substantive plan should be immediately recognized as a gain or loss, without the benefit of the corridor or other delayed recognition alternatives. Because the effect of the deviation from the substantive plan has no future economic benefit to the employer, and relates to benefits already paid, the Board believes that delayed recognition of that effect would be inappropriate.

Minimum Liability

303. The Exposure Draft proposed that, similar to Statement 87, a minimum liability should be prescribed to limit the extent to which the delayed recognition of the transition obligation, plan amendments, and losses could result in omission of liabilities from an employer's statement of financial position. The minimum liability was defined as the unfunded accumulated postretirement benefit obligation for retirees and other fully eligible plan participants. The Board believed that that measurement represented a threshold below which the recognized liability would not be sufficiently representationally faithful. The proposed minimum liability provisions would have been effective five years after the effective date of this Statement.

304. Respondents generally disagreed with prescribing the minimum liability that should be recognized. They believed that the proposed minimum liability provision represented a departure from accrual accounting and was inconsistent with the provisions of this Statement that provide for delayed recognition of gains and losses, prior service cost, and an employer's transition obligation. Respondents stated that unlike pensions, postretirement benefit obligations do not vest, as that term is used in its legal sense. They observed that the minimum liability provisions in Statement 87 approximate the statutory liability a U.S. employer would face if its pension plan were terminated. Currently, there are no similar statutory requirements for postretirement health care or welfare benefits. Some respondents also believed that the minimum liability provision would be confusing because it introduces an alternative measure of an employer's postretirement benefit obligation.

305. The Board concluded that this Statement should not require recognition of a minimum liability. The field test of the Exposure Draft provisions suggested that, ignoring the effects of gains and losses and plan amendments, the minimum liability provision for mature companies as defined in that study (companies with a ratio of one retiree to two to six active employees) generally would be inoperative after eight years. For companies with a higher retiree to active employee ratio, the field test suggested that the minimum liability provisions might be operative for more than 10 years. In other words, for possibly 10 or more years the minimum liability provisions could be effective solely as a result of phasing in recognition of the transition obligation. The Board concluded that the transition provisions of this Statement that provide for the delayed recognition of an employer's obligation for postretirement benefits at the date this Statement is initially applied should not be overridden by a requirement to recognize a liability that would accelerate recognition of that obligation in the statement of financial position.

306. The Board considered and decided not to amend Statement 87 to eliminate its minimum liability provision. Because most pension plans were thought to be adequately funded when Statement 87 was issued, the minimum liability provision served to identify those exceptional situations in which the pension plan was underfunded. However, it is widely acknowledged that postretirement benefit plans are significantly or totally underfunded. As a result, recognition of a minimum liability for such plans would be commonplace rather than an exception.

307. Some Board members believe that a liability that reflects only the accrued and unfunded postretirement benefit cost, in and of itself, is not a relevant or reliable representation of an employer's probable future sacrifice if recognition of significant losses, prior service costs, or the transition obligation has been delayed. They support retaining the minimum liability provision proposed in the Exposure Draft for the reasons described in paragraph 303. They observe that the liability for accrued and unfunded postretirement benefit cost does not purport to be a measure of the employer's present obligation in most cases; rather, it is the residual resulting from an allocation process. To the extent that one assumes that the employer is a going concern and that a postretirement benefit plan will continue, the employer's

probable future sacrifice is represented by benefits to which retirees and other fully eligible plan participants are entitled and the portion of expected future benefits earned by other active plan participants. That probable future sacrifice can only be determined by considering the current funded status of the plan.

Measurement of Plan Assets

308. The Board considered whether employer assets intended to be used for the payment of postretirement benefits, including funds set aside in a separate trust or similar funding vehicle, should be included in plan assets. The Board concluded that if those assets can be used for other purposes at the employer's discretion, they should not be considered to be plan assets. In measuring the funded status of a postretirement benefit plan, the Board concluded that it is appropriate and consistent with pension accounting to include in plan assets only those assets that are restricted for the purpose of paying the plan's postretirement benefit obligations. Some respondents questioned whether certain funding vehicles can be restricted solely for the provision of postretirement benefits, as opposed to funding both active employees' and retirees' benefits, and would, therefore, qualify as plan assets. Whether a funding vehicle can be restricted solely for the payment of retirees' benefits is subject to legal, not accounting, interpretation.

309. The Board concluded that plan investments should be measured at fair value for purposes of this Statement, except as provided in paragraph 57 for purposes of determining the extent of delayed recognition of gains and losses. Fair value is the most relevant information that can be provided for assessing both the plan's ability to pay benefits as they come due and the future contributions necessary to provide for benefits already promised to employees. The relevance of fair value outweighs objections to its use based on difficulty of measurement. The same reasons led to a similar decision in Statements 35 and 87.

310. Measuring investments at fair value could introduce volatility into the financial statements as a result of short-term changes in fair values. Some respondents indicated that that volatility would be meaningless or even misleading, particularly because of the long-run nature of the postretirement benefit commitment or because plan investments are often held for long periods, thus providing the opportunity for some gains or losses to reverse. As noted in paragraphs 58–60, the Board concluded that the difference between the actual return on plan assets and the expected return on plan assets could be recognized in net periodic postretirement benefit cost on a delayed basis. That conclusion was based on (a) the probability that at least some gains would be offset by subsequent losses, and vice versa, and (b) arguments that immediate recognition would produce unacceptable volatility and would be inconsistent with the present accounting model.

311. The Board also concluded that, similar to the conclusion in Statement 87, including accrued postretirement benefit costs as plan assets for purposes of the disclosure of funded status (paragraph 74(c)) (a) would be inappropriate because that amount has not been funded (contributed) and (b) would unnecessarily complicate the recognition and disclosure requirements of this Statement. Similarly, the Board concluded that elimination from plan assets of all securities of the employer held by the plan 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. However, the Board concluded that disclosure of the amount of those securities held is appropriate and should be required.

Measurement Date

312. The Board concluded that the prescribed measurement date should be responsive to the difficulties inherent in measurement of the accumulated postretirement benefit obligation as well as the time required to obtain actuarial valuation reports. The Board believed those considerations justified some flexibility in selecting the date at which the accumulated postretirement benefit obligation and plan assets should be measured.

313. Measuring plan assets as of the date of the financial statements does not present very significant or unusual problems; the difficulty arises primarily with measurement of the accumulated postretirement benefit obligation. The Board concluded that it should be feasible to provide information about the accumulated postretirement benefit obligation as of the date of the financial statements based on a valuation performed at an earlier date with adjustments for relevant subsequent events (especially employee service) after that date.

314. The Board concluded that the benefits of having information on a timely basis and measured consistently with other financial information will usually

outweigh the incremental costs. The Board acknowledges that practical problems may sometimes make it costly to obtain information, especially information about the accumulated postretirement benefit obligation and related components of net periodic postretirement benefit cost, as of the date of the financial statements. 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. That measurement date is consistent with the measurement date prescribed by Statement 87. Measurements of postretirement benefit cost for interim and annual financial statements should be based on the assumptions used for the previous year-end financial reporting unless more recent measures of both plan assets and the accumulated postretirement benefit obligation are available, for example, as a result of a significant event, such as a plan amendment.

Settlements and Curtailments

315. This Statement provides for delayed recognition of the effects of plan initiations and amendments and gains and losses arising in the ordinary course of operations. In certain circumstances, however, recognition of some or all of those delayed effects may be appropriate. Paragraphs 316–332 discuss the basis for the Board's conclusions on settlement and curtailment accounting for postretirement benefit plans, which draw on the basis for conclusions in Statement 88. Except as discussed in paragraph 325, the Board's conclusions are the same as those prescribed in Statement 88 for a settlement or a curtailment of a defined benefit pension plan.

316. Settlements and curtailments are events that require income or expense recognition of previously unrecognized amounts and adjustments to liabilities or assets recognized in the employer's statement of financial position. The Board concluded that, similar to employers' accounting for pensions, previously unrecognized prior service cost, including any unrecognized transition obligation, and the previously unrecognized net gain (including any unrecognized transition asset) or loss should be recognized in the period when all of the following conditions are met:

a. All postretirement health care or other welfare benefit obligations under the plan are settled.
b. Defined benefits are no longer accrued under the plan.
c. The plan is not replaced by another defined benefit plan.
d. No plan assets remain.
e. The employees are terminated.
f. The plan ceases to exist as an entity.

317. It is not uncommon for some, but not all, of the above conditions to exist in a particular situation. For example, the accumulated postretirement benefit obligation may be settled without terminating the plan, or a plan may be suspended so that no further benefits will accrue for future services but its obligations are not settled. In other situations one or more of the above conditions may apply to only part of a plan. For example, one plan may be divided into two plans, one of which is then terminated, or one-half of the employees in a plan may terminate employment and the obligation for their benefits may be settled.

318. If recognition of previously unrecognized prior service cost and net gain or loss were required only when a plan is completely terminated and settled and if no recognition occurred when a plan is partially curtailed or an obligation is partially settled, anomalies and implementation problems would result. For example, if one employer had two plants with separate plans and another employer had two plants with a single plan, the accounting result of closing one plant and settling the related obligation would be a recognizable event for one employer but not for the other. If recognition were an all-or-nothing proposition, it would be necessary to determine when the extent of settlement or curtailment is sufficient for recognition. If all employees but one from a large group are terminated and obligations to the terminated employees are settled, presumably the accounting should reflect a plan termination. But it is not clear whether that accounting should apply if 5 percent, 10 percent, or 25 percent of the original group were to remain. The Board concluded in Statement 88 and reconfirmed in this Statement that a complete plan termination and settlement need not occur to recognize previously unrecognized amounts.

Settlement of the obligation

319. The Board concluded that settlement of all or part of the accumulated postretirement benefit obligation should be the event that requires recognition of all or part of the previously unrecognized net gain (including any unrecognized transition asset) or loss. Delayed recognition of gains and losses under this Statement is based in part on the possibility that gains or losses occurring in one period will be offset by losses or gains in subsequent periods. To the extent that the accumulated postretirement benefit obligation has been settled, the possibility of future gains

and losses related to that obligation and the assets used to effect the settlement is eliminated.

320. Settlement of all or a large portion of the accumulated postretirement benefit obligation also may be viewed as realization of past gains or losses associated with that portion of the obligation and the assets used to effect the settlement. That realization would not be affected by the employer's subsequent decision to undertake or not to undertake future defined benefit obligations.

321. The Board acknowledges that other actions an employer can take, especially those related to plan assets, can affect the possibility of a subsequent net gain or loss. For example, an employer may avoid or minimize certain risks by investing in a portfolio of high-quality fixed-income securities with principal and interest payment dates similar to the estimated payment dates of benefits, as with a dedicated bond portfolio.

322. Settlement differs from other actions in that (a) it is irrevocable, (b) it relieves the employer (or the plan) of primary responsibility for the obligation, and (c) it eliminates significant risks related to the obligation, such as the risk that participants will live longer than assumed, and to the assets used to effect the settlement. The decision to have a dedicated bond portfolio can be reversed, it does not relieve the employer of primary responsibility for the obligation, and such a strategy does not eliminate various risks, such as mortality risk and the escalating cost of providing the benefits. The Board concluded that the circumstances requiring gain or loss recognition should be defined narrowly.

323. The Board recognizes that changes in the previously estimated values of the accumulated postretirement benefit obligation and the plan assets may become evident at the time the obligation is settled. For example, the interest rates inherent in the price actually paid for insurance contracts that settle an obligation may be different from the assumed discount rates. Some respondents suggested that those changes should be recognized immediately in income as a gain or loss directly resulting from the settlement. The Board concluded that, based on the measurement principles adopted in this Statement, those changes reflect factors expected to be considered in the measurement of the postretirement benefit obligation and plan assets. The Board also concluded that those amounts should be included with the previously unrecognized net gain or loss before a pro rata portion of that amount is recognized.

324. This Statement requires measurement of a pro rata portion of the unrecognized net gain or loss based on the decrease in the accumulated postretirement benefit obligation resulting from a settlement. The Board acknowledges that a decrease in the amount of plan assets also can affect the possibility of future gains and losses. However, the Board concluded that it would be simpler and more practical to base the measurement only on the obligation settled.

325. Under Statement 88, a gain resulting from settlement of a pension obligation is measured without regard to any remaining unrecognized transition obligation. In contrast with the nature of the transition obligation that may arise under Statement 87, any unrecognized transition obligation for postretirement benefits is likely to include a significant amount of previously unrecognized current service cost and interest cost. For an ongoing plan, this Statement requires that for an employer that elects immediate recognition of gains or losses, any net gain for the year that does not offset a loss previously recognized in income must first reduce any remaining unrecognized transition obligation. Similarly, the Board has concluded that any gain arising from a settlement should be reduced by any unrecognized transition obligation; only the excess is recognized as a settlement gain. The Board concluded that an employer should not be permitted to accelerate recognition of gains if the underlying obligation that was remeasured, causing those gains to arise, has not yet been recognized.

Curtailment of the plan

326. One basis for delayed recognition of prior service cost is the likelihood of future economic benefits to the employer as a result of a plan initiation or amendment. Those benefits, in the Board's view, are derived from the future services of active plan participants, and the amortization of unrecognized prior service cost is based on those services. A curtailment, as defined in this Statement, is an event that significantly reduces the expected years of future service of present active plan participants or eliminates for a significant number of active plan participants the accrual of defined benefits for some or all of their future services.

327. The Board concluded that reduction of the expected years of future service of the work force or elimination of the accrual of defined postretirement benefits for a significant number of active plan participants raises doubt about the continued existence of the future economic benefits of unrecognized prior

service cost. Therefore, the Board concluded that any remaining unrecognized prior service cost, including any unrecognized transition obligation, should be recognized when it is probable that a curtailment will occur, the effects are reasonably estimable, and the net result of the curtailment (as described in paragraphs 97 and 98) is a loss.

328. The Board also considered whether either the settlement or the termination of one plan and the adoption of a substantially equivalent replacement plan should trigger recognition of prior service cost. The Board concluded that neither of those events, absent a curtailment, raises sufficient doubt as to the existence of future economic benefits to trigger that recognition.

329. A curtailment may directly cause a decrease in the accumulated postretirement benefit obligation (a gain) or an increase in the accumulated postretirement benefit obligation (a loss). For example, the accumulated postretirement benefit obligation may decline if active plan participants who are not yet eligible for benefits are terminated (a gain). On the other hand, the accumulated postretirement benefit obligation may increase if an event occurs that causes active plan participants fully eligible for benefits to leave earlier than previously expected (a loss).

330. Conceptually, the Board concluded that it would be appropriate to recognize those gains or losses immediately to the extent they do not represent the reversal of previously unrecognized losses or gains. However, the obligation eliminated or created by a curtailment may not be independent of previously unrecognized losses or gains. For example, part of that obligation could relate to past changes in actuarial assumptions about the discount rates that produced gains or losses not yet fully recognized. To illustrate, if in year 1 the employer reduces the assumed weighted-average discount rate from 9 percent to 8 percent, any accumulated postretirement benefit obligation is increased, resulting in an unrecognized loss. If in year 2 the employer terminates active plan participants, the obligation related to their nonvested accumulated benefits is eliminated and a gain arises, which is, at least in part, a reversal of the previously unrecognized loss.

331. The Board concluded that, similar to Statement 88, a curtailment gain or loss as defined in paragraph 97 (which does not include recognition of prior service cost) should first be offset to the extent possible against the plan's previously existing unrecognized net loss or gain. Any remainder of the curtailment gain or loss cannot, at least in an overall sense, be a reversal of unrecognized amounts, and, therefore, recognition of that remainder is appropriate.

332. The Board considered whether curtailment gains should be recognized before the curtailment occurs. It concluded that continuing the delayed recognition feature of this Statement for a curtailment gain should be retained until the related active plan participants terminate or the plan suspension or amendment is adopted. That is consistent with Statement 88 and Opinion 30 and avoids the inconsistent results that would otherwise occur if the curtailment gain is directly related to a disposal of a segment of a business.

Measurement of Special Termination Benefits

333. FASB Statement No. 74, *Accounting for Special Termination Benefits Paid to Employees,* acknowledged that other benefits, in addition to pensions, may be offered pursuant to a special termination arrangement and should be included in measuring the termination expense. Statement 88, which superseded Statement 74, retains that scope and therefore applies to other benefits in addition to pensions. However, the Board concluded that reiterating the applicability of Statement 88 is necessary, since practice may have been to exclude postretirement health care costs from the measurement of termination benefits.

334. The primary conclusion of the Board in Statement 74 was that the cost of special termination benefits should be recognized as a liability and a loss when the employees accept the offer and the amount can be reasonably estimated. That conclusion is incorporated in Statement 88. The cost of other contractual termination benefits provided by the existing terms of a plan that are payable only in the event of employees' involuntary termination of service due to a plant closing or a similar event should be recognized when it is probable that employees will be entitled to benefits and the amount can be reasonably estimated.

335. Paragraph 3 of Statement 74 stated:

> The termination of employees under a special termination benefit arrangement may affect the estimated costs of other employee benefits, such as pension benefits, because of differences between past assumptions and actual experience. If reliably measurable, the effects of any such changes on an employer's

> previously accrued expenses for those benefits that result directly from the termination of employees shall be included in measuring the termination expense. [Footnote reference omitted.]

Statement 88 superseded that paragraph and provides that a gain or loss in a plan arising as a direct result of a curtailment, including a curtailment resulting from an offer of special termination benefits, is first offset against any previously existing unrecognized net loss or gain for that plan and any excess is then recognized (paragraph 13).

336. The Board considered the following three alternative measures of the termination expense[37] arising from the acceptance of an offer of special postretirement health care or other welfare termination benefits:

a. The difference between (1) the accumulated postretirement benefit obligation under the existing plan that would have been attributed to service to date assuming that active plan participants not yet fully eligible for benefits would terminate at their full eligibility date and that fully eligible active plan participants would retire immediately, without considering any special termination benefits, and (2) the remeasured accumulated postretirement benefit obligation based on the special termination benefits
b. The difference between (1) the accumulated postretirement benefit obligation attributed to service to date and (2) the remeasured accumulated postretirement benefit obligation based on the special termination benefits
c. The difference between (1) the actuarial present value of the postretirement benefits an employee would have received if the employee had terminated voluntarily immediately before the offer and (2) the actuarial present value of the postretirement benefits the employee is expected to receive after accepting the offer.

337. The Board concluded that the first alternative was appropriate because it better reflects the exchange. Unlike the second alternative, it recognizes the incentive offered in exchange for termination earlier than expected. The first alternative becomes more compelling when one considers the offer of special termination benefits for fully eligible active plan participants. For those employees, there may be no incentive in the form of benefits not already available. Under the first alternative, the effects of the change in the expected retirement dates for employees who accept the offer may be a curtailment loss pursuant to paragraphs 97–99.

338. In contrast, the third alternative ignores the notion that the obligation to provide postretirement benefits arises with the rendering of employee service. That notion underlies the accounting for all deferred compensation contracts. The Board also noted that the third alternative fails to recognize that the termination benefit incentive for an employee one year away from eligibility for retirement differs from the incentive for an employee five years away.

Disclosure

General considerations

339. Decisions on disclosure requirements require 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 relative to those criteria is generally a matter of judgment. Cost, for example, is affected by several factors, such as the number of different plans and the difficulty of aggregating or meaningfully summarizing some disclosures. As the total amount of disclosure increases, consideration must be given to whether the incremental cost to both preparers and users of additional disclosure may be greater than the benefit of the additional information. Conversely, there is also a cost of not disclosing information. The absence of certain disclosures may directly affect the ability of financial statement users to make well-informed decisions.

340. Many of the disclosure requirements arise as a result of provisions of this Statement that reflect practical, rather than conceptual, decisions. For example, the components of net periodic postretirement benefit cost are disclosed because the recognized consequences of events and transactions affecting a postretirement benefit plan are reported as a single amount that includes at least three types of transactions that conceptually should be reported separately.

[37] The cost of any related curtailment would be determined separately pursuant to paragraphs 97–99.

The effects of those events or transactions—the exchange of employee service for deferred compensation in the form of postretirement benefits, interest cost reflecting the passage of time until those benefits are paid, and the returns from the investment of plan assets—are therefore disclosed. Similarly, the reconciliation of the funded status of the plan(s) is disclosed as a result of the decision to exclude certain obligations and assets from the statement of financial position due to provisions that permit delayed recognition of (a) the transition obligation, (b) the effect of certain changes in the measure of an employer's accumulated postretirement benefit obligation, and (c) the effect of certain changes in the value of plan assets set aside to meet that obligation. Although those effects are identified and measured, they are not required to be recognized in the financial statements as they arise.

341. Many of the disclosures required by this Statement are similar to required disclosures for pension plans. Some studies of the pension disclosures required by Statement 87 have suggested they are valuable because of the information provided.

Specific disclosure requirements

Descriptive information

342. Respondents generally agreed with disclosure of information about plan provisions and employee groups. The Board concluded that a brief description of the plan that is the basis for the accounting (the substantive plan), including any modifications of the existing cost-sharing provisions or increases in monetary benefits that are encompassed by the substantive plan, the employee groups covered, and the types of benefits provided, could assist users in understanding the reported effects of the plan on the employer's financial statements. The Board also concluded that financial statements should disclose the nature and effects of significant changes in the factors affecting the computation of the accumulated postretirement benefit obligation and related cost recognized in the financial statements. Any other significant or unusual matters, such as the effect of a business combination, also should be disclosed to enhance a user's understanding of the impact of those matters on an employer's financial position and results of operations.

343. Many postretirement benefit plans currently in existence are unfunded. For those that are funded, the Board concluded that disclosure of the funding policy would be useful in understanding differences between funding and accounting for that plan. Information that highlights any changes in funding policies also can be useful in assessing future cash flows.

Net periodic postretirement benefit cost information

344. Most respondents indicated that information about an employer's net periodic postretirement benefit cost would be useful. As with pensions, the cost of providing postretirement benefits comprises several components. Disclosure of the components will, over time, increase the general understanding of the nature of postretirement benefit cost, the reasons for changes in that cost, and the relationship between financing activities and employee compensation cost.

Information about obligations and assets

345. Most respondents who addressed the proposed disclosures agreed with disclosures about the funded status of the postretirement benefit plan. They stated that it provides information that is important to an understanding of the economics of the plan. Some respondents indicated that as part of that disclosure, it is important to present the components of the accumulated postretirement benefit obligation. The Exposure Draft proposed disclosure of the vested postretirement benefit obligation to provide information about the employer's obligation to retirees and other former employees, and active employees assuming they terminated immediately. The Board believed the information required to measure the vested postretirement benefit obligation would be available and that no significant incremental cost would be associated with providing that disclosure.

346. Most respondents opposed disclosure of the vested postretirement benefit obligation. They said the disclosure would be misleading because the term *vested,* although used in its accounting sense, could be misunderstood to imply a legal obligation. Although an employer may have a social or moral obligation to provide the postretirement benefits that have been earned, employers indicated that they currently do not have a statutory requirement to provide those promised benefits, unlike their legal obligation to provide certain vested pension benefits. In addition, respondents observed that if a postretirement benefit plan were terminated, the actual liability would very likely differ from the amount proposed to be measured as the vested obligation.

347. The Board accepted those arguments and concluded that disclosure of the vested postretirement

benefit obligation should not be required. However, the Board added paragraph 74(c)(2), which requires disaggregated information about the accumulated benefit obligation for retirees, other fully eligible plan participants, and other active plan participants. Respondents suggested those disclosures would be more useful.

348. Management has a stewardship responsibility for efficient use of plan assets just as it does for operating assets. The Board concluded that disclosure of general information about the major types of any plan assets (and nonbenefit liabilities, if any) and the actual amount of return on plan assets for the period is useful in assessing the profitability of investment policies and the degree of risk assumed.

349. The Board concluded that a reconciliation of the amounts included in the employer's statement of financial position to the funded status of the plan's accumulated postretirement benefit obligation is essential to understanding the relationship between the accounting for and the funded status of the plan. The Board acknowledges that the amount recognized in the financial statements as a net postretirement benefit liability or asset pursuant to this Statement generally will not fully reflect the underlying funded status of the plan, that is, the plan assets and the accumulated postretirement benefit obligation for an overfunded or underfunded plan.

Information about assumptions

350. The Exposure Draft proposed disclosure, if applicable, of the weighted-average assumed discount rate, rate of compensation increase, health care cost trend rate, expected long-term rate of return on plan assets, and, for plans whose income is segregated from the employer's income for tax purposes, the estimated income tax rate on the expected return on plan assets. Most respondents who addressed the disclosure issues supported disclosure of the significant assumptions used in measuring an employer's postretirement benefit obligation and cost. A few respondents, however, maintained that a more descriptive disclosure about the assumed health care cost trend rates would be more useful. They noted that a weighted-average rate can mask differences in an employer's assumptions about year-by-year health care cost trend rates. For example, two employers could report the same weighted-average health care cost trend rate even though they made significantly different assumptions about future trends in health care costs and have very different expected payment schedules.

351. The Board concluded that descriptive information about an employer's assumed health care cost trend rates would be more useful than disclosure of a weighted-average rate. Therefore, this Statement requires disclosure of the assumed health care cost trend rate(s) used to measure the expected cost of benefits covered by the plan (gross eligible charges) for the year following the measurement date and a more general description of the direction and pattern of change in the assumed trend rates thereafter. The Board believes that disclosure will result in more comparable and understandable information about the assumptions used by employers in measuring their postretirement benefit obligations and costs.

352. The Board concluded that the weighted-average assumed discount rate, rate of compensation increase, and long-term rate of return on plan assets should be required to be disclosed as proposed in the Exposure Draft. In determining those weighted averages, employers should consider both the timing and amount of the expected benefit payments, compensation increases, or return on plan assets. The weighted-average discount rate reflects an assumption that significantly affects the computation of the accumulated postretirement benefit obligation and net periodic postretirement benefit cost, as might the weighted-average rate of compensation increase for pay-related plans. Those disclosures assist in assessing the comparability of that information among employers. Because the weighted-average assumed long-term rate of return on plan assets is expected to differ from the weighted-average discount rate, the Board concluded that disclosure of that assumption should be required. As proposed in the Exposure Draft, disclosure of the estimated income tax rate on the return on plan assets is required for plans whose income is segregated from the employer's income for tax purposes.

353. This Statement also requires disclosure of the effect on the current measurement of the accumulated benefit obligation for postretirement health care benefits and the combined service cost and interest cost components of net periodic postretirement benefit cost, assuming a one-percentage-point increase in the health care cost trend rates for each year following the measurement date, holding all other assumptions constant. Respondents generally did not support disclosure of the sensitivity of reported amounts to particular assumptions. Some respondents asserted that disclosure of sensitivity information would diminish the credibility of the amounts reported in the financial statements and would ignore the effects of changes in other assumptions. They also noted that

the effects of a one-percentage-point change are not linear, reducing, therefore, the predictive value of the information and its usefulness. Other respondents who supported sensitivity disclosures stated that the information would assist users in judging the sensitivity of the measures of an employer's postretirement benefit obligation and cost to changes in one of its significant underlying assumptions and would provide information about the potential impact of subsequent events different from that assumed.

354. Measuring the sensitivity of the accumulated postretirement benefit obligation and the combined service and interest cost components to a change in the assumed health care cost trend rates requires remeasuring the accumulated postretirement benefit obligation as of the beginning and end of the year. That measurement should be possible at minimal incremental cost as part of the actuarial valuation needed to develop the basic information required by this Statement. The Board concluded that requiring that sensitivity information will assist users in assessing the comparability of information reported by different employers as well as the extent to which future changes in assumptions or actual experience different from that assumed may affect the measurement of the obligation and cost. In addition, the sensitivity information may assist users in understanding the relative significance of an employer's cost-sharing policy as encompassed by the employer's substantive plan.

355. Sensitivity disclosures were initially proposed in accounting for pension costs. However, the Board ultimately decided not to require those disclosures for pensions because the cost of providing that information was viewed as outweighing the benefits to users. The Board concluded that the need for sensitivity information is more compelling for postretirement health care measurements. Financial statement users are considerably less familiar with postretirement health care measurements than with pension measurements and with the subjectivity of the health care cost trend rate and the significant effect that assumption may have on measurement of the postretirement health care obligation. The Board acknowledges that the effects of percentage-point changes are not linear but concluded that the significance of the sensitivity disclosure outweighs concerns about users erroneously extrapolating from the amounts disclosed.

356. Some Board members believe the volume of disclosures required by this Statement is excessive and further contributes to the already extensive disclosures required in general-purpose financial statements. They believe that at some point the sheer volume of all required disclosures may overwhelm users' ability to assimilate information and focus on the more important matters. In particular, those Board members do not support the required sensitivity disclosures because they highlight only one aspect of the postretirement benefit obligation and cost. Similar sensitivity requirements could be imposed for other aspects of this Statement's requirements and, for that matter, any accounting estimate. They are also concerned that sensitivity disclosures may confuse or mislead users who attempt to use the information to make their own estimates of measures of the obligation and cost in different scenarios, without realizing the limitations of the disclosure.

Two or More Plans

357. Under certain circumstances, this Statement permits combining two or more *unfunded* plans for financial accounting and reporting purposes. Plans that provide different benefits to the same group of participants may be combined. For example, an employer may have separate medical care, dental care, and eye care plans that provide benefit coverage to all retirees of the company. Similarly, an employer may combine two or more unfunded plans that provide the same benefits to different groups of plan participants. For example, an employer may have identical postretirement medical care plans at each of its operating locations. This Statement permits combining plans in those situations because the differences in the plans are not substantive. Combining information in those cases results in combined measurements for accounting and disclosure purposes.

358. The Board concluded 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. Netting the plan assets of one plan against the net unfunded obligation of another would be an inappropriate disclosure of the unfunded obligation if those assets cannot be used to settle that obligation. That conclusion is consistent with existing generally accepted accounting principles that generally preclude offsetting assets and liabilities unless a right of setoff exists. The Exposure Draft proposed separate disclosure by over- and underfunded plans. However, the Board concluded that limiting the requirement for separate disclosure to the accumulated postretirement benefit obligation and the fair value of plan assets for plans with assets less than the accumulated postretirement benefit obligation (underfunded plans)

would provide satisfactory information about the financial condition of an employer's plans and would reduce the cost of providing the required disclosures.

Different Accounting for Certain Small Employers

359. The 1985 FASB Exposure Draft, *Employers' Accounting for Pensions,* recognized that the cost of compliance with a pension standard was relatively greater for small employers than for large employers and more likely to exceed the perceived benefits. In that Exposure Draft, the Board tentatively concluded that the different relative costs and benefits might justify reduced disclosure requirements.

360. However, the Board ultimately concluded that the measurement of pension costs and recognition of pension liabilities should not differ for small or nonpublic employers, in part because evidence from users of financial statements of those employers did not support a different approach. Further, in the Board's view, the existence of a separate set of measurement requirements or a range of alternatives for certain employers probably would not reduce costs significantly, but would add complexity and reduce the comparability and usefulness of financial statements.

361. Similarly, the Board does not believe that postretirement benefit plans for small employers are sufficiently different from the plans of larger employers to warrant fundamentally different measurement and recognition or disclosure requirements. Although the costs of applying this Statement may be relatively higher for small employers, the postretirement benefit obligations of those employers are no different in nature from the postretirement benefit obligations of larger employers. The measurement provisions and effective date of this Statement take into account the data limitations of certain employers and the cost of measuring expected postretirement benefit costs. Paragraph 38 provides for the use of claims experience of other employers in developing current per capita claims cost. Paragraph 41 permits the use of certain alternative approaches to developing assumed per capita claims cost. Therefore, the Board concluded that the requirements of this Statement should apply to all employers.

362. The Exposure Draft proposed a 2-year delay in the effective date for nonpublic employers whose plans all had fewer than 100 participants. Respondents generally agreed with the proposed delay in the effective date, although some suggested that the size criterion be increased to encompass larger groups of plan participants. Those respondents were concerned about the availability of data and the general lack of experience in measuring the postretirement benefit obligations for smaller plan populations.

363. The effective date of this Statement is delayed 2 years for those nonpublic employers whose plans in the aggregate have fewer than 500 participants. The size criterion was increased in response to the concerns expressed by respondents. The Board concluded that small employers and the professionals serving those employers may need additional time to obtain and evaluate the necessary data including, perhaps, tailoring data collected by actuaries or insurers for use in developing the assumed per capita claims cost by age. The Board concluded that a delayed effective date is a practical and appropriate means for facilitating adoption of this Statement by those employers.

Different Accounting for Certain Industries

364. For some 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 cost based on cash disbursements, the effects of the requirement to accrue the cost of postretirement benefits (the difference between the cost accrued and the pay-as-you-go cost for a period) may not be recoverable currently. The Board recognizes the practical concerns of those employers but concluded that the cost of a promise to provide postretirement benefits to qualifying employees is not changed by the circumstances described. The Board concluded that this Statement should include no special provisions for those employers. For some rate-regulated enterprises, FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation,* may require that the difference between net periodic postretirement benefit cost as defined in this Statement and amounts of postretirement benefit 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 periodic postretirement benefit cost as an expense; they do not otherwise affect the requirements of this Statement.

Other Situations and Types of Plans

Contracts with Insurance Companies

365. 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 postretirement benefit cost. If those contracts have features linked with the insurance company's possible future obligation to pay benefits, their fair values may be difficult or impossible to determine. Although the Board concluded that fair value should be the measurement basis for all types of investments, it acknowledges that for some contracts the best available estimate of fair value may be contract value.

366. The Board recognizes that, except for single-premium life insurance contracts, there are few, if any, contracts at the present time that unconditionally obligate an insurance company to provide most forms of postretirement benefits. However, some insurance contracts, such as single-premium, nonparticipating life insurance contracts, do effectively transfer the primary obligation for payment of benefits from the employer (or the plan) to the insurance company. In those circumstances, the premium paid for the benefits attributed to the current period is an appropriate measure of postretirement benefit cost for that period. The Board concluded that the purchase of a nonparticipating insurance contract is a settlement of a postretirement benefit obligation rather than an investment.

367. Under some insurance 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 contracts). Under those contracts, if the insurance company has favorable experience, the purchaser receives dividends. For example, if the insurance company's investment return is better than anticipated, or perhaps if actual experience related to mortality or other assumptions is favorable, the purchaser will receive dividends that reduce the cost of the contract.

368. Participating contracts have some of the characteristics of an investment. However, the employer is as fully relieved of the obligation as with a nonparticipating contract, and a separate actuarial computation ordinarily would not be performed. The Board concluded that, except as indicated in paragraphs 369, 370, and 374, it would be appropriate to treat a participating contract the same as a nonparticipating contract and to exclude the benefits covered from measures of the accumulated postretirement benefit obligation.

369. The Board was concerned that a participating contract could be structured in such a way that the premium would be significantly in excess of the cost of nonparticipating contracts because of the expectation of future dividends. If the full amount of the premium were recognized as service cost in the year paid and dividends were recognized as return on plan assets when received, the resulting measures of postretirement benefit 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 (the participation right) is in substance an investment that should be recognized as an asset.

370. The Board concluded that, consistent with the measurement of other assets, the participation right should be measured at fair value in periods subsequent to its acquisition to the extent that fair value can be reasonably determined. The Board recognizes, however, that some participating contracts may not provide a basis for a better estimate of fair value 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.

371. When it addressed employers' accounting for pensions, the Board was advised that the information needed to treat insurance contracts purchased from an insurance company affiliated with the employer as investments (that is, to include those contracts and covered benefits in plan assets and the accumulated postretirement benefit obligation, respectively) was not available and would not be cost beneficial to develop. The Board expects that also to be true for postretirement benefits. Therefore, this Statement requires only contracts purchased from a captive insurance subsidiary, and contracts purchased from an insurance company when there is reasonable doubt whether the insurance company will meet its obligations under the contract, to be treated as investments. However, because an employer remains indirectly at risk if insurance contracts are purchased from an affiliate, the Board concluded that disclosure

of the approximate amount of annual benefits covered by those contracts should be required.

Insurance contracts used in settlements

372. As discussed in paragraph 368, an employer is as fully relieved of the accumulated postretirement benefit obligation by the purchase of a participating contract as it is by the purchase of a nonparticipating contract. Consequently, except as discussed in paragraphs 369 and 374, the Board concluded that it would be appropriate to treat a participating contract the same as a nonparticipating contract and to consider purchases of participating contracts as settlements of accumulated postretirement benefit obligations.

373. The Board recognizes that it is difficult to determine the extent to which a participating contract exposes the purchaser to the risk of unfavorable experience, which would be reflected in lower than expected future dividends or failure to recover the cost of the participation right. The Board also recognizes that under some insurance contracts described as participating, the purchaser might remain subject to all or most of the same risks and rewards of future experience that would have existed had the contract not been purchased. The Board also is aware that some participating contracts may require or permit payment of additional premiums if experience is unfavorable. The Board concluded that if a participating contract requires or permits payment of additional premiums because of experience losses, or if the substance of the contract is such that the purchaser retains all or most of the related risks and rewards, the purchase of that contract does not constitute a settlement.

374. If the purchase of a participating contract constitutes a settlement for purposes of this Statement, recognition of a previously unrecognized net gain or loss is required (paragraphs 93 and 94) except for settlement of a small portion of the accumulated postretirement benefit obligation (paragraph 95). However, the possibility of a subsequent loss is not completely eliminated with a participating contract because realization of the participation right is not assured. Because of the continuing risk of the participation right, this Statement requires that the maximum gain subject to recognition from a settlement (paragraph 94) be reduced by an amount equal to the cost of the participation right before determining the full or pro rata portion of that maximum gain (paragraph 93) to be recognized.

Multiemployer Plans

375. Generally, the employers that participate in multiemployer postretirement benefit plans are similar, in terms of both nature and industry affiliation, to employers that participate in multiemployer pension plans. Although the plans provide defined benefits, they typically require a defined contribution from participating employers. Consequently, an employer's obligation to a multiemployer plan may be changed by events affecting other participating employers and their employees.

376. At present in the United States, the consequences of an employer's withdrawal from a multiemployer postretirement benefit plan are different from an employer's withdrawal from a multiemployer pension plan. In addition to any contractual requirements, withdrawal from a multiemployer pension plan is governed by the Multiemployer Pension Plan Amendments Act of 1980. An employer withdrawing from a multiemployer postretirement benefit plan is currently only subject to any contractual requirements.

377. In a multiemployer setting, eligibility for benefits is defined by the plan; retired employees continue to receive benefits whether or not their former employers continue to contribute to the plan. On the other hand, plan participants not yet eligible for benefits may lose accumulated postretirement benefits if their current or former employer withdraws from a plan unless they take or have a job with other employers who participate in the plan. While the plan may have the option of cancelling the accrued service credits that apply toward the required service, within the bargaining unit, of plan participants who were employed by a withdrawing employer and who become or are employed by another participating employer, that rarely occurs because of the difficulty of matching employees to specific employers. For example, in certain industries, an employee may work for more than one employer in a single day and different employers on different days, making it difficult to associate any portion of that employee's past service with a specific employer.

378. The Board considered the substantive differences between a multiemployer plan and a single-employer plan and concluded that separate disclosure for the two types of plans would enhance the understandability and usefulness of the information. This Statement requires disclosures that provide descriptive information about multiemployer plans and the

cost recognized for the period. In some situations, employers participating in a multiemployer plan that provides health and welfare benefits to active employees and retirees may be unable to distinguish the portion of their required contribution that is attributable to postretirement benefits. In those situations, the amount of the aggregate contribution to the general health and welfare benefit plan is to be disclosed. The Board also noted that the provisions of FASB Statement No. 5, *Accounting for Contingencies,* apply when additional liabilities, such as a withdrawal liability or increased contribution pursuant to a plan's "maintenance of benefits" clause, are probable and should be recognized, or are reasonably possible and, therefore, should be disclosed.

Multiple-Employer Plans

379. Some plans to which two or more unrelated employers contribute are not multiemployer plans. Rather, they are in substance more like aggregations of single-employer plans than like multiemployer plans. In a multiple-employer plan, the plan terms are defined by each participating employer. Whereas an employer's obligation to a multiemployer plan may be changed by events affecting other participating employers and their employees, an employer's accumulated postretirement benefit obligation in a multiple-employer plan is unchanged by those events. Therefore, the Board concluded that for purposes of this Statement, multiple-employer plans should be considered single-employer plans rather than multiemployer plans and each employer's accounting should be based on its respective interest in the plan.

Postretirement Benefit Plans outside the United States

380. The Board understands that employer-provided postretirement benefits currently are not prevalent outside the United States. In countries where those plans are provided, the Board believes that this Statement should be applied. The Board is not aware of extraordinary problems arising from the application of Statement 87 to foreign plans, and those requirements are based on actuarial calculations and assumptions similar to those needed to apply this Statement. Therefore, the provisions of this Statement are equally applicable to postretirement benefit plans in the United States and in other countries.

381. The Board concluded, however, that practical problems could arise in communicating the requirements of and obtaining the information necessary for initial application of this Statement to plans outside the United States. 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. Unless the accumulated postretirement benefit obligation of the plans outside the United States is significant relative to the accumulated postretirement benefit obligation for all of an employer's postretirement benefit plans, the Board concluded that disclosures for those plans could be combined with disclosures for plans in the United States.

Defined Contribution Plans

382. The Board concluded that in most cases the formula in a defined contribution plan unambiguously assigns contributions to periods of employee service. The employer's present obligation under the terms of the plan is fully satisfied when the contribution for the period is made, provided that costs (defined contributions) are not being deferred and recognized in periods after the related service period of the individual to whose account the contributions are to be made. The Board concluded that defined contribution plans are sufficiently different from defined benefit plans that disclosures about the two types of plans should not be combined. The disclosures about defined contribution plans required by this Statement are limited to a description of the plan, the basis for determining contributions, the nature and effect of significant matters affecting comparability of information presented, and the cost recognized during the period.

Business Combinations

383. Opinion 16 requires that, in a business combination accounted for as a purchase, an acquiring company allocate the cost of an acquired company to the assets acquired and the obligations assumed. Paragraph 88 of that Opinion sets forth general guides for assigning amounts to the individual assets acquired and liabilities assumed, and includes in that list liabilities and accruals, such as deferred compensation, measured at the present value of the amounts to be paid determined at appropriate current interest rates. Practice has been mixed, with most acquiring companies assigning no value to those postretirement benefit obligations.

384. This Statement amends Opinion 16 to clarify that, in a business combination accounted for as a purchase, the purchaser recognize a postretirement

benefit obligation (asset) for any assumed accumulated postretirement benefit obligation in excess of (less than) plan assets. That obligation (asset) is to be measured using the assumptions that reflect the purchaser's assessment of relevant future events. The terms of the substantive plan as determined by the purchaser may differ from the acquired company's plan if the criteria set forth in paragraph 24 for defining the substantive plan that is the basis of the accounting are satisfied. The Board concluded that those criteria apply equally in establishing an obligation that is assumed and an obligation that arises from the exchange of benefits for employee service.

385. Improvements to the acquired company's plan that are attributed to employee service prior to the date the business combination is consummated and that are conditions of the purchase agreement are not to be accounted for as prior service cost, but as part of the purchase agreement. Other improvements to the plan that are not part of the purchase agreement are to be accounted for as prior service cost to the extent they are attributable to employees' prior service pursuant to this Statement. If it is expected that the plan will be terminated or curtailed, the effects of those actions should be reflected in measuring the accumulated postretirement benefit obligation.

386. The Board concluded that measurement of the unfunded or overfunded accumulated postretirement benefit obligation defined by this Statement generally is consistent with measurement of a pension benefit obligation (or asset) assumed in a business combination accounted for as a purchase pursuant to paragraph 88 of Opinion 16, as amended by paragraph 75 of Statement 87. 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 postretirement benefit cost of the acquiring company. That is consistent with purchase accounting as defined by Opinion 16, which specifies that a new basis of accounting reflect the bargained (fair) value of assets acquired and liabilities assumed whether or not those values were previously reflected in the acquired company's financial statements.

387. The Board concluded that no recognition of additional liabilities for multiemployer plans should be required under Opinion 16 unless conditions exist that make an additional liability probable. The Board was not convinced that there ordinarily is an obligation for future contributions to a multiemployer plan or that recognition of any contractual withdrawal liability would provide useful information about such an obligation, absent a probable withdrawal.

Effective Dates

388. The Exposure Draft proposed that this Statement generally be effective for fiscal years beginning after December 15, 1991. Most respondents urged the Board to delay the proposed effective date for at least one year because of their concerns about the availability and reliability of data necessary to measure employers' postretirement benefit obligations and cost. Other respondents noted the significant improvement to financial statements resulting from adoption of the accounting required by this Statement and suggested accelerating the effective date.

389. The Board decided to allow more than the normal amount of time between issuance of this Statement and its required application to give employers and their advisors time to assimilate the requirements and to obtain the information required. The Board concluded that an additional one-year delay in the general effective date to fiscal years beginning after December 15, 1992, is adequate for those purposes. As noted previously, the Board also allowed an additional two years before employers are required to apply the provisions of this Statement to plans outside the United States and before certain small employers are required to apply those provisions. Paragraph 267 discusses the effective date for the amendment of Opinion 12.

Appendix B

COMPARISON OF EMPLOYERS' ACCOUNTING FOR OTHER POSTRETIREMENT BENEFITS WITH EMPLOYERS' ACCOUNTING FOR PENSIONS

390. This appendix provides a summary comparison of the major provisions of this Statement with the provisions of FASB Statement No. 87, *Employers' Accounting for Pensions.*

	Other Postretirement Benefit Plan	Non-pay-related Pension Plan
Basis for accounting	Extant written plan unless (a) past practice of maintaining a consistent level of cost sharing or consistently increasing or decreasing the cost-sharing provisions of the plan, (b) communication of intended changes to cost-sharing policy,* or (c) past practice of regular increases in monetary benefits indicates substantive plan differs from extant written plan; substantive plan is basis for accounting	Extant written plan unless a past practice of regular increases in non-pay-related benefits or benefits under career-average-pay plan indicates substantive commitment differs from extant written plan, then substantive commitment is basis for accounting
Attribution method and period	Benefit/years-of-service approach that attributes expected benefit obligation (EBO)† for postretirement benefits to years of service to date employee attains full eligibility for benefits expected to be provided to employee; beginning of attribution period is employee's date of hire unless plan only grants credit for service from a later date, in which case benefits are generally attributed from beginning of that credited service period; equal amount of EBO attributed to each year of service in attribution period	Benefit/years-of-service approach that attributes EBO to years of service in accordance with plan benefit formula If plan benefit formula results in disproportionate attribution to later years of service, equal amount of EBO attributed to years of service to date employee attains full eligibility for those benefits
Recognition of net cost		
Service cost	Actuarial present value (APV) of EBO allocated to a period of employee service during attribution period	Same as for other postretirement benefits

Note: This appendix compares employers' accounting for a *postretirement benefit plan* with employers' accounting for a *non-pay-related pension plan* because most postretirement benefit plans (in particular, postretirement health care plans) do not have benefit formulas that are pay related.

*Conditions (a) and (b) are subject to the criteria in paragraph 25.

†*Expected benefit obligation (EBO)*—actuarial present value (APV) as of a particular date of postretirement benefits expected to be paid to or for a current plan participant.

	Other Postretirement Benefit Plan	Non-pay-related Pension Plan
Recognition of net cost (continued)		
Interest cost	Accrual of interest, to reflect effects of passage of time on the accumulated benefit obligation (ABO)[‡]	Same as for other postretirement benefits
Actual return on plan assets	Actual return based on fair value (FV) of plan assets at beginning and end of period, adjusted for contributions and benefit payments	Same as for other postretirement benefits
Prior service cost	Plan initiations and amendments treated as retroactive except for plan initiations that specifically provide new benefits only in exchange for future service	Retroactive benefits defined by plan initiation or amendment
Measurement	Change in ABO for new or amended benefits granted to plan participants	Same as for other postretirement benefits
Amortization	Delayed; equal amount assigned to each future year of service to full eligibility date of each active plan participant	Delayed; equal amount assigned to each future year of service of each active plan participant
	Presumption of economic benefit in future years; can overcome presumption if evidence that *increasing* plan benefits has no future economic benefit for the employer	Same as for other postretirement benefits
	If all or almost all participants are fully eligible for benefits, their remaining life expectancy used, rather than future service period	If all or almost all participants are inactive, their remaining life expectancy used, rather than remaining service period
	Alternative approaches permitted that more rapidly reduce unrecognized cost	Same as for other postretirement benefits
Negative plan amendment	Immediate recognition of effect precluded; initially offsets existing unrecognized prior service cost and unrecognized transition obligation, balance is amortized	Same treatment as pension benefit increase
Gains and losses	Changes in ABO and plan assets from experience different from that assumed or from changes in assumptions	Same as for other postretirement benefits

[‡]*Accumulated benefit obligation (ABO)*—the portion of EBO attributed to service rendered to a specified date. That portion for a pension plan with a benefit formula that is pay related is referred to as the *projected benefit obligation.* However, for a pension plan with a benefit formula that excludes the effects of future compensation levels, the accumulated benefit obligation is the appropriate measure of the pension obligation for comparative purposes throughout this appendix.

	Other Postretirement Benefit Plan	Non-pay-related Pension Plan
Gains and losses (continued)	Gain-loss component of net cost consists of (a) differences between actual and expected return on plan assets, (b) amortization of unrecognized net gain or loss, and (c) amount immediately recognized as a gain or loss due to decision to temporarily deviate from substantive plan; asset gains/losses not reflected in market-related value (MRV)[§] not required to be amortized	Except for (c), same as for other postretirement benefits
Recognition	Either immediate or delayed; if immediate, gains (losses) that do not offset previously recognized losses (gains) first reduce any unrecognized transition obligation (asset)	Either immediate (without offsetting any unrecognized transition obligation or asset) or delayed
Minimum amortization	Unrecognized net gain or loss in excess of 10 percent of greater of ABO or MRV of plan assets, amortized over average remaining service period of active plan participants	Same as for other postretirement benefits
	If all or almost all participants are inactive, amortized over their average remaining life expectancy rather than over remaining service period	Same as for other postretirement benefits
Definition of plan assets	Assets segregated and restricted for sole purpose of providing the defined benefit	Same as for other postretirement benefits
Recognition of minimum liability	Recognition of minimum liability not required	ABO (for all plan participants) in excess of FV of plan assets
		If additional liability recognized, contra amount recognized first as intangible asset up to amount of unrecognized prior service cost and unrecognized transition obligation, with any excess reported as reduction of equity
Business combinations	Measure obligation assumed as unfunded ABO for all plan participants, using purchaser's assumptions	Same as for other postretirement benefits
Transition		
Measurement	Over- or underfunded ABO for all plan participants	Same as for other postretirement benefits

[§]*Market-related value (MRV)*—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.

	Other Postretirement Benefit Plan	Non-pay-related Pension Plan
Transition (continued)		
Recognition	Either immediate or delayed	Delayed recognition required
	If immediate, amount attributable to plan initiation or benefit improvements adopted after December 21, 1990 treated as unrecognized prior service cost and amount attributable to purchase business combinations consummated after December 21, 1990 treated as retroactive adjustment of purchase price allocation	Immediate recognition precluded
	If delayed, amortized on straight-line basis over average remaining service period of active plan participants; cannot be less rapid than pay-as-you-go cost	Amortized on a straight-line basis over average remaining service period of active plan participants
	If amortization period determined above is less than 20 years, may use a 20-year period	If amortization period determined above is less than 15 years, may use a 15-year period
	If all or almost all participants are inactive, their average remaining life expectancy used	Same as for other postretirement benefits
Disclosure	Similar to disclosures required by Statement 87, supplemented by disclosure of descriptive information about the substantive plan, amortization of transition obligation or asset, assumed health care cost trend rate, and the effect on the measure of the ABO and aggregate of service and interest cost components of net periodic cost of a one-percentage-point increase in the health care cost trend rate, holding all other assumptions constant	Disclosures required by Statement 87
	Disclosures for plans in and outside the United States may be combined unless ABO for plans outside the United States is significant relative to aggregate ABO	Disclosures for plans in and outside the United States may not be combined unless those plans use similar economic assumptions

Appendix C

ILLUSTRATIONS

CONTENTS

	Paragraph Numbers
Introduction	391–392
Illustration 1—Illustration of Terms	393–416
Case 1A—Expected Postretirement Benefit Obligation and Accumulated Postretirement Benefit Obligation	393–396
Case 1B—Full Eligibility Date	397–408
Case 1C—Attribution	409–412
Case 1D—Individual Deferred Compensation Contracts	413–416
Illustration 2—Delayed Recognition of Net Periodic Postretirement Benefit Cost	417–429
Case 2A—[This case has been deleted. See Status page.]	
Case 2B—Employer Accrual of Net Periodic Postretirement Benefit Cost	421
Case 2C—Plan Amendment That Increases Benefits	423–424
Case 2D—Negative Plan Amendment	426–427
Case 2E—Change in Assumption	429
Illustration 3—[This illustration has been deleted. See Status page.]	
Illustration 4—Plan Amendments and Prior Service Cost	449–454
Case 4A—Equal Amount Assigned to Each Future Year of Service to Full Eligibility Date	451–453
Case 4B—Straight-Line Amortization over Average Remaining Years of Service to Full Eligibility Date	454
Illustration 5—Accounting for Gains and Losses and Timing of Measurements	455–471
Case 5A—Loss on Obligation	458–461
Case 5B—Gain on Assets	462–464
Case 5C—Loss on Assets and Gain on Obligation	465–467
Supporting Schedules	468–471
Illustration 6—Defined-Dollar Capped Plans	472–478
Case 6A—Dollar Cap Defined on Individual Coverage	473–475
Case 6B—Dollar Cap Defined in the Aggregate for the Retiree Group	476–478
Illustration 7—Disclosure Requirements [Replaced]	
Illustration 8—Accounting for Settlements	484–495
Case 8A—Settlement When a Transition Obligation Remains in Accumulated Other Comprehensive Income	485–486
Case 8B—Settlement When a Transition Asset Remains in Accumulated Other Comprehensive Income	487–488
Case 8C—Effect of Mid-Year Settlement on Transition Constraint	489–495
Illustration 9—Accounting for Curtailments	496–501
Case 9A—Curtailment When a Gain and a Transition Obligation Remain in Accumulated Other Comprehensive Income	498–499
Case 9B—Curtailment Related to a Disposal of a Portion of the Business When a Loss and a Transition Obligation Remain in Accumulated Other Comprehensive Income	500–501
Illustration 10—Accounting for a Partial Settlement and a Full Curtailment That Occur as a Direct Result of a Sale of a Line of Business	502–506
Illustration 11—Accounting for the Effects of an Offer of Special Termination Benefits	507–511

Appendix C

ILLUSTRATIONS

Introduction

391. This appendix provides additional discussion and examples that illustrate the application of certain requirements of this Statement to specific aspects of employers' accounting for postretirement benefits other than pensions. The illustrations are referenced to the applicable paragraph(s) of the standards section of this Statement where appropriate. Certain illustrations have been included to facilitate the understanding and application of certain provisions of this Statement that apply in specific circumstances that may not be encountered frequently by employers. The fact patterns shown may not be representative of actual situations but are presented only to illustrate those requirements.

391A. [This paragraph has been deleted. See Status page.]

392. Throughout these illustrations the accumulated postretirement benefit obligation and service cost are assumed as inputs rather than calculated based on some underlying population. For simplicity, benefit payments are assumed to be made at the end of the year, service cost is assumed to include interest on the portion of the expected postretirement benefit obligation attributed to the current year, and interest cost is based on the accumulated postretirement benefit obligation as of the beginning of the year. For unfunded plans, benefits are assumed to be paid directly by the employer and are reflected as a reduction in the liability for postretirement benefits. In many of the cases, application of the underlying concepts has been simplified by focusing on a single employee for purposes of illustration. In practice, the determination of the full eligibility date and the measurement of postretirement benefit cost and obligation are based on employee groups and consider various possible retirement dates and the probabilities associated with retirement at each of those dates.

Illustration 1—Illustration of Terms

Case 1A—Expected Postretirement Benefit Obligation and Accumulated Postretirement Benefit Obligation

393. This Statement uses two terms to describe certain measures of the obligation to provide postretirement benefits: *expected postretirement benefit obligation* and *accumulated postretirement benefit obligation.* The expected postretirement benefit obligation for an employee is the actuarial present value as of a measurement date of the postretirement benefits expected to be paid to or for the employee, the employee's beneficiaries, and any covered dependents. Prior to the date on which an employee attains full eligibility for the benefits that employee is expected to earn under the terms of the postretirement benefit plan (the full eligibility date), the accumulated postretirement benefit obligation for an employee is a portion of the expected postretirement benefit obligation. On and after the full eligibility date, the accumulated postretirement benefit obligation and the expected postretirement benefit obligation for an employee are the same. (Refer to paragraphs 20 and 21.) The following example illustrates the notion of the expected postretirement benefit obligation and the relationship between that obligation and the accumulated postretirement benefit obligation at various dates.

394. Company A's plan provides postretirement health care benefits to all employees who render at least 10 years of service and attain age 55 while in service. A 50-year-old employee, hired January 1, 20X3 at age 30 and eligible for benefits upon attaining age 55, is expected to terminate employment at age 62 and is expected to live to age 77. A discount rate of 8 percent is assumed.

[38] [This footnote has been deleted. See Status page.]

At December 31, 20Z2, Company A estimates the expected amount and timing of benefit payments for that employee as follows:

Age	Expected Future Claims	Present Value at Age 50	Present Value at Age 53	Present Value at Age 55
63	$ 2,796	$1,028	$1,295	$1,511
64	3,093	1,052	1,326	1,547
65	856	270	339	396
66	947	276	348	406
67	1,051	284	357	417
68	1,161	291	366	427
69	1,282	297	374	436
70	1,425	306	385	449
71	1,577	313	394	460
72	1,744	321	404	471
73	1,934	329	415	484
74	2,137	337	424	495
75	2,367	346	435	508
76	2,620	354	446	520
77	3,899	488	615	717
	$28,889	$6,292	$7,923	$9,244

395. The expected and accumulated postretirement benefit obligations at December 31, 20Z2 (age 50) are $6,292 and $5,034 (20/25 of $6,292), respectively. An equal amount of the expected postretirement benefit obligation is attributed to each year of service from the employee's date of hire to the employee's full eligibility date (age 55) (paragraphs 43 and 44). Therefore, when the employee is age 50, the accumulated postretirement benefit obligation is measured as 20/25 of the expected postretirement benefit obligation, as the employee has rendered 20 years of the 25-year credited service period. Refer to Case 1B (paragraphs 397–408) for additional illustrations on the full eligibility date and Case 1C (paragraphs 409–412) for additional illustrations on attribution.

396. Assuming no changes in health care costs or other circumstances, the accumulated postretirement benefit obligation at December 31, 20Z5 (age 53) is $7,289 (23/25 of $7,923). At the end of the employee's 25th year of service and thereafter, the expected postretirement benefit obligation and the accumulated postretirement benefit obligation are equal. In this example, at December 31, 20Z7, when the employee is 55 and fully eligible for benefits, the accumulated and expected postretirement benefit obligations are $9,244. At the end of the 26th year of service (December 31, 20Z8) when the employee is 56, those obligations are $9,984 ($9,244 plus interest at 8 percent for 1 year).

Case 1B—Full Eligibility Date

397. The *full eligibility date* (paragraph 21) is the date at which an employee has rendered all of the service necessary to have earned the right to receive all of the benefits expected to be received by that employee under the terms of the postretirement benefit plan. Therefore, the present value of all of the benefits expected to be received by or on behalf of an employee is attributed to the employee's credited service period, which ends at the full eligibility date. Determination of an employee's full eligibility date is affected by plan terms that provide incremental benefits expected to be received by the employee for additional years of service, unless those incremental benefits are trivial. Determination of the full eligibility date is *not* affected by an employee's current dependency status or by plan terms that define when benefit payments commence. The following examples (paragraphs 398–408) are presented to assist in understanding the full eligibility date.

Plans that provide incremental benefits for additional years of service

Graded benefit formula

398. Some plans have benefit formulas that define different benefits for different years of service. To illustrate, assume a plan in which the percentage of postretirement health care coverage to be provided by an employer is defined by groups of years of service. The plan provides 20 percent postretirement health care coverage for 10 years of service after age 35, 50 percent for 20 years of service after age 35, 70 percent for 25 years of service after age 35, and 100 percent for 30 years of service after age 35. The full eligibility date for an employee who was hired at age 35 and is expected to retire at age 62 is at age 60. At that date the employee has rendered 25 years of service after age 35 and is eligible to receive a benefit of 70 percent health care coverage after retirement. The employee receives no additional benefits for the last two years of service.

Pay-related plans

399. Some plans may base the amount of benefits or level of benefit coverage on employees' compensation, for example, as a percentage of their final pay. To the extent the plan's postretirement benefit formula defines benefits wholly or partially as a function

of future compensation (that is, the plan provides incremental benefits for additional years of service when it is assumed that final pay will increase), determination of the full eligibility date for an employee is affected by those additional years of service the employee is expected to render (paragraph 21). In addition, measurements of the postretirement benefit obligation and service cost reflect the best estimate of employees' future compensation levels (paragraph 33).

400. For example, assume a plan provides life insurance benefits to employees who render 20 years of service and attain age 55 while in service; the benefit is equal to 20 percent of final pay. A 55-year-old employee, who currently earns a salary of $90,000, has worked 22 years for the company. The employee is expected to retire at age 60 and is expected to be earning $120,000 at that time. The employee is eligible for life insurance coverage under the plan at age 55, when the employee has met the age and service requirements. However, because the employee's salary continues to increase each year, the employee is not *fully eligible* for benefits until age 60 when the employee retires because the employee earns an incremental benefit for each additional year of service beyond age 55. That is, the employee earns an additional benefit equal to 20 percent of the increase in salary each year from age 55 to retirement at age 60 for service during each of those years.

Spousal coverage

401. Some postretirement benefit plans provide spousal or dependent coverage or both if the employee works a specified number of years beyond the date at which the employee attains eligibility for single coverage. For example, a postretirement health care plan provides single coverage to employees who work 10 years and attain age 50 while in service; the plan provides coverage for dependents if the employee works 20 years and attains age 60 while in service. Because the additional 10 years of service may provide an incremental benefit to employees, for employees expected to satisfy the age and service requirements and to have covered dependents during the period following the employee's retirement, their full eligibility date is the date at which they have both rendered 20 years of service and attained age 60 while in service. For employees not expected to have covered dependents after their retirement or who are not expected to render at least 20 years of service or attain age 60 while in service, or both, their full eligibility date is the date at which they have both rendered 10 years of service and attained age 50 while in service.

Single plan provides health care and life insurance benefits

402. Some postretirement benefit plans may have different eligibility requirements for different types of benefits. For example, assume a plan provides a postretirement death benefit of $100,000 to employees who render 20 or more years of service. Fifty percent health care coverage is provided to eligible employees who render 10 years of service, 70 percent coverage to those who render 20 years of service, and 100 percent coverage to those who render 30 years of service. Employees are eligible for the health care and death benefits if they attain age 55 while in service.

403. The full eligibility date for an individual hired at age 30 and expected to terminate employment at age 62 is the date on which that employee has rendered 30 years of service and attained age 55 while in service (age 60 in this example). At that date the employee is eligible for all of the benefits expected to be paid to or on behalf of that employee under the postretirement benefit plan ($100,000 death benefits and 100 percent health care coverage). The full eligibility date for an employee hired at age 37 and expected to retire at age 62 is the date on which that employee has rendered 20 years of service and attained age 55 while in service (age 57 in this example). At that date the employee is eligible for all of the benefits expected to be paid to or on behalf of that employee under the postretirement benefit plan ($100,000 death benefits and 70 percent health care coverage).

Plans that provide benefits based on status at date of termination

404. Some postretirement benefit plans provide coverage for the spouse to whom an employee is married when the employee terminates service; that is, the marital status of an employee upon termination of employment determines whether single or spousal coverage is to be provided. In measuring the expected postretirement benefit obligation, consideration is given to factors such as when benefit coverage will commence, who will receive benefits (employee and any covered dependents), and the expected need for and utilization of benefit coverage. However, determination of an employee's full eligibility date is not affected by plan terms that define

when payments commence or by an employee's current marital (or dependent) status (paragraph 21).

405. For example, assume a plan provides postretirement health care coverage to employees who render at least 10 years of service and attain age 55 while in service; health care coverage also is provided to employees' spouses at the date of the employees' retirement. A 55-year-old employee is single, has worked for the company for 30 years, and is expected to marry at age 59 and to retire at age 62. Although the employee is entitled to spousal coverage only if married at retirement, at age 55 the employee has earned the right to spousal coverage. The probability that the employee will be married when the employee retires is included in the actuarial assumptions developed to measure the expected postretirement benefit obligation for that plan participant. The full eligibility date (age 55 in this example) is not affected by that measurement assumption.

Postretirement benefits to be received by disabled plan participants

406. Some plans provide postretirement benefits to disabled employees. For example, Company B provides disability income and health care benefits to employees who become disabled while in service and have rendered 10 or more years of service. Retiree health care benefits are provided to employees who render 20 or more years of service and attain age 55 while in service. Employees receiving disability benefits continue to accrue "credit" toward their eligibility for retiree health care benefits. Under this plan, an employee hired at age 25, who becomes permanently disabled at age 40, is entitled to receive retiree health care benefits commencing at age 55 (in addition to any disability income benefits commencing at age 40) because that employee worked for Company B for more than 10 years before becoming disabled. Under the terms of the plan the employee is given credit for working to age 55 even though no actual service is rendered by the employee after the disabling event occurs.

407. Because the employee is permanently disabled, the full eligibility date is accelerated to recognize the shorter period of service required to be rendered in exchange for the retiree health care benefits—in this case the full eligibility date is age 40, the date of the disabling event. For a similar employee who is temporarily disabled at age 40 but returns to work and attains age 55 while in service, the full eligibility date is age 55. Company B's expected postretirement benefit health care obligation for the permanently disabled employee is based on the employee's expected health care costs commencing at age 55 and is attributed ratably to that employee's active service to age 40.

408. Only some employees become and remain disabled. Therefore, in measuring the expected postretirement benefit obligation and in determining the attribution period for plan participants expected to become disabled, the probability and timing of a disabling event is considered in determining whether employees are likely to become disabled and whether they will be entitled to receive postretirement benefits.

Case 1C—Attribution

Attribution period

409. Paragraph 44 states that the beginning of the *attribution period* shall be the date of hire unless the plan's benefit formula grants credit only for service from a later date, in which case benefits generally shall be attributed from the beginning of that credited service period. For example, for a plan that provides benefit coverage to employees who render 30 or more years of service or who render at least 10 years of service and attain age 55 while in service, without specifying when the credited service period begins, the expected postretirement benefit obligation is attributed to service from the date of hire to the earlier of the date at which a plan participant has rendered 30 years of service or has rendered 10 years of service and attained age 55 while in service. However, for a plan that provides benefit coverage to employees who render at least 20 years of service after age 35, the expected postretirement benefit obligation is attributed to a plan participant's first 20 years of service after attaining age 35 or after the date of hire, if later than age 35.

410. For a plan with a benefit formula that attributes benefits to a credited service period that is nominal in relation to employees' total years of service prior to their full eligibility dates, an equal amount of the expected postretirement benefit obligation for an employee is attributed to each year of that employee's service from date of hire to date of full eligibility for benefits. For example, a plan with a benefit formula that defines 100 percent benefit coverage for service for the year in which employees attain age 60 has a 1-year credited service period. If plan participants are expected to have rendered an average of 20 years of

service at age 60, the credited service period is nominal in relation to their total years of service prior to their full eligibility dates. In that case, the service cost is recognized from date of hire to age 60.

Attribution pattern

411. For all plans, except those that "frontload" benefits, the expected postretirement benefit obligation is attributed ratably to each year of service in the attribution period (paragraph 43). That is, an equal amount of the expected postretirement benefit obligation is attributed to each year of service from the employee's date of hire or beginning of the credited service period, if later, to the employee's full eligibility date unless (a) the credited service period is nominal relative to the total years of service prior to the full eligibility date (paragraph 410) or (b) the benefit formula frontloads benefits (paragraph 412).

Frontloaded plans

412. Some plans may have a benefit formula that defines benefits in terms of specific periods of service to be rendered in exchange for those benefits but attributes all or a disproportionate share of the expected postretirement benefit obligation to employees' early years of service in the credited service period. An example would be a life insurance plan that provides postretirement death benefits of $250,000 for 10 years of service after age 45 and $5,000 of additional death benefits for each year of service thereafter up to age 65 (maximum benefit of $300,000). For plans that frontload the benefit, the expected postretirement benefit obligation is attributed to employee service in accordance with the plan's benefit formula (paragraph 43). In this example, the actuarial present value of a $25,000 death benefit is attributed to each of the first 10 years of service after age 45, and the actuarial present value of an additional $5,000 death benefit is attributed to each year of service thereafter up to age 65.

Case 1D—Individual Deferred Compensation Contracts

413. An employer may provide postretirement benefits to selected employees under individual contracts with specific terms determined on an individual-by-individual basis. Paragraph 13 of this Statement amends APB Opinion No. 12, *Omnibus Opinion—1967,* to attribute those benefits to the individual employee's years of service following the terms of the contract. Paragraphs 414–416 illustrate the application of paragraph 13 for individual deferred compensation contracts.

Contract provides only prospective benefits

414. A company enters into a deferred compensation contract with an employee at the date of hire. The contract provides for a payment of $150,000 upon termination of employment following a minimum 3-year service period. The contract provides for a compensation adjustment for each year of service after the third year determined by multiplying $150,000 by the company's return on equity for the year. Also, each year after the third year of service, interest at 10 percent per year is credited on the amount due under the contract at the beginning of that year. Accordingly, a liability of $150,000 is accrued in a systematic and rational manner over the employee's first 3 years of service. Following the third year of service, the accrued liability is adjusted annually for accrued interest and the increased or decreased compensation based on the company's return on equity for that year. At the end of the third year and each subsequent year of the employee's service, the amount accrued equals the then present value of the benefit expected to be paid in exchange for the employee's service rendered to that date.

Contract provides retroactive benefits

415. A company enters into a contract with a 55-year-old employee who has worked 5 years for the company. The contract states that in exchange for past and future services and for serving as a consultant for 2 years after the employee retires, the company will pay an annual pension of $20,000 to the employee, commencing immediately upon the employee's retirement. It is expected that the future benefits to the employer from the consulting services will be minimal. Consequently, the actuarial present value of a lifetime annuity of $20,000 that begins at the employee's expected retirement date is accrued at the date the contract is entered into because the employee is fully eligible for the pension benefit at that date.

416. If the terms of the contract described in paragraph 415 had stated that the employee is entitled to the pension benefit only if the sum of the employee's age and years of service equal 70 or more at the date of retirement, the employee would be fully eligible for the pension benefit at age 60, after rendering 5 more years of service. The actuarial present value

of a lifetime annuity of $20,000 that begins at the expected retirement date would be accrued in a systematic and rational manner over the 5-year period from the date the contract is entered into to the date the employee is fully eligible for the pension benefit.

Illustration 2—Delayed Recognition of Net Periodic Postretirement Benefit Cost

417. The following cases (2B–2E, paragraphs 421–429) show how events that change the accumulated postretirement benefit obligation are reflected in net periodic postretirement benefit cost and other comprehensive income.

418–419. [These paragraphs (Case 2A) have been deleted. See Status page.]

420. Any change in the accumulated postretirement benefit obligation or the plan assets (other than contributions and benefit payments) either is initially recognized in other comprehensive income or is included in net periodic postretirement benefit cost. Contributions to a funded plan by the employer decrease the recognized postretirement benefit liability or increase the recognized postretirement benefit asset, subject to the provision of paragraph 112 requiring recognition in net periodic postretirement benefit cost of an additional amount of the transition obligation remaining in accumulated other comprehensive income in certain situations. The following tables (Cases 2B–2E) illustrate the effect of changes in assumptions or changes in the plan on measurement of the accumulated postretirement benefit obligation. In each case, it is assumed that the plan is unfunded.

Case 2B—Employer Accrual of Net Periodic Postretirement Benefit Cost

421. Benefit payments of $42,000 are made at the end of 20X3. Net periodic postretirement benefit cost and other comprehensive income for 20X3, and changes in the postretirement benefit liability and accumulated other comprehensive income for 20X3 are summarized as follows:

	Net Periodic Postretirement Benefit Cost	Other Comprehensive Income	Postretirement Benefit Liability	Transition Obligation Remaining in Accumulated Other Comprehensive Income
Beginning of year			$(600,000)	$400,000
Recognition of components of net periodic postretirement benefit cost:				
Service cost	$ 32,000		(32,000)	
Interest cost[a]	48,000		(48,000)	
Amortization of transition obligation[b]	30,000	$(30,000)		(30,000)
Total net periodic postretirement benefit cost	$110,000			
Total other comprehensive income		$(30,000)		
Benefit payments			42,000	
Net change			(38,000)	(30,000)
End of year			$(638,000)	$370,000

[a]Assumed discount rate of 8% applied to the accumulated postretirement benefit obligation at the beginning of the year.

[b]The transition obligation of $400,000 is amortized on a straight-line basis over the remaining amortization period of approximately 13 years.

422. [This paragraph has been deleted. See Status page.]

Case 2C—Plan Amendment That Increases Benefits

423. The plan is amended on January 2, 20X4, resulting in a $90,000 increase in the accumulated postretirement benefit obligation. The effects of plan amendments are reflected immediately in the postretirement benefit liability through a corresponding charge to other comprehensive income. Other comprehensive income is subsequently adjusted as that prior service cost is amortized as a component of net periodic postretirement benefit cost (paragraph 52).

424. Benefit payments of $39,000 are made at the end of 20X4. Net periodic postretirement benefit cost and other comprehensive income for 20X4, and changes in the postretirement benefit liability and accumulated other comprehensive income for 20X4 are summarized as follows:

	Net Periodic Postretirement Benefit Cost	Other Comprehensive Income	Postretirement Benefit Liability	Amounts Remaining in Accumulated Other Comprehensive Income	
				Transition Obligation	Prior Service Cost
Beginning of year			$(638,000)	$370,000	$ 0
Plan amendment		$ 90,000	(90,000)		90,000
Recognition of components of net periodic postretirement benefit cost:					
Service cost	$ 30,000		(30,000)		
Interest cost[a]	58,240		(58,240)		
Amortization of transition obligation	30,000	(30,000)		(30,000)	
Amortization of prior service cost[b]	9,000	(9,000)			(9,000)
Total net periodic postretirement benefit cost	$127,240				
Total other comprehensive income		$ 51,000			
Benefit payments			39,000		
Net change			(139,240)	(30,000)	81,000
End of year			$(777,240)	$340,000	$81,000

[a]Assumed discount rate of 8% applied to the accumulated postretirement benefit obligation at the beginning of the year and to the increase in that obligation for the prior service cost initially recognized in other comprehensive income at the date of the plan amendment [($638,000 × 8%) + ($90,000 × 8%)].

[b]As permitted by paragraph 53, prior service cost of $90,000 is amortized in net periodic postretirement benefit cost on a straight-line basis over the average remaining years of service to *full eligibility* for benefits of the active plan participants (10 years in this example).

425. [This paragraph has been deleted. See Status page.]

Case 2D—Negative Plan Amendment

426. The plan is amended on January 4, 20X5, resulting in a $99,000 reduction in the accumulated postretirement benefit obligation. As with a plan amendment that increases benefits, the effect of a negative plan amendment (an amendment that decreases benefits) is reflected immediately in the measurement of the accumulated postretirement benefit obligation. The effects of the negative plan amendment are recognized by first reducing any existing prior service cost included in accumulated other comprehensive income and then any existing transition obligation remaining in accumulated other comprehensive income; the remainder is recognized in net periodic postretirement benefit cost on a delayed basis.

427. Benefit payments in 20X5 are $40,000. Net periodic postretirement benefit cost and other comprehensive income for 20X5, and the changes in the postretirement benefit liability and accumulated other comprehensive income for 20X5 are summarized as follows:

	Net Periodic Postretirement Benefit Cost	Other Comprehensive Income	Postretirement Benefit Liability	Amounts Remaining in Accumulated Other Comprehensive Income	
				Transition Obligation	Prior Service Cost
Beginning of year			$(777,240)	$340,000	$ 81,000
Plan amendment[a]		$ (99,000)	99,000	(18,000)	(81,000)
Recognition of components of net periodic postretirement benefit cost:					
Service cost	$ 30,000		(30,000)		
Interest cost[b]	54,259		(54,259)		
Amortization of transition obligation[c]	29,000	(29,000)		(29,000)	
Amortization of prior service cost	0	0			0
Total net periodic postretirement benefit cost	$113,259				
Total other comprehensive income		$(128,000)			
Benefit payments			40,000		
Net change			54,741	(47,000)	(81,000)
End of year			$(722,499)	$293,000	$ 0

[a]Paragraph 55 requires that the effects of a plan amendment that reduces the accumulated postretirement benefit obligation be used first to reduce any existing prior service cost included in accumulated other comprehensive income, then any transition obligation remaining in accumulated other comprehensive income. Amounts remaining in accumulated other comprehensive income are recognized in net periodic postretirement benefit cost on a delayed basis over the remaining years of service to full eligibility for those plan participants who were active at the date of the amendment. If all or almost all of the plan participants were fully eligible at that date, the remaining effects should be recognized over the remaining life expectancy of those plan participants.

[b]Assumed discount rate of 8% applied to the accumulated postretirement benefit obligation at the beginning of the year and to the decrease in that obligation at the date of the plan amendment [($777,240 × 8%) – ($99,000 × 8%)].

[c]Transition obligation remaining in accumulated other comprehensive income of $322,000 ($340,000 – $18,000) is amortized on a straight-line basis over the remaining transition period of approximately 11 years.

428. [This paragraph has been deleted. See Status page.]

Case 2E—Change in Assumption

429. The assumed health care cost trend rates are changed at December 31, 20X5, resulting in a $55,000 increase in the accumulated postretirement benefit obligation. The net loss that results from a change in the health care cost trend rates assumption is reflected immediately in the postretirement benefit liability. However, as with most other gains and losses, the effect of a change in assumption may be recognized immediately in net periodic postretirement benefit cost or on a delayed basis through a charge or credit to other comprehensive income with subsequent amortization as a component of net periodic postretirement benefit cost, as long as the method of recognizing the change in assumption in net periodic postretirement benefit cost is applied consistently.

	Before Change	Loss Recognized in Other Comprehensive Income	After Change
Accumulated postretirement benefit obligation	$(722,499)	$(55,000)	$(777,499)
Plan assets at fair value	0		0
Funded status and recognized liability	$(722,499)	$(55,000)	$(777,499)
Accumulated other comprehensive income:			
Net loss[a]	$ 0	$ 55,000	$ 55,000
Transition obligation	293,000		293,000
	$ 293,000	$ 55,000	$ 348,000

[a]This Statement generally does not require recognition of gains and losses in net periodic postretirement benefit cost in the period in which they arise (paragraphs 56–61). However, at a minimum, amortization of a net gain or loss included in accumulated other comprehensive income is required to be subsequently recognized as a component of net periodic postretirement benefit cost if the net gain or loss exceeds 10 percent of the greater of the accumulated postretirement benefit obligation or the market-related value of plan assets. Applications of those provisions are included in Illustration 5 (paragraphs 455–471).

430–448. [These paragraphs (Illustration 3) have been deleted. See Status page.]

Illustration 4—Plan Amendments and Prior Service Cost

449. This Statement requires that prior service cost arising from a plan initiation or plan amendment be recognized initially in other comprehensive income with subsequent amortization in net periodic postretirement benefit cost, at a minimum, by assigning an equal amount of the prior service cost to each remaining year of service to the full eligibility date of each plan participant active at the date of the plan initiation or amendment (paragraph 52). Consistent use of an alternative amortization method that more rapidly reduces the prior service cost in accumulated other comprehensive income is permitted (paragraph 53).

450. Company H has a postretirement benefit plan that provides benefits to employees who render at least 20 years of service after age 35. On January 2, 20X4, Company H amends its postretirement benefit plan to increase the lifetime cap on benefits provided, resulting in prior service cost of $750,000 that is initially recognized in other comprehensive income (the increase in the accumulated postretirement benefit obligation as a result of the plan amendment). Cases 4A and 4B (paragraphs 451–454) illustrate the amortization of prior service cost included in accumulated other comprehensive income.

Case 4A—Equal Amount Assigned to Each Future Year of Service to Full Eligibility Date

451. The determination of the amortization of prior service cost in net periodic postretirement benefit cost is based on remaining years of service prior to the full eligibility date of each plan participant active at the date of the amendment but not yet fully eligible for benefits. (Refer to the glossary for the definition of plan participant.) Future years of service of active employees who are not plan participants are excluded. Each remaining year of service prior to the full eligibility date of each active plan participant not yet fully eligible for benefits is assigned an equal share of the prior service cost (paragraph 52). Thus, the portion of prior service cost to be recognized in net periodic postretirement benefit cost in each of those future years is weighted based on the number of those plan participants expected to render service in each of those future years.

452. At the date of the amendment (January 2, 20X4), Company H has 165 employees of whom 15 are fully eligible for benefits, 10 are under age 35, and 40 are expected to terminate before becoming eligible for any benefits. Because the 10 employees under age 35 have not met the age requirements to participate in the plan (only service after age 35 is credited) and 40 employees are not expected to receive benefits under the plan, those 50 employees are not considered to be plan participants and, therefore, are excluded from the calculation. The 15 fully eligible plan participants also are excluded from the calculation because they do not have to render any additional service to earn the added benefits. The remaining 100 employees have not yet earned the full amount of the benefits they are expected to earn under the plan. Those employees are expected to become fully eligible for those benefits over the next 20 years. Their remaining years of service to full eligibility for benefits is the basis for amortization of the prior service cost.

453. The following schedules illustrate the calculation of the expected remaining years of service prior to full eligibility (Schedule 1) and the amortization schedule for recognizing the prior service cost in net periodic postretirement benefit cost (Schedule 2). Employees hired after the date of the plan amendment or who attain age 35 after the date of the plan amendment do not affect the amortization nor do revised estimates of remaining years of service, except those due to a curtailment.

Schedule 1—Determination of expected remaining years of service prior to full eligibility as of January 2, 20X4

Indiv.	Remaining Years of Service Prior to Full Elig.	Year 20X4	20X5	20X6	20X7	20X8	20X9	20Y0	20Y1	20Y2	20Y3	20Y4	20Y5	20Y6	20Y7	20Y8	20Y9	20Z0	20Z1	20Z2	20Z3	Total Remaining Years of Service Prior to Full Elig.
A1–A4	1	4																				4
B1–B6	2	6	6																			12
C1–C5	3	5	5	5																		15
D1–D5	4	5	5	5	5																	20
E1–E7	5	7	7	7	7	7																35
F1–F5	6	5	5	5	5	5	5															30
G1–G9	7	9	9	9	9	9	9	9														63
H1–H7	8	7	7	7	7	7	7	7	7													56
I1–I5	9	5	5	5	5	5	5	5	5	5												45
J1–J5	10	5	5	5	5	5	5	5	5	5	5											50
K1–K4	11	4	4	4	4	4	4	4	4	4	4	4										44
L1–L8	12	8	8	8	8	8	8	8	8	8	8	8	8									96
M1–M8	13	8	8	8	8	8	8	8	8	8	8	8	8	8								104
N1–N5	14	5	5	5	5	5	5	5	5	5	5	5	5	5	5							70
O1–O4	15	4	4	4	4	4	4	4	4	4	4	4	4	4	4	4						60
P1–P3	16	3	3	3	3	3	3	3	3	3	3	3	3	3	3	3	3					48
Q1–Q4	17	4	4	4	4	4	4	4	4	4	4	4	4	4	4	4	4	4				68
R1–R3	18	3	3	3	3	3	3	3	3	3	3	3	3	3	3	3	3	3	3			54
S1–S2	19	2	2	2	2	2	2	2	2	2	2	2	2	2	2	2	2	2	2	2		38
T1	20	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	20
Service Years Rendered		100	96	90	85	80	73	68	59	52	47	42	38	30	22	17	13	10	6	3	1	932
Amortization Fraction		100/932	96/932	90/932	85/932	80/932	73/932	68/932	59/932	52/932	47/932	42/932	38/932	30/932	22/932	17/932	13/932	10/932	6/932	3/932	1/932	

Note: To determine total remaining service years prior to full eligibility, consideration is given to the remaining number of years of service to the full eligibility date of each plan participant or group of plan participants active at the date of the plan amendment who is not yet fully eligible for benefits. For example, in 20X4, individuals A1–A4 meet the company's age and service requirements for full eligibility for the benefits they are expected to receive under the plan. Although it may be expected that those employees will work beyond 20X4, benefits are not attributed to years of service beyond their full eligibility date (paragraph 21). Refer to Case 4B, paragraph 454, for less complex amortization approaches.

Schedule 2—Amortization of prior service cost

Year	Beginning-of-Year Balance	Amortization Rate	Amortization	End-of-Year Balance
20X4	$750,000	100/932	$80,472	$669,528
20X5	669,528	96/932	77,253	592,275
20X6	592,275	90/932	72,425	519,850
20X7	519,850	85/932	68,401	451,449
20X8	451,449	80/932	64,378	387,071
20X9	387,071	73/932	58,745	328,326
20Y0	328,326	68/932	54,721	273,605
20Y1	273,605	59/932	47,479	226,126
20Y2	226,126	52/932	41,845	184,281
20Y3	184,281	47/932	37,822	146,459
20Y4	146,459	42/932	33,798	112,661
20Y5	112,661	38/932	30,579	82,082
20Y6	82,082	30/932	24,142	57,940
20Y7	57,940	22/932	17,704	40,236
20Y8	40,236	17/932	13,680	26,556
20Y9	26,556	13/932	10,461	16,095
20Z0	16,095	10/932	8,047	8,048
20Z1	8,048	6/932	4,828	3,220
20Z2	3,220	3/932	2,414	806
20Z3	806	1/932	806	0

Case 4B—Straight-Line Amortization over Average Remaining Years of Service to Full Eligibility Date

454. To reduce the complexity and detail of the computations shown in Case 4A (paragraph 453, Schedules 1 and 2), alternative amortization approaches that more rapidly reduce prior service cost previously recognized in other comprehensive income may be applied if used consistently (paragraph 53). For example, if Company H (Case 4A) elects to use straight-line amortization of prior service cost over the average remaining years of service prior to full eligibility for benefits of the active plan participants (932 future service years ÷ 100 employees = 9.32 years), the amortization would be as follows:

Year	Beginning-of-Year Balance	Amortization	End-of-Year Balance
20X4	$750,000	$80,472[a]	$669,528
20X5	669,528	80,472	589,056
20X6	589,056	80,472	508,584
20X7	508,584	80,472	428,112
20X8	428,112	80,472	347,640
20X9	347,640	80,472	267,168
20Y0	267,168	80,472	186,696
20Y1	186,696	80,472	106,224
20Y2	106,224	80,472	25,752
20Y3	25,752	25,752	0

[a]$750,000 ÷ 9.32 years = $80,472.

Note: Under this approach, the first year's amortization is the same as the first year's amortization under the weighted remaining years of service method illustrated in Case 4A (paragraph 453, Schedule 2). Thereafter, the amortization pattern will differ.

Illustration 5—Accounting for Gains and Losses and Timing of Measurements

455. Gains and losses are changes in the amount of the accumulated postretirement benefit obligation or plan assets resulting from experience different from that assumed or changes in assumptions (paragraph 56). This illustration demonstrates the effects of gains and losses in accounting for postretirement benefits for Company I from 20X3 to 20X5. Case 5A (paragraphs 457–461) illustrates the accounting for a loss resulting from changes in assumptions in measuring the accumulated postretirement benefit obligation. Case 5B (paragraphs 462–464) illustrates the effect of a gain when the return on plan assets exceeds projections. Case 5C (paragraphs 465–467) illustrates the accounting in a year when both gains and losses are experienced.

456. Company I's plan is unfunded and the accumulated postretirement benefit obligation is $6,000,000 at the beginning of 20X3. There is also a $2,000,000 transition obligation remaining in accumulated other comprehensive income at that date. Beginning in 20X3, and unless otherwise noted, the company decides to fund at the end of each year an amount equal to the benefits paid that year plus the service cost and interest cost for that year. For illustrative purposes, the following assumptions are used to project changes in the accumulated postretirement benefit obligation and plan assets during the period 20X3–20X5:

	20X3	20X4	20X5
Discount rate	9.5%	9.0%	9.0%
Expected long-term rate of return on plan assets		10.0%	10.0%
Average remaining years of service of active plan participants	12	12	12

Case 5A—Loss on Obligation

457. [This paragraph has been deleted. See Status page.]

458. Pursuant to paragraph 112, Company I amortizes the transition obligation remaining in accumulated other comprehensive income over a 20-year period rather than the average remaining service period of active plan participants at the date of transition (12 years). Projected changes in net periodic postretirement benefit cost and other comprehensive income for 20X3, and changes in the postretirement benefit liability and accumulated other comprehensive income for 20X3 are summarized as follows:

	Net Periodic Postretirement Benefit Cost	Other Comprehensive Income	Postretirement Benefit Liability	Transition Obligation Remaining in Accumulated Other Comprehensive Income
Beginning of year 20X3			$(6,000,000)	$2,000,000
Recognition of components of net periodic postretirement benefit cost:				
Service cost	$ 300,000		(300,000)	
Interest cost	570,000		(570,000)	
Amortization of transition obligation	300,000	$(300,000)		(300,000)
Total net periodic postretirement benefit cost	$1,170,000			
Total other comprehensive income		$(300,000)		
Excess of assets contributed to plan over benefit payments ($1,500,000 – $630,000 = $870,000)			870,000	
Benefit payments from plan			630,000	
Net change			630,000	(300,000)
End of year 20X3—projected			$(5,370,000)	$1,700,000

459. When Company I's plan assets and obligations are measured at December 31, 20X3, the accumulated postretirement benefit obligation is $760,000 greater than been projected (a loss occurs) because the discount rate declined to 9 percent and for various other reasons not specifically identified. Company I elects to amortize amounts in excess of the "corridor" over the average remaining service period of active plan participants.[a]

[a]Paragraph 59 states that, at a minimum, amortization of a net gain or loss remaining in accumulated other comprehensive income is included as a component of net periodic postretirement benefit cost if that net gain or loss exceeds 10 percent of the greater of the accumulated postretirement benefit obligation or market-related value of plan assets. As used herein, *amounts in excess of the corridor* refers to the portion of the net gain or loss remaining in accumulated other comprehensive income in excess of the greater of those defined amounts.

460. The projected and actual postretirement benefit liability and accumulated other comprehensive income at December 31, 20X3, and the difference between those projected and actual amounts at that date follow:

	Projected 12/31/X3	Loss Recognized in Other Comprehensive Income	Actual 12/31/X3
Accumulated postretirement benefit obligation	$(6,240,000)	$(760,000)	$(7,000,000)
Plan assets at fair value	870,000		870,000
Funded status and recognized liability	$(5,370,000)	$(760,000)	$(6,130,000)
Accumulated other comprehensive income:			
Net loss	$ 0	$ 760,000	$ 760,000
Transition obligation	1,700,000		1,700,000
	$ 1,700,000	$ 760,000	$ 2,460,000

461. In addition to disclosures regarding changes in plan assets and benefit obligations required by paragraphs 5(a) and 5(b) of Statement 132(R), the 20X3 financial statements include the following disclosure of the components of net periodic postretirement benefit cost (as required by paragraph 5(h) of Statement 132(R)):

Service cost	$ 300,000
Interest cost	570,000
Amortization of transition obligation	300,000
Net periodic postretirement benefit cost	$1,170,000

Case 5B—Gain on Assets

462. Net periodic postretirement benefit cost and other comprehensive income for 20X4, and changes in the postretirement benefit liability and accumulated other comprehensivc income are projected at the beginning of the year. That projection serves as the basis for interim accounting until a subsequent event occurs requiring remeasurement. The projection at the beginning of 20X4 follows:

	Net Periodic Postretirement Benefit Cost	Other Comprehensive Income	Postretirement Benefit Liability	Amounts Remaining in Accumulated Other Comprehensive Income: Transition Obligation	Amounts Remaining in Accumulated Other Comprehensive Income: Net Loss
Beginning of year 20X4			$(6,130,000)	$1,700,000	$760,000
Recognition of components of net periodic postretirement benefit cost:					
Service cost	$ 320,000		(320,000)		
Interest cost	630,000		(630,000)		
Amortization of transition obligation	300,000	$(300,000)		(300,000)	
Amortization of net loss[a]	5,000	(5,000)			(5,000)
Expected return on plan assets[b]	(87,000)		87,000		
Total net periodic postretirement benefit cost	$1,168,000				
Total other comprehensive income		$(305,000)			
Excess of assets contributed to plan over benefit payments ($1,650,000 – $700,000 = $950,000)			950,000		
Benefit payments from plan			700,000		
Net change			787,000	(300,000)	(5,000)
End of year 20X4—projected			$(5,343,000)	$1,400,000	$755,000

[a]Refer to Schedule 2 (paragraph 469) for computation.

[b]Refer to Schedule 1 (paragraph 468) for computation.

463. When Company I's plan assets and obligations are measured at December 31, 20X4, the fair value of the plan assets is $150,000 greater than expected (an experience gain) because market performance was better than the 10 percent return that was assumed. The projected and actual postretirement benefit liability and accumulated other comprehensive income at December 31, 20X4, and the difference between those projected and actual amounts at that date follow:

	Projected 12/31/X4	Gain Recognized in Other Comprehensive Income	Actual 12/31/X4
Accumulated postretirement benefit obligation	$(7,250,000)		$(7,250,000)
Plan assets at fair value	1,907,000	$ 150,000[c]	2,057,000
Funded status and recognized liability	$(5,343,000)	$ 150,000	$(5,193,000)
Accumulated other comprehensive income:			
Net (gain) or loss	$ 755,000	$(150,000)	$ 605,000
Transition obligation	1,400,000		1,400,000
	$ 2,155,000	$(150,000)	$ 2,005,000

[c]Refer to Schedule 1 (paragraph 468) for computation.

464. The 20X4 financial statements include the following disclosure of the components of net periodic postretirement benefit cost:

Service cost	$ 320,000
Interest cost	630,000
Expected return on plan assets	(87,000)
Amortization of transition obligation	300,000
Amortization of net actuarial loss	5,000
Net periodic postretirement benefit cost	$1,168,000

Case 5C—Loss on Assets and Gain on Obligation

465. Projected changes in net periodic postretirement benefit cost and other comprehensive income for 20X5, and changes in the postretirement benefit liability and accumulated other comprehensive income for 20X5 are summarized as follows:

				Amounts Remaining in Accumulated Other Comprehensive Income	
	Net Periodic Postretirement Benefit Cost	**Other Comprehensive Income**	**Postretirement Benefit Liability**	**Transition Obligation**	**Net Loss**
Beginning of year 20X5			$(5,193,000)	$1,400,000	$605,000
Recognition of components of net periodic postretirement benefit cost:					
Service cost	$ 360,000		(360,000)		
Interest cost	652,500		(652,500)		
Amortization of transition obligation	300,000	$(300,000)		(300,000)	
Amortization of net loss[a]	0	0			0
Expected return on plan assets[b]	(193,700)		193,700		
Total net periodic postretirement benefit cost	$1,118,800				
Total other comprehensive income		$(300,000)			
Excess of assets contributed to plan over benefit payments ($1,912,500 – $900,000 = $1,012,500)			1,012,500		
Benefit payments from plan			900,000		
Net change			1,093,700	(300,000)	0
End of year 20X5—projected			$(4,099,300)	$1,100,000	$605,000

[a]Refer to Schedule 2 (paragraph 469) for computation.

[b]Refer to Schedule 1 (paragraph 468) for computation.

466. When Company I's plan assets and obligations are measured at December 31, 20X5, both an asset loss of $220,360 and a liability gain of $237,260 are determined. The projected and actual postretirement benefit liability and accumulated other comprehensive income at December 31, 20X5, and the difference between those projected and actual amounts at that date follow:

	Projected 12/31/X5	Gain/Loss Recognized in Other Comprehensive Income	Actual 12/31/X5
Accumulated postretirement benefit obligation	$(7,362,500)	$ 237,260	$(7,125,240)
Plan assets at fair value	3,263,200	(220,360)[c]	3,042,840
Funded status and recognized liability	$(4,099,300)	$ 16,900	$(4,082,400)
Accumulated other comprehensive income:			
Net (gain) or loss	$ 605,000	$ (16,900)	$ 588,100
Transition obligation	1,100,000		1,100,000
	$ 1,705,000	$ (16,900)	$ 1,688,100

[c]Refer to Schedule 1 (paragraph 468) for computation.

467. The 20X5 financial statements include the following disclosure of the components of net periodic postretirement benefit cost:

Service cost	$ 360,000
Interest cost	652,500
Expected return on plan assets	(193,700)
Amortization of transition obligation	300,000
Net periodic postretirement benefit cost	$1,118,800

Supporting Schedules

Schedule 1—Plan assets

468. This Statement requires use of an assumption about the long-term rate of return on plan assets and a market-related value of plan assets to calculate the expected return on plan assets. If the fund holding plan assets is a taxable entity, the expected long-term rate of return on plan assets is net of estimated income taxes, and the nonbenefit liability for accrued income taxes reduces plan assets. 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 (paragraph 57). This schedule reflects the calculation of market-related value, the fair value of plan assets, the actual return on plan assets, and the deferred asset gain or loss for the year (the difference between actual and expected return on plan assets included in the net amortization and deferral component of net periodic postretirement benefit cost).

	20X3	20X4	20X5
Expected long-term rate of return on plan assets		10.0%	10.0%
Beginning balance, market-related value[a]	$ 0	$ 870,000	$1,937,000
Contributions to plan (end of year)	1,500,000	1,650,000	1,912,500
Benefits paid by plan	(630,000)	(700,000)	(900,000)
Expected return on plan assets		87,000	193,700
	870,000	1,907,000	3,143,200
20% of each of last 5 years' asset gains (losses)		30,000	(14,072)
Ending balance, market-related value	$ 870,000	$1,937,000	$3,129,128
Beginning balance, fair value of plan assets	$ 0	$ 870,000	$2,057,000
Contributions to plan	1,500,000	1,650,000	1,912,500
Benefits paid	(630,000)	(700,000)	(900,000)
Actual return (loss) on plan assets[b]	0	237,000	(26,660)
Ending balance, fair value of plan assets	$ 870,000	$2,057,000	$3,042,840
Deferred asset gain (loss) for year[c]	$ 0	$ 150,000	$ (220,360)
Gain (loss) not included in ending balance of market-related value[d]	$ 0	$ 120,000	$ (86,288)

[a]This example uses an approach that adds in 20% of each of the last 5 years' gains or losses.

[b]Refer to Schedule 3 (paragraph 470) for computation.

[c](Actual return on plan assets) – (expected return on plan assets).

[d](Ending balance, fair value of plan assets) – (ending balance, market-related value of plan assets).

Schedule 2—Test for amortization in net periodic postretirement benefit cost of the net gain or loss initially recognized in other comprehensive income

469. This Statement generally does not require immediate recognition in net periodic postretirement benefit cost of any of the gain or loss in the period in which it arises. Rather, it permits initial recognition of gains and losses in other comprehensive income with a minimum amortization of the net gain or loss in accumulated other comprehensive income whereby the net amount in excess of the "corridor" is amortized over the average remaining service period of active plan participants (paragraph 59 and paragraph 459, footnote a). That allows a reasonable opportunity for gains and losses to offset each other without affecting net periodic postretirement benefit cost.

	20X3	20X4	20X5
10% of beginning balance of accumulated postretirement benefit obligation	$600,000	$700,000	$725,000
10% of beginning balance of market-related value of plan assets[e]	$ 0	$ 87,000	$193,700
Greater of the above	$600,000	$700,000	$725,000
Net (gain) loss in accumulated other comprehensive income at beginning of year		$760,000	$605,000
Asset gain (loss) not included in beginning balance of market-related value[f]		0	120,000
Amount subject to amortization		$760,000	$725,000
Amount in excess of the corridor subject to amortization		$ 60,000	$ 0
Divided by average remaining service period (years)		12	
Required amortization		$ 5,000	

[e]Refer to Schedule 1 (paragraph 468) for calculation of market-related value of plan assets.

[f]Refer to Schedule 1 (paragraph 468) for calculation of gain or loss not included in prior year's ending balance market-related value.

Schedule 3—Determination of actual return or loss on plan assets

470. The determination of the actual return or loss on plan assets component of net periodic postretirement benefit cost is as follows:

	20X3	20X4	20X5
Plan assets at fair value, beginning of year	$ 0	$ 870,000	$ 2,057,000
Plus: assets contributed to plan	1,500,000	1,650,000	1,912,500
Less: benefit payments from plan	(630,000)	(700,000)	(900,000)
	870,000	1,820,000	3,069,500
Less: plan assets at fair value, end of year	(870,000)	(2,057,000)	(3,042,840)
Actual (return) loss on plan assets	$ 0	$ (237,000)	$ 26,660

471. [This paragraph has been deleted. See Status page.]

Illustration 6—Defined-Dollar Capped Plans

472. The following cases (6A and 6B, paragraphs 473–478) demonstrate the operation of defined-dollar capped plans and the possible effect of the "cap" on projecting costs for purposes of measuring the accumulated postretirement benefit obligation and net periodic postretirement benefit cost. The examples are simplified and illustrate only one aspect of the measurement process (paragraph 17 and paragraph 33, footnote 13).

Case 6A—Dollar Cap Defined on Individual Coverage

473. Company J sponsors a postretirement health care plan for its salaried employees. The plan has an annual limitation (a "cap") on the dollar amount of the employer's share of the cost of covered benefits incurred by a plan participant. The retiree is responsible, therefore, for the amount by which the cost of the benefit coverage under the plan incurred during a year exceeds that cap. The company adjusts the cap annually for the effects of inflation. For 20X3, the cap is $1,500; the inflation adjustment in 20X4 and 20X5 is assumed to be 4 percent. The employer's health care cost trend rate assumption is 13 percent for 20X4 and 12 percent for 20X5.

474. The employer's projected cost of providing benefit coverage in 20X3–20X5 for a 67-year-old retiree follows. Similar projections are made for each age at which a plan participant is expected to receive benefits under the plan. In this example, the incurred claims cost exceeds the cap on the employer's share of the cost in each year.

	Expected Cost for 67-Year-Old Retiree		
	20X3	**20X4**	**20X5**
Gross eligible charges	$3,065	$ 3,463	$ 3,879
Medicare[a]	(890)	(1,003)	(1,125)
Deductible/coinsurance	(325)	(340)	(355)
Incurred claims cost	$1,850	$ 2,120	$ 2,399
Annual cap on employer's cost	$1,500	$ 1,560	$ 1,622
Employer's share of incurred claims cost	$1,500	$ 1,560	$ 1,622
Retiree's share of gross eligible charges[b]	$ 675	$ 900	$ 1,132

[a]The change in Medicare reflects the portion of the gross eligible charges for which Medicare is responsible under enacted Medicare legislation.

[b]Deductible/coinsurance plus share of incurred claims: 20X3—[$325 + ($1,850 – $1,500)]; 20X4—[$340 + ($2,120 – $1,560)]; 20X5—[$355 + ($2,399 – $1,622)].

475. If, based on the health care cost trend rate assumptions, the employer's share of costs for each plan participant is not expected to be less than the cap in the future, Company J could measure its expected postretirement benefit obligation by projecting the annual cap. However, if per capita claims data for some plan participants or estimates of the health care cost trend rate indicate that in the future the employer's share of the incurred claims cost will be less than the cap for at least some plan participants, the employer's obligation is to be measured as described in paragraphs 34–42.

Case 6B—Dollar Cap Defined in the Aggregate for the Retiree Group

476. Company K sponsors a contributory postretirement health care plan for its hourly employees. The plan has an annual limitation (a "cap") on the dollar amount of the employer's share of the cost of covered benefits incurred by the retiree group as a whole. The Company agrees to bear annual costs equal to a specified dollar amount ($1,500 in 20X3) multiplied

by the number of retired plan participants (the employer contribution); participating retirees are required to contribute a stated amount each year ($1,000 in 20X3). The cap on the employer's share of annual costs and the retirees' contribution rates are increased 5 percent annually. The shortfall in a year (the amount by which incurred claims cost exceeds the combined employer and retiree contributions) is initially borne by the employer but is passed back to retirees in the subsequent year through supplemental retiree contributions for that year (a retrospective adjustment).

477. The employer projects the aggregate cost of benefits expected to be paid to current plan participants (40 retirees) in each future period as follows:

	20X3	20X4	20X5
Gross eligible charges	$160,000	$215,000	$197,000
Medicare	(46,500)	(62,350)	(57,300)
Deductible/coinsurance	(20,750)	(27,440)	(24,700)
Incurred claims cost	$ 92,750	$125,210	$115,000
Retiree contributions[a]	$ 40,000	$ 42,000	$ 44,080
Maximum employer contribution[b]	60,000	63,000	66,160
	$100,000	$105,000	$110,240
Shortfall (to be recovered by additional retiree contributions in subsequent year)		$ 20,210	$ 4,760
Supplemental contribution from retirees due to shortfall in prior year			$ 20,210

[a]Per retiree: 20X3—$1,000; 20X4—$1,050; 20X5—$1,102.
[b]Per retiree: 20X3—$1,500; 20X4—$1,575; 20X5—$1,654.

478. If, as in this example, retirees absorb the entire shortfall in annual contributions and if there is a projected shortfall for all future years, the employer could measure its expected postretirement benefit obligation by projecting its annual contribution (contribution rate × expected number of retirees = expected obligation for the year).

Illustration 7—Disclosure Requirements

479–483. [These paragraphs have been replaced. Refer to the illustrations in paragraphs C1 through C5 in Statement 132(R). See Status page.]

Illustration 8—Accounting for Settlements

484. This Statement provides for delayed recognition in net periodic postretirement benefit cost of the effects of a plan initiation or a plan amendment, the transition obligation or transition asset, and gains or losses arising in the ordinary course of operations. That is, this Statement permits those amounts to be recognized in other comprehensive income with subsequent amortization in net periodic postretirement benefit cost. In certain circumstances, however, recognition in net periodic postretirement benefit cost of some or all of those amounts initially recognized in other comprehensive income is appropriate. Settlements are events that may require income or expense recognition of certain amounts initially recognized in other comprehensive income and adjustments to liabilities or assets recognized in the employer's statement of financial position. The settlement of all or part of the accumulated postretirement benefit obligation is an event that requires recognition in income of all or part of a net gain or loss and transition asset remaining in accumulated other comprehensive income. A settlement also may accelerate recognition in income of a transition obligation under the constraint in paragraph 112 (paragraphs 92 and 93). The following cases (8A–8C, paragraphs 485–495) illustrate the accounting for settlements in various circumstances.

Case 8A—Settlement When a Transition Obligation Remains in Accumulated Other Comprehensive Income

485. Company L sponsors a postretirement life insurance plan. On December 31, 20X4, Company L settles the accumulated postretirement benefit obligation for its current retirees ($70,000) through the purchase of nonparticipating life insurance contracts.

486. In accounting for the settlement, Company L must determine whether recognition in income of an additional amount of any transition obligation remaining in accumulated other comprehensive income is required pursuant to the constraint on delayed recognition in income of the transition obligation (paragraphs 112 and 113). At December 31, 20X4, the cumulative postretirement benefit cost accrued subsequent to the date of transition exceeds the cumulative benefits payments subsequent to that date (including payments made pursuant to the settlement) in this example; thus, the constraint on delayed recognition in income of the transition obligation remaining in accumulated other comprehensive income is not operative. The results of the settlement are as follows:

	December 31, 20X4		
	Before Settlement	Settlement	After Settlement
Accumulated postretirement benefit obligation	$(257,000)	$ 70,000	$(187,000)
Plan assets at fair value	73,000	(70,000)[a]	3,000
Funded status and recognized liability	$(184,000)	$ 0	$(184,000)
Accumulated other comprehensive income:			
Net gain	$ (44,575)	$ 12,124[a]	$ (32,451)
Prior service cost	33,000		33,000
Transition obligation	195,000	(12,124)[a]	182,876
	$ 183,425	$ 0	$ 183,425

[a]The maximum settlement gain subject to recognition in income is the net gain included in accumulated other comprehensive income subsequent to transition plus any transition asset remaining in accumulated other comprehensive income ($44,575 + $0 = $44,575) (paragraph 92). If, as in this case, only part of the accumulated postretirement benefit obligation is settled, a pro rata portion of the maximum gain based on the relationship of the accumulated postretirement benefit obligation settled to the total accumulated postretirement benefit obligation ($70,000 ÷ $257,000 or 27.2%) is subject to recognition in income. That amount ($44,575 × 27.2% = $12,124) must first reduce any transition obligation remaining in accumulated other comprehensive income; any excess is recognized in income in the current period (paragraph 93). In this case, the settlement gain is entirely offset against the transition obligation remaining in accumulated other comprehensive income.

Case 8B—Settlement When a Transition Asset Remains in Accumulated Other Comprehensive Income

487. Company M sponsors a postretirement life insurance plan. On January 2, 20X5, Company M settles the accumulated postretirement benefit obligation for its current retirees ($200,000) through the purchase of nonparticipating life insurance contracts.

488. Pursuant to paragraphs 92 and 93, a settlement gain of $78,506 is recognized in income, determined as follows:

	January 2, 20X5		
	Before Settlement	Settlement	After Settlement
Accumulated postretirement benefit obligation	$(257,000)	$ 200,000	$ (57,000)
Plan assets at fair value	350,900	(200,000)	150,900
Funded status and recognized [asset]	$ 93,900	$ 0	$ 93,900
Accumulated other comprehensive income:			
Net gain	$ (44,575)	$ 34,679[a]	$ (9,896)
Prior service cost	33,000		33,000
Transition asset	(56,333)	43,827[a]	(12,506)
	$ (67,908)	$ 78,506	$ 10,598

[a]The maximum settlement gain is measured as the net gain included in accumulated other comprehensive income subsequent to transition plus the transition asset remaining in accumulated other comprehensive income ($44,575 + $56,333 = $100,908) (paragraph 92). Since only a portion of the accumulated postretirement benefit obligation is settled, a pro rata portion of the maximum gain based on the relationship of the accumulated postretirement benefit obligation settled to the total accumulated postretirement benefit obligation ($200,000 ÷ $257,000 or 77.8%) is subject to recognition in income. That amount ($100,908 × 77.8% = $78,506) must first reduce any transition obligation remaining in accumulated other comprehensive income ($0); any excess is recognized in income in the current period (paragraph 93). In this case, the entire settlement gain of $78,506 is recognized in income. The transition constraint of paragraph 112 that requires additional recognition in income of a *transition obligation* remaining in accumulated other comprehensive income in certain circumstances is not applicable because there is a *transition asset* remaining in accumulated other comprehensive income.

Case 8C—Effect of Mid-Year Settlement on Transition Constraint

489. A settlement is an event that requires remeasurement of the accumulated postretirement benefit obligation prior to the settlement. This case illustrates the accounting for a settlement of part of the accumulated postretirement benefit obligation that occurs mid-year and the interaction between that event and other provisions of the Statement, such as the constraint on delayed recognition in net periodic postretirement benefit cost of the transition obligation.

490. Company N's accumulated postretirement benefit obligation for its postretirement life insurance plan was $6,000,000, and there were no plan assets. In 20X3, the company establishes a policy of funding at the end of each year an amount equal to the benefits paid during the year plus the service and interest cost for the year. Benefits are paid at the end of each year and in 20X3 are $630,000, which is less than the net periodic postretirement benefit cost accrued for the year ($1,170,000); thus, no additional transition obligation is recognized in net periodic postretirement benefit cost pursuant to paragraph 112. Company N elects to amortize net gains and losses included in accumulated other comprehensive income in excess of the "corridor" over the average remaining service period of plan participants (paragraph 59 and paragraph 459, footnote a).

491. At the beginning of 20X4, Company N projects the life insurance benefits expected to be paid in 20X4 to retirees' beneficiaries to determine whether recognition in net periodic postretirement benefit cost of an additional amount of the transition obligation remaining in accumulated other comprehensive income will be required (paragraph 113). Although Company N is considering settling a portion of the accumulated postretirement benefit obligation, the effects of the settlement are not included in the projection because plan settlements are not anticipated for measurement or recognition prior to their occurrence. The projection indicates that no additional amount is required to be recognized in net periodic postretirement benefit cost. On June 30, 20X4, Company N contributes additional funds ($1,430,000) and settles a portion ($1,900,000) of the accumulated postretirement benefit obligation for its current retirees through the purchase of nonparticipating life insurance contracts.

492. The changes in the funded status of the plan and amounts included in accumulated other comprehensive income during the first six months of the year are as follows:

	Actual 12/31/X3	Six Months Postretirement Benefit Cost	Assets Contributed to Plan	Effects of Remeasurement Immediately before Settlement	Before Settlement 6/30/X4
Accumulated postretirement benefit obligation	$(6,600,000)	$ (457,000)[a]		$ 420,000[b]	$(6,637,000)
Plan assets at fair value	870,000	43,500[c]	$1,430,000	0[b]	2,343,500
Funded status and recognized liability	$(5,730,000)	(413,500)	$1,430,000	$ 420,000	$(4,293,500)
Accumulated other comprehensive income:					
Net (gain) or loss	$ 360,000	0		$ (420,000)[b]	$ (60,000)
Transition obligation	5,700,000	(150,000)			5,550,000
Total accumulated other comprehensive income	$ 6,060,000	(150,000)		$ (420,000)	$ 5,490,000[d]
Total net periodic postretirement benefit cost		$ (563,500)			

[a]Represents 6 months' service cost of $160,000 and interest cost of $297,000 on the accumulated postretirement benefit obligation for 20X4, assuming a 9% discount rate.

[b]A gain results from the remeasurement of the accumulated postretirement benefit obligation immediately prior to the settlement as a result of a change in the assumed discount rates based on the interest rates inherent in the price at which the accumulated postretirement benefit obligation for the retirees will be settled. No gain or loss results from remeasurement of plan assets.

[c]Represents 6 months' return on plan assets, assuming a 10% return.

[d]Because there is a settlement (treated as a benefit payment) and funds are provided by the employer to effect that settlement, the constraint on delayed recognition in net periodic postretirement benefit cost of the transition obligation pursuant to paragraph 112 may be applicable. The test to determine whether additional recognition in income is necessary should be done based on amounts for the full year (paragraph 494).

493. In accounting for a settlement, an employer must determine whether recognition in income of an additional amount of any transition obligation remaining in accumulated other comprehensive income is required pursuant to the constraint on delayed recognition in income (paragraph 112). Any additional transition obligation required to be recognized in income as a result of a settlement is recognized when the related settlement is recognized (paragraph 113) as illustrated in the following table. Detailed calculations are presented in paragraph 494.

	June 30, 20X4			
	Before Settlement	Settlement	Recognition in Income of Transition Obligation	After Settlement
Accumulated postretirement benefit obligation	$(6,637,000)	$ 1,900,000		$(4,737,000)
Plan assets at fair value	2,343,500	(1,900,000)		443,500
Funded status and recognized liability	$(4,293,500)	$ 0		$(4,293,500)
Accumulated other comprehensive income:				
Net (gain) or loss	$ (60,000)	$ 17,160[e]		$ (42,840)
Transition obligation	5,550,000	(17,160)[e]	$(718,822)	4,814,018
	$ 5,490,000	$ 0	$(718,822)	$ 4,771,178

[e]The maximum settlement gain subject to recognition in income is the net gain included in accumulated other comprehensive income subsequent to transition plus any transition asset remaining in accumulated other comprehensive income ($60,000 + $0 = $60,000). If, as in this case, only part of the accumulated postretirement benefit obligation is settled, a pro rata portion of the maximum gain based on the relationship of the accumulated postretirement benefit obligation settled to the total accumulated postretirement benefit obligation ($1,900,000 ÷ $6,637,000 or 28.6%) is subject to recognition in income. That amount ($60,000 × 28.6% = $17,160) must first reduce any transition obligation remaining in accumulated other comprehensive income (paragraph 93); any excess is recognized in income. In this situation, the settlement gain is entirely offset against the transition obligation remaining in accumulated other comprehensive income.

494. When a settlement occurs in the middle of the year, as in this example, the additional transition obligation to be recognized in income, if any, pursuant to the constraint in paragraph 112 is determined based on projected amounts for the full year. In this case, at June 30, 20X4, cumulative benefit payments from the date of transition to December 31, 20X4 are projected to exceed cumulative postretirement benefit cost accrued for that same period as illustrated in the following table. The additional transition obligation to be recognized in income is the amount by which cumulative benefit payments exceed cost accrued, or $718,822.

	Projected 12/31/X4
Benefit payments:	
Date of transition to beginning of 20X4	$ 9,160,000
20X4 excluding settlement	410,000
Settlement	1,900,000
Cumulative benefit payments	$11,470,000
Postretirement benefit cost recognized:	
Date of transition to beginning of 20X4	$ 9,700,000
20X4	1,051,178[f]
Cumulative cost recognized	$10,751,178
Benefit payments in excess of cost recognized	$ 718,822

[f]$563,500 for period 1/1/X4–6/30/X4 plus $487,678 for period 7/1/X4–12/31/X4. The net postretirement benefit cost of $487,678 recognized in the second half of 20X4 (paragraph 495) includes amortization ($130,108) of the transition obligation that remains in accumulated other comprehensive income after recognizing in income an additional portion ($718,822) of the transition obligation remaining in accumulated other comprehensive income pursuant to paragraph 112. Because determination of the additional portion of the transition obligation to be recognized in income and the transition obligation amortized in income in the second half of 20X4 are interrelated, those amounts are determined in a single computation that is intended to result in the transition obligation remaining in accumulated other comprehensive income at the end of the year that appropriately reflects the constraint of paragraph 112.

495. After the settlement, net periodic postretirement benefit cost for the remainder of the year is remeasured. The projected funded status of the plan and the amounts remaining in accumulated other comprehensive income follow:

	After Settlement 6/30/X4	Six Months Postretirement Benefit Cost	Benefit Payments	Assets Contributed to Plan	Projected 12/31/X4
Accumulated postretirement benefit obligation	$(4,737,000)	$ (379,745)[g]	$ 410,000		$(4,706,745)
Plan assets at fair value	443,500	22,175[h]	(410,000)	$1,246,745	1,302,420
Funded status and recognized liability	$(4,293,500)	(357,570)	$ 0	$1,246,745	$(3,404,325)
Accumulated other comprehensive income:					
Net gain	$ (42,840)	0			$ (42,840)
Transition obligation	4,814,018	(130,108)[i]			4,683,910
Total accumulated other comprehensive income	$ 4,771,178	(130,108)			$ 4,641,070
Total net periodic postretirement benefit cost		$ (487,678)			

[g]Represents 6 months' service cost of $150,000 and interest cost of $229,745 on the accumulated postretirement benefit obligation, assuming a 9.7% discount rate.

[h]Represents 6 months' return on plan assets, assuming a 10% return.

[i]Transition obligation remaining in accumulated other comprehensive income at 6/30/X4 of $4,814,018 ÷ 18.5 years remaining in amortization period = $260,217; half-year amortization = $130,108.

Illustration 9—Accounting for Curtailments

496. This Statement provides for delayed recognition in net periodic postretirement benefit cost of the effects of a plan initiation or a plan amendment, the transition obligation or transition asset, and gains or losses arising in the ordinary course of operations. That is, this Statement permits those amounts to be recognized in other comprehensive income with subsequent amortization in net periodic postretirement benefit cost. In certain circumstances, however, recognition in net periodic postretirement benefit cost of some or all of those amounts initially recognized in other comprehensive income is appropriate. Curtailments are events that may require income or expense recognition of certain amounts that were initially recognized in other comprehensive income.

497. A curtailment is an event that significantly reduces the expected years of future service of active plan participants or eliminates the accrual of defined benefits for some or all of the future services of a significant number of active plan participants. Such a reduction or elimination raises doubt about the continued existence of the future economic benefits of prior plan amendments. Therefore, an appropriate portion of the prior service cost remaining in accumulated other comprehensive income should be recognized in income when it is probable that a curtailment will occur, the effects are reasonably estimable, and the estimated effects of the curtailment are a net loss. When the estimated effects of a curtailment are a net gain, the gain should be recognized in income when the related employees terminate or the plan suspension or amendment is adopted (paragraphs 97–99). For purposes of measuring those effects, any transition obligation remaining in accumulated other comprehensive income is treated as prior service cost remaining in accumulated other comprehensive income. The following cases (9A and 9B, paragraphs 498–501) illustrate the accounting for curtailments.

Case 9A—Curtailment When a Gain and a Transition Obligation Remain in Accumulated Other Comprehensive Income

498. Company P sponsors a postretirement benefit plan. On October 29, 20X4, Company P decides to reduce its operations by terminating a significant number of employees effective December 31, 20X4. On October 29, 20X4, it is expected that a curtailment gain will result from the termination. A consequence of the curtailment is a significant reduction in the number of employees accumulating benefits under the plan. The *remaining years of expected service*

associated with those terminated employees who were plan participants at the date of transition is 22 percent of the remaining years of service of all plan participants at the date of transition. The *remaining years of service prior to full eligibility* associated with those terminated employees who were plan participants at the date of a prior plan amendment is 18 percent of the remaining years of service of all plan participants at the date of that plan amendment.

499. The sum of the effects of the plan curtailment is a gain of $5,160 that should be recognized in income when the related employees terminate (paragraph 99). That gain is determined as follows:

	December 31, 20X4		
	Before Curtailment	Curtailment	After Curtailment
Accumulated postretirement benefit obligation	$(257,000)	$ 54,000[a]	$(203,000)
Plan assets at fair value	73,000		73,000
Funded status and recognized liability	$(184,000)	$ 54,000	$(130,000)
Accumulated other comprehensive income:			
Net gain	$ (44,575)		$ (44,575)
Prior service cost	33,000	$ (5,940)[a]	27,060
Transition obligation	195,000	(42,900)[a]	152,100
Total accumulated other comprehensive income	$ 183,425	$ (48,840)	$ 134,585
Gain from curtailment		$ (5,160)	

[a]The effect of the curtailment consists of two components:

1. The transition obligation and prior service cost remaining in accumulated other comprehensive income associated with remaining years of service no longer expected to be rendered—measured as 22% (reduction in the remaining years of expected service associated with those terminated employees who were plan participants at the date of transition) of the transition obligation remaining in accumulated other comprehensive income of $195,000 ($42,900) and 18% (reduction in the remaining years of service prior to full eligibility for benefits associated with those terminated employees who were plan participants at the date of a prior plan amendment) of the prior service cost included in accumulated other comprehensive income of $33,000 related to that amendment ($5,940) (paragraph 97)
2. The gain from the decrease in the accumulated postretirement benefit obligation of $54,000 (due to the termination of employees whose accumulated benefits were not vested under the plan) in excess of the net loss included in accumulated other comprehensive income of $0, or $54,000 (paragraph 98(a)).

Case 9B—Curtailment Related to a Disposal of a Portion of the Business When a Loss and a Transition Obligation Remain in Accumulated Other Comprehensive Income

500. Company R sponsors a postretirement benefit plan. On December 31, 20X4, Company R sells a portion of its business at a gain of $100,000 before considering the effect of the related curtailment of its postretirement benefit plan. In connection with the sale, the number of employees accumulating benefits under the plan is significantly reduced; thus, a curtailment occurs. The *remaining years of expected service* associated with the terminated employees who were plan participants at the date of transition is 22 percent of the remaining years of service of all plan participants at the date of transition. The *remaining years of service prior to full eligibility* associated with the terminated employees who were plan participants at the date of that prior plan amendment is 18 percent of the remaining years of service of all plan participants at the date of that plan amendment.

501. The sum of the effects of the plan curtailment is a loss of $36,265 that should be recognized in income with the gain of $100,000 associated with Company R's sale of a portion of its business. The loss is determined as follows:

	December 31, 20X4		
	Before Curtailment	Curtailment	After Curtailment
Accumulated postretirement benefit obligation	$(343,000)	$ 54,000[a]	$(289,000)
Plan assets at fair value	73,000		73,000
Funded status and recognized liability	$(270,000)	$ 54,000	$(216,000)
Accumulated other comprehensive income:			
Net loss	$ 41,425	$ (41,425)[a]	$ 0
Prior service cost	33,000	(5,940)[a]	27,060
Transition obligation	195,000	(42,900)[a]	152,100
Total accumulated other comprehensive income	$ 269,425	$ (90,265)	$ 179,160
Curtailment loss		$ 36,265	

[a]The effect of the curtailment consists of two components:

1. The transition obligation and prior service cost remaining in accumulated other comprehensive income associated with remaining years of service no longer expected to be rendered—measured as 22% (reduction in the remaining years of expected service associated with those terminated employees who were plan participants at the date of transition) of the transition obligation remaining in accumulated other comprehensive income of $195,000 ($42,900) and 18% (reduction in the remaining years of service prior to full eligibility for benefits associated with those terminated employees who were plan participants at the date of a prior plan amendment) of the prior service cost included in accumulated other comprehensive income of $33,000 related to that amendment ($5,940) (paragraph 97)
2. The gain from the decrease in the accumulated postretirement benefit obligation of $54,000 (due to the termination of employees whose accumulated benefits were not vested under the plan) in excess of the net loss included in accumulated other comprehensive income of $41,425, or $12,575 (paragraph 98(a)).

Illustration 10—Accounting for a Partial Settlement and a Full Curtailment That Occur as a Direct Result of a Sale of a Line of Business

502. Company S sells a line of business on December 31, 20X4; prior to that date, the company had no formal plan for disposal of those operations. Company S has a separate postretirement benefit plan that provides health care benefits to retirees of the division that is sold. In connection with that sale, (a) all of the employees of that division are terminated by Company S resulting in no further accumulation of benefits under the postretirement benefit plan (a full curtailment), (b) most of the terminated employees are hired by the acquiring company (some terminated employees fully eligible for benefits elect to retire immediately), (c) an accumulated postretirement benefit obligation of $80,000 for postretirement benefits related to the hired employees is assumed by the acquiring company (a partial settlement, since the obligation for current retirees is retained by Company S), and (d) plan assets of $100,000, representing $80,000 for the settlement of the accumulated postretirement benefit obligation and $20,000 as an excess contribution, are transferred from the plan to the acquiring company. A $300,000 gain from the sale is calculated before considering the related effects on the plan.

503. The employer's accounting policy is to determine the effects of a curtailment before determining the effects of a settlement when both events occur simultaneously. Pursuant to paragraph 97, the prior service cost included in accumulated other comprehensive income associated with the portion of the future years of service that had been expected to be rendered, but as a result of a curtailment are no longer expected to be rendered, is a loss. When a full curtailment occurs, the entire prior service cost and transition obligation remaining in accumulated other comprehensive income is a loss because there are no future years of service to be rendered.

504. The effect of the curtailment is determined as follows:

	December 31, 20X4		
	Before Curtailment	Curtailment-Related Effects Resulting from Sale	After Curtailment
Accumulated postretirement benefit obligation	$(257,000)	$ (10,000)[a]	$(267,000)
Plan assets at fair value	110,000		110,000
Funded status and recognized liability	$(147,000)	$ (10,000)	$(157,000)
Accumulated other comprehensive income:			
Net gain	$ (49,575)	$ 10,000[a]	$ (39,575)
Prior service cost	33,000	(33,000)[b]	0
Transition obligation	195,000	(195,000)[c]	0
Total accumulated other comprehensive income	$ 178,425	$ (218,000)	$ (39,575)
Curtailment loss		$ 228,000	

[a]The increase in the accumulated postretirement benefit obligation as a result of the fully eligible employees retiring earlier than expected is a loss of $10,000. That loss reduces the net gain included in accumulated other comprehensive income of $49,575; any excess (none in this case) would be recognized in income as the effect of a curtailment (paragraph 98).

[b]Measured as 100% (reduction in the remaining years of service prior to full eligibility for benefits associated with those terminated employees who were plan participants at the date of a prior plan amendment) of the prior service cost included in accumulated other comprehensive income of $33,000 related to that amendment (paragraph 97).

[c]Measured as 100% (reduction in the remaining years of expected service associated with those terminated employees who were plan participants at the date of transition) of the transition obligation remaining in accumulated other comprehensive income of $195,000 (paragraph 97).

505. The $8,128 loss related to the settlement and transfer of plan assets that is recognized in income with the gain from the sale is determined as follows:

	December 31, 20X4		
	After Curtailment	Settlement and Transfer of Plan Assets	After Settlement
Accumulated postretirement benefit obligation	$(267,000)	$ 80,000[d]	$(187,000)
Plan assets at fair value	110,000	(100,000)[d]	10,000
Funded status and recognized liability	$(157,000)	$ (20,000)	$(177,000)
Accumulated other comprehensive income:			
Net gain	$ (39,575)	$ 11,872[e]	$ (27,703)
Prior service cost	0		0
Transition obligation	0		0
Total accumulated other comprehensive income	$ (39,575)	$ 11,872	$ (27,703)
Settlement loss		$ 8,128	

[d]The accumulated postretirement benefit obligation for the employees hired by the purchaser is determined to be $80,000 and is settled when Company S transfers plan assets of an equal amount to the purchaser. In connection with the purchase agreement, Company S transfers an additional $20,000 of plan assets.

[e]Represents a pro rata amount of the maximum gain based on the relationship of the accumulated postretirement benefit obligation settled to the total accumulated postretirement benefit obligation ($80,000 ÷ $267,000 or 30%). The maximum gain is measured as the net gain included in accumulated other comprehensive income subsequent to transition plus any transition asset remaining in accumulated other comprehensive income ($39,575 + $0 = $39,575). The settlement gain is, therefore, 30% of $39,575, or $11,872; recognition in income of that gain is subject to first reducing any transition obligation remaining in accumulated other comprehensive income. As there is no transition obligation remaining in accumulated other comprehensive income (the remainder was recognized in income in connection with the curtailment), the gain of $11,872 is recognized in income together with the excess $20,000 transfer of plan assets as part of the net gain from the sale (paragraphs 92 and 93).

506. The sum of the effects related to postretirement benefits resulting from the sale is a loss of $236,128, the components of which are as follows:

Curtailment loss (paragraph 504)	$228,000
Net settlement loss (paragraph 505)	8,128
Effects of sale	$236,128

Illustration 11—Accounting for the Effects of an Offer of Special Termination Benefits

507. The measurement of the effects of an offer of special termination benefits pursuant to paragraphs 101 and 102 and the accounting for the related curtailment are illustrated in the following paragraphs.

508. On January 16, 20X5, Company T offers for a short period of time (until January 30, 20X5) special benefits to its employees who elect voluntary termination of employment during that period (special termination benefits). As part of the offer, employees who voluntarily terminate will be credited with an additional five years of service and five years of age to determine eligibility for postretirement health care benefits. Employees are normally eligible for those benefits upon attaining age 55 and rendering at least 20 years of service.

509. On January 30, 20X5, employees representing 18 percent of the work force accept the offer of special termination benefits. For those employees, the accumulated postretirement benefit obligation attributed to prior service periods based on their previously expected retirement dates (without consideration of the special offer) is $280,000. If those employees were assumed to terminate (retire) immediately upon attaining full eligibility for benefits (age 55 with 20 years of service), the accumulated postretirement benefit obligation for those employees would be $450,000. The accumulated postretirement benefit obligation for those employees after they accept the offer of the special termination benefits (full eligibility date accelerated, benefit coverage begins immediately) is $630,000.

510. The *remaining years of expected service* associated with the terminated employees who were plan participants at the date of transition is 24 percent of the remaining years of service of all plan participants at the date of transition. In addition, the portion of the prior service cost remaining in accumulated other comprehensive income arising from a prior plan amendment associated with the *remaining years of service prior to full eligibility* that are no longer expected to be rendered by the terminated employees is $25,000.

511. Pursuant to paragraph 99, if the sum of the effects resulting from a curtailment is a net loss, it shall be recognized in income when it is probable that a curtailment will occur and the effects are reasonably estimable. In this illustration, the effects resulting from the curtailment are not reasonably estimable until January 30, 20X5, the acceptance date of the offer of special termination benefits. Consequently, at January 30, 20X5, the employer recognizes a loss of $453,400 that includes the cost of the special termination benefits ($180,000) and the net loss from the curtailment ($273,400) determined as follows:

	January 30, 20X5			
	Before Employee Terminations	Special Termination Benefits	Effect of Curtailment	After Employee Terminations
Accumulated postretirement benefit obligation:				
Employees accepting offer	$(280,000)	$ (180,000)[a]	$ (170,000)[b]	$ (630,000)
Other employees	(633,000)			(633,000)
	(913,000)	(180,000)	(170,000)	(1,263,000)
Plan assets at fair value	141,000			141,000
Funded status and recognized liability	$(772,000)	$ (180,000)	$ (170,000)	$(1,122,000)
Accumulated other comprehensive income:				
Net gain	$ (88,000)		$ 88,000[b]	$ 0
Prior service cost	148,500		(25,000)[c]	123,500
Transition obligation	693,333		(166,400)[c]	526,933
Total accumulated other comprehensive income	$ 753,833		$ (103,400)	$ 650,433
Net loss		$ 180,000	$ 273,400	

[a]The loss from acceptance of the special termination benefits is $180,000 ($450,000 – $630,000), representing the difference between (1) the accumulated postretirement benefit obligation measured assuming that active plan participants not yet fully eligible for benefits would terminate employment at their full eligibility date and that fully eligible plan participants would retire immediately and (2) the accumulated postretirement benefit obligation reflecting the special termination benefits (paragraph 102).

[b]The increase in the accumulated postretirement benefit obligation as a result of the employees (fully eligible plan participants and other active plan participants not yet fully eligible for benefits) retiring at a date earlier than expected is a loss of $170,000 ($280,000 – $450,000). That amount is reduced by the net gain of $88,000 included in accumulated other comprehensive income (paragraph 98(b)) as part of the accounting for the curtailment.

[c]Additional effects of the curtailment are (1) the reduction of $25,000 in the prior service cost included in accumulated other comprehensive income (arising from a prior plan amendment) associated with the remaining years of service prior to full eligibility that are no longer expected to be rendered by the terminated employees and (2) the reduction of $166,400 in the transition obligation remaining in accumulated other comprehensive income associated with remaining years of service no longer expected to be rendered—measured as 24% (reduction in the remaining years of expected service associated with those employees affected by the early retirement who were plan participants at the date of transition) of the transition obligation remaining in accumulated other comprehensive income of $693,333 (paragraph 97).

Appendix D

BACKGROUND INFORMATION

512. In 1979, the Board added other postemployment benefits to its project on employers' accounting for pensions. The Board was concerned about the lack of information in financial statements about the cost of and obligation for other postemployment benefits. Evidence suggested that most large employers, as well as many smaller ones, provided health care and life insurance benefits to their retirees and were accounting for those benefits on a pay-as-you-go (cash) basis. Existing accounting pronouncements did not cover postretirement benefits provided outside a pension plan.

513. Other postemployment benefits were first considered in a 1981 FASB Discussion Memorandum, *Employers' Accounting for Pensions and Other Postemployment Benefits.* In its 1982 Preliminary Views, *Employers' Accounting for Pensions and Other Postemployment Benefits,* the Board tentatively concluded that the cost of postemployment health care and life insurance provided to retirees should be accrued during the service lives of the employees expected to receive benefits under those plans. The Board did not consider the cash basis and terminal accrual (accrual at retirement) methods to be acceptable methods for recognizing the cost of those benefits.

514. The Board based its tentative conclusion on its view that an employer has an obligation for promised postretirement benefits to the extent that future payments are probable and the service required of retirees and future retirees in exchange for those benefits has been rendered. That view led to the conclusion that postemployment benefits are a form of deferred

compensation. Those views were reiterated in a 1983 FASB Discussion Memorandum, *Employers' Accounting for Pensions and Other Postemployment Benefits,* that addressed additional issues not raised in the 1981 Discussion Memorandum. However, in considering comments on that second Discussion Memorandum, the Board concluded that the accounting issues related to other postemployment benefits were being overshadowed by pension issues.

515. In February 1984, the Board concluded that it should address employers' accounting for postemployment benefits other than pensions as a separate project. As an interim measure, in 1984 the Board issued FASB Statement No. 81, *Disclosure of Postretirement Health Care and Life Insurance Benefits*. In April 1987, FASB Technical Bulletin No. 87-1, *Accounting for a Change in Method of Accounting for Certain Postretirement Benefits,* was issued to provide temporary guidance to employers making a voluntary change in their method of accounting for postretirement health care benefits and postretirement life insurance benefits provided outside a pension plan.

516. A task force was appointed in December 1986. Employers' accounting for postretirement benefits was addressed at 29 public Board meetings and 3 public task force meetings between February 1987 and October 1988. In February 1989, the Board issued an Exposure Draft, *Employers' Accounting for Postretirement Benefits Other Than Pensions.* The Exposure Draft proposed standards of financial accounting and reporting for an employer that offers postretirement benefits other than pensions to its employees. Twenty-five companies participated in a field test of the Exposure Draft that was sponsored by the Financial Executives Research Foundation.

517. The Board received more than 475 comment letters in response to the Exposure Draft. Public hearings on the Exposure Draft were conducted in October and November 1989. Sixty-two organizations and individuals presented their views at the 5 days of hearings. Based on the information received in the comment letters and at the public hearings, the Board reconsidered its proposals in the Exposure Draft at 28 public Board meetings during the remainder of 1989 and 1990. The task force met at a public meeting in June 1990 to discuss the Board's tentative conclusions on employers' accounting for postretirement benefits. Appendix B discusses the basis for the Board's conclusions, including reasons for changes made to the provisions of the 1989 Exposure Draft.

Appendix E

GLOSSARY

518. This appendix contains definitions of certain terms used in accounting for postretirement benefits.

Accumulated postretirement benefit obligation

The actuarial present value of benefits attributed to employee service rendered to a particular date. Prior to an employee's full eligibility date, the accumulated postretirement benefit obligation as of a particular date for an employee is the portion of the expected postretirement benefit obligation attributed to that employee's service rendered to that date; on and after the full eligibility date, the accumulated and expected postretirement benefit obligations for an employee are the same.

Active plan participant

Any active employee who has rendered service during the credited service period and is expected to receive benefits, including benefits to or for any beneficiaries and covered dependents, under the postretirement benefit plan. Also refer to **Plan participant.**

Actual return on plan assets (component of net periodic postretirement benefit cost)

The change in the fair value of the plan's assets for a period including the decrease due to expenses incurred during the period (such as income tax expense incurred by the fund, if applicable), adjusted for contributions and benefit payments during the period.

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 (for example, by means of decrements for events such as death, disability, or withdrawal) between the specified date and the expected date of payment.

Amortization

Usually refers to the process of reducing a recognized liability systematically by recognizing revenues or of reducing a recognized asset systematically by recognizing expenses or costs. In

accounting for postretirement benefits, amortization is also used to refer to the systematic recognition in net periodic postretirement benefit cost over several periods of amounts previously recognized in other comprehensive income, that is, gains or losses, prior service cost or credits, and any transition obligation or asset.

Assumed per capita claims cost (by age)

The annual per capita cost, for periods after the measurement date, of providing the postretirement health care benefits covered by the plan from the earliest age at which an individual could begin to receive benefits under the plan through the remainder of the individual's life or the covered period, if shorter. To determine the assumed per capita claims cost, the per capita claims cost by age based on historical claims costs is adjusted for assumed health care cost trend rates. The resulting assumed per capita claims cost by age reflects expected future costs and is applied with the plan demographics to determine the amount and timing of future gross eligible charges. Also refer to **Gross eligible charges** and **Per capita claims cost by age.**

Assumptions

Estimates of the occurrence of future events affecting postretirement benefit costs, such as turnover, retirement age, mortality, dependency status, per capita claims costs by age, health care cost trend rates, levels of Medicare and other health care providers' reimbursements, and discount rates to reflect the time value of money.

Attribution

The process of assigning postretirement benefit cost to periods of employee service.

Attribution period

The period of an employee's service to which the expected postretirement benefit obligation for that employee is assigned. The beginning of the attribution period is the employee's date of hire unless the plan's benefit formula grants credit only for service from a later date, in which case the beginning of the attribution period is generally the beginning of that credited service period. The end of the attribution period is the full eligibility date. Within the attribution period, an equal amount of the expected postretirement benefit obligation is attributed to each year of service unless the plan's benefit formula attributes a disproportionate share of the expected postretirement benefit obligation to employees' early years of service. In that case, benefits are attributed in accordance with the plan's benefit formula. Also refer to **Credited service period.**

Benefit formula

The basis for determining benefits to which participants may be entitled under a postretirement benefit plan. A plan's benefit formula specifies the years of service to be rendered, age to be attained while in service, or a combination of both that must be met for an employee to be eligible to receive benefits under the plan. A plan's benefit formula may also define the beginning of the credited service period and the benefits earned for specific periods of service.

Benefits

The monetary or in-kind benefits or benefit coverage to which participants may be entitled under a postretirement benefit plan, including health care benefits, life insurance not provided through a pension plan, and legal, educational, and advisory services.

Captive insurer

An insurance company that does business primarily with related entities.

Contributory plan

A plan under which retirees or active employees contribute part of the cost. In some contributory plans, retirees or active employees wishing to be covered must contribute; in other contributory plans, participants' contributions result in increased benefits.

Cost-sharing (provisions of the plan)

The provisions of the postretirement benefit plan that describe how the costs of the covered benefits are to be shared between the employer and the plan participants. Cost-sharing provisions describe retired and active plan participants' contributions toward their postretirement health care benefits, deductibles, coinsurance, out-of-pocket limitations on participant costs, caps on employer costs, and so forth.

Credited service period

Employee service period for which benefits are earned pursuant to the terms of the plan. The beginning of the credited service period may be the

date of hire or a later date. For example, a plan may provide benefits only for service rendered after a specified age. Service beyond the end of the credited service period does not earn any additional benefits under the plan. Also refer to **Attribution period.**

Curtailment (of a postretirement benefit plan)
An event that significantly reduces the expected years of future service of active plan participants or eliminates the accrual of defined benefits for some or all of the future services of a significant number of active plan participants.

Defined benefit postretirement plan
A plan that defines postretirement benefits in terms of monetary amounts (for example, $100,000 of life insurance) or benefit coverage to be provided (for example, up to $200 per day for hospitalization, 80 percent of the cost of specified surgical procedures, and so forth). Any postretirement benefit plan that is not a defined contribution postretirement plan is, for purposes of this Statement, a defined benefit postretirement plan.

Defined contribution postretirement plan
A plan that provides postretirement benefits in return for services rendered, provides an individual account for each plan participant, and specifies how contributions to the individual's account are to be determined rather than specifies the amount of benefits the individual is to receive. Under a defined contribution postretirement plan, the benefits a plan participant will receive depend solely on the amount contributed to the plan participant's account, the returns earned on investments of those contributions, and the forfeitures of other plan participants' benefits that may be allocated to that plan participant's account.

Dependency status
The status of a current or former employee having dependents (for example, a spouse or other relatives) who are expected to receive benefits under a postretirement benefit plan that provides dependent coverage.

Discount rates
The rates used to reflect the time value of money. Discount rates are used in determining the present value as of the measurement date of future cash flows currently expected to be required to satisfy the postretirement benefit obligation. Also refer to **Actuarial present value.**

Expected long-term rate of return on plan assets
An assumption about the rate of return on plan assets reflecting the average rate of earnings expected on existing plan assets and expected contributions to the plan during the period.

Expected postretirement benefit obligation
The actuarial present value as of a particular date of the benefits expected to be paid to or for an employee, the employee's beneficiaries, and any covered dependents pursuant to the terms of the postretirement benefit plan.

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 plan 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.

Full eligibility (for benefits)
The status of an employee having reached the employee's full eligibility date. Full eligibility for benefits is achieved by meeting specified age, service, or age and service requirements of the postretirement benefit plan. Also refer to **Full eligibility date.**

Full eligibility date
The date at which an employee has rendered all of the service necessary to have earned the right to receive all of the benefits expected to be received by that employee (including any beneficiaries and dependents expected to receive benefits). Determination of the full eligibility date is affected by plan terms that provide incremental benefits expected to be received by or on behalf of an employee for additional years of service, unless those incremental benefits are trivial. Determination of the full eligibility date is *not* affected by plan terms that define when benefit payments commence or by an employee's current dependency status.

Fully eligible plan participants
Collectively, that group of former employees (including retirees) and active employees who have rendered service to or beyond their full eligibility date and who are expected to receive benefits under the plan, including benefits to their beneficiaries and covered dependents.

Funding policy
The program regarding the amounts and timing of contributions by the employer(s), plan participants, and any other sources to provide the benefits a postretirement benefit plan specifies.

Gain or loss
A change in the value of either the accumulated postretirement benefit obligation or the plan assets resulting from experience different from that assumed or from a change in an actuarial assumption, or the consequence of a decision to temporarily deviate from the substantive plan. Gains or losses that are not recognized in net periodic postretirement benefit cost when they arise are recognized in other comprehensive income. Those gains or losses are subsequently recognized as a component of net periodic postretirement benefit cost based on the recognition and amortization provisions of this Statement.

Gain or loss component (of net periodic postretirement benefit cost)
The sum of (a) the difference between the actual return on plan assets and the expected return on plan assets, (b) any gain or loss immediately recognized or the amortization of the net gain or loss recognized in accumulated other comprehensive income, and (c) any amount immediately recognized as a gain or loss pursuant to a decision to temporarily deviate from the substantive plan. The gain or loss component is generally the net effect of delayed recognition in determining net periodic postretirement benefit cost of gains and losses (the net change in the net gain or loss recognized in accumulated other comprehensive income) except that it does not include changes in the accumulated postretirement benefit obligation occurring during the period and deferred for later recognition in net periodic postretirement benefit cost.

Gross eligible charges
The cost of providing the postretirement health care benefits covered by the plan to a plan participant, before adjusting for expected reimbursements from Medicare and other providers of health care benefits and for the effects of the cost-sharing provisions of the plan.

Health care cost trend rates
An assumption about the annual rate(s) of change in the cost of health care benefits currently provided by the postretirement benefit plan, due to factors other than changes in the composition of the plan population by age and dependency status, for each year from the measurement date until the end of the period in which benefits are expected to be paid. The health care cost trend rates implicitly consider estimates of health care inflation, changes in health care utilization or delivery patterns, technological advances, and changes in the health status of the plan participants. Differing types of services, such as hospital care and dental care, may have different trend rates.

Incurred claims cost (by age)
The cost of providing the postretirement health care benefits covered by the plan to a plan participant, after adjusting for reimbursements from Medicare and other providers of health care benefits and for deductibles, coinsurance provisions, and other specific claims costs borne by the retiree. Also refer to **Net incurred claims cost (by age).**

Insurance contract
A contract in which an insurance company unconditionally undertakes a legal obligation to provide specified benefits to specific individuals in return for a fixed consideration or premium. An insurance contract is irrevocable and involves the transfer of significant risk from the employer (or the plan) to the insurance company. If the insurance company providing the contract is 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 insurance contract for purposes of this Statement.

Interest cost (component of net periodic postretirement benefit cost)
The accrual of interest on the accumulated postretirement benefit obligation due to the passage of time.

Market-related value of plan assets
A balance used to calculate the expected return

on plan assets. Market-related value can 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 methods of calculating market-related value may be used for different classes of plan assets, but the manner of determining market-related value shall be applied consistently from year to year for each class of plan asset.

Medicare reimbursement rates
The health care cost reimbursements expected to be received by retirees through Medicare as mandated by currently enacted legislation. Medicare reimbursement rates vary by the type of benefits provided.

Multiemployer plan
A postretirement benefit 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 postretirement benefit plan maintained by more than one employer but not treated as a multiemployer plan. Multiple-employer plans are generally not collectively bargained and are intended to allow participating employers, commonly in the same industry, to pool their plan assets for investment purposes and to reduce the cost 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. Multiple-employer plans may 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 incurred claims cost (by age)
The employer's share of the cost of providing the postretirement health care benefits covered by the plan to a plan participant; incurred claims cost net of retiree contributions. Also refer to **Incurred claims cost (by age).**

Net periodic postretirement benefit cost
The amount recognized in an employer's financial statements as the cost of a postretirement benefit plan for a period. Components of net periodic postretirement benefit cost include service cost, interest cost, actual return on plan assets, gain or loss, amortization of prior service cost or credit, and amortization of the transition obligation or asset.

Nonparticipating insurance contract
An insurance contract that does not provide for the purchaser to participate in the investment performance or in other experience of the insurance company. Also refer to **Insurance 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.

Participating insurance contract
An insurance contract that provides for the purchaser to participate in the investment performance and possibly other experience (for example, morbidity experience) of the insurance company. Also refer to **Insurance contract.**

Participation right
A purchaser's right under a participating insurance contract to receive future dividends or retroactive rate credits from the insurance company.

Pay-related plan
A plan that has a benefit formula that bases benefits or benefit coverage on compensation, such as a final-pay or career-average-pay plan.

Per capita claims cost by age

The current cost of providing postretirement health care benefits for one year at each age from the youngest age to the oldest age at which plan participants are expected to receive benefits under the plan. Also refer to **Assumed per capita claims cost (by age).**

Plan

An arrangement that is mutually understood by an employer and its employees, whereby an employer undertakes to provide its employees with benefits after they retire in exchange for their services over a specified period of time, upon attaining a specified age while in service, or a combination of both. A plan may be written or it may be implied by a well-defined, although perhaps unwritten, practice of paying postretirement benefits or from oral representations made to current or former employees. Also refer to **Substantive plan.**

Plan amendment

A change in the existing terms of a plan. A plan amendment may increase or decrease benefits, including those attributed to years of service already rendered.

Plan assets

Assets—usually stocks, bonds, and other investments—that have been segregated and restricted (usually in a trust) to provide for postretirement benefits. The amount of plan assets includes amounts contributed by the employer (and by plan participants for a contributory plan) and amounts earned from investing the contributions, less benefits, income taxes, and other expenses incurred. 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, even though it may be intended that those assets be used to provide postretirement benefits. Amounts accrued by the employer as net periodic postretirement benefit cost but not yet paid to the plan are not plan assets. 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 are considered as reductions of plan assets.

Plan demographics

The characteristics of the plan population including geographical distribution, age, sex, and marital status.

Plan participant

Any employee or former employee who has rendered service in the credited service period *and is expected to receive employer-provided benefits* under the postretirement benefit plan, including benefits to or for any beneficiaries and covered dependents. Also refer to **Active plan participant.**

Plan termination

An event in which the postretirement benefit plan ceases to exist and all benefits are settled by the purchase of insurance contracts or by 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.

Postretirement benefit fund

Assets accumulated in the hands of a funding agency for the sole purpose of paying postretirement benefits when the claims are incurred or benefits are due. Those assets may or may not qualify as plan assets. Also refer to **Plan assets.**

Postretirement benefit plan

Refer to **Plan.**

Postretirement benefits

All forms of benefits, other than retirement income, provided by an employer to retirees. Those benefits may be defined in terms of specified benefits, such as health care, tuition assistance, or legal services, that are provided to retirees as the need for those benefits arises, such as certain health care benefits, or they may be defined in terms of monetary amounts that become payable on the occurrence of a specified event, such as life insurance benefits.

Postretirement benefits other than pensions

Refer to **Postretirement benefits.**

Postretirement health care benefits

A form of postretirement benefit provided by an employer to retirees for defined health care services or coverage of defined health care costs, such

as hospital and medical coverage, dental benefits, and eye care.

Prior service cost

The cost of benefit improvements attributable to plan participants' prior service pursuant to a plan amendment or a plan initiation that provides benefits in exchange for plan participants' prior service.

Retirees

Collectively, that group of plan participants that includes retired employees, their beneficiaries, and covered dependents.

Service cost (component of net periodic postretirement benefit cost)

The portion of the expected postretirement benefit obligation attributed to employee service during a period.

Settlement (of a postretirement benefit plan)

An irrevocable action that relieves the employer (or the plan) of primary responsibility for a postretirement 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 postretirement benefits and (b) purchasing nonparticipating insurance contracts for the accumulated postretirement benefit obligation for some or all of the plan participants.

Single-employer plan

A postretirement benefit 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.

Substantive plan

The terms of the postretirement benefit plan as understood by an employer that provides postretirement benefits and the employees who render services in exchange for those benefits. The substantive plan is the basis for the accounting for that exchange transaction. In some situations an employer's cost-sharing policy, as evidenced by past practice or by communication of intended changes to a plan's cost-sharing provisions, or a past practice of regular increases in certain monetary benefits may indicate that the substantive plan differs from the extant written plan.

Termination benefits

Benefits provided by an employer to employees in connection with their termination of employment. They may be either special termination benefits offered only for a short period of time or contractual benefits required by the terms of a plan only if a specified event, such as a plant closing, occurs.

Transition asset

The amount, as of the date this Statement is initially applied, of (a) the fair value of plan assets plus any recognized accrued postretirement benefit cost or less any recognized prepaid postretirement benefit cost in excess of (b) the accumulated postretirement benefit obligation.

Transition obligation

The amount, as of the date this Statement is initially applied, of (a) the accumulated postretirement benefit obligation in excess of (b) the fair value of plan assets plus any recognized accrued postretirement benefit cost or less any recognized prepaid postretirement benefit cost.

Unfunded accumulated postretirement benefit obligation

The accumulated postretirement benefit obligation in excess of the fair value of plan assets.

Appendix F

ADDITIONAL IMPLEMENTATION GUIDANCE

Note: This appendix contains additional implementation guidance for applying the provisions of this Statement. Numbers in brackets refer to the paragraphs in this Statement to which the question and answer relate. To simplify the illustrations, the effects of income taxes have been ignored.

Scope

F1. *Q*—Does this Statement apply to long-term disability benefits paid to former employees on disability retirement under an employer's postretirement benefit plan? [6, 11, 136, 137]

A—Yes. This Statement applies to postretirement benefits expected to be provided to disabled employees, whether in cash or in kind, for example, disability medical benefits. Paragraphs 136 and 137 contain additional discussion of this issue. Disability benefits paid to former or inactive employees not on disability retirement should be accounted for under FASB Statement No. 112, *Employers' Accounting for Postemployment Benefits.* Disability income benefits paid pursuant to a pension plan should be accounted for under FASB Statement No. 87, *Employers' Accounting for Pensions.* Thus, which Statement applies depends on the type of plan that pays the benefits and on how the employer defines *retirement* in administering its plan(s).

F2. *Q*—If some employees at retirement voluntarily elect under the provisions of the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA), as amended, to continue their health care coverage provided through the active employee health care plan and the cost to the employer of their continuing coverage exceeds the retirees' contributions, should the employer account for that cost under this Statement? [6]

A—No. The right to continue health care coverage under COBRA does not constitute a postretirement benefit plan per se because an employee need not be a retiree to receive that benefit. It is a right generally available upon termination of employment. The employer should account for the excess cost in accordance with Statement 112.

F3. *Q*—A collectively bargained defined benefit postretirement health care plan of a single employer may stipulate that benefits will be provided for the duration of the collective-bargaining agreement or may imply or explicitly state that benefits are subject to renegotiation upon the expiration of the current collective-bargaining agreement. Past negotiations have resulted in the continuation of the plan, although the plan has been amended at various times. Should the accumulated postretirement benefit obligation (APBO) be measured based only on benefits expected to be paid during the period the current agreement will be in force? [8, 23]

A—No. The APBO should be measured assuming that benefits will be provided beyond the period covered by the current collective-bargaining agreement. Paragraph 8 states, "Absent evidence to the contrary, it shall be presumed that an employer that has provided postretirement benefits in the past or is currently promising those benefits to employees will continue to provide those future benefits." Thus, like accounting for the substantive plan, the practice of providing postretirement benefits creates a presumption that postretirement benefits will continue to be provided in the future. Unless the most recently negotiated collective-bargaining agreement explicitly states for the first time that the payment of postretirement benefits will be discontinued upon the contract's expiration and that is the expectation of the parties to the agreement, the presumption of an ongoing plan is not overcome by the presence of an expiration date for the present collective-bargaining agreement.

Deferred Compensation Contracts

F4. *Q*—How should an employer account for a deferred compensation contract that does not provide a vested benefit for the employee's prior service at the date the contract is entered into? For example, an employee must render 30 years of service to receive benefits under a deferred compensation contract and has rendered 16 years of service at the date of entering into the contract. Credit is granted for that prior service in determining eligibility for the benefit to be provided. Should the total obligation be accrued over the remaining 14 years of service, or should the employer immediately recognize the portion related to the 16 years of service already rendered? [9, 13]

A—In this example, the employer should accrue the total obligation under the deferred compensation contract in a systematic and rational manner over the employee's future service period to the date full eligibility for the benefits is attained, that is, over the next 14 years, pursuant to paragraph 6 of APB Opinion No. 12, *Omnibus Opinion—1967,* as amended by this Statement. If the employee is eligible to receive a portion of the benefits without regard to future service, that is, the credit for prior service results in a vested benefit, the obligation for that benefit should be fully accrued at the time the contract is entered into.

F5. *Q*—An employee becomes fully eligible for benefits under a deferred compensation contract five years after entering into the contract. The contract states, however, that if the employee dies or becomes disabled, benefits will be payable immediately. The contract is not one of a group of contracts that possess the characteristics of a pension plan. What is the attribution period? [9, 13]

A—If the employee is expected to render service over the next five years, benefits should be attributed over that service period. If death or disability unexpectedly occurs during the five-year period, the benefit obligation should be remeasured and any previously unrecognized amount should be immediately recognized at the date of the event. If the employee is expected to terminate service within the next five years, an accrual is normally not required because the employee is not expected to receive benefits under the plan. However, in the rare situation that it is probable that death or disability will occur during the five-year period, the benefit should be accrued over the relevant service period.

Substantive Plan

F6. *Q*—Can future amendments to a written postretirement health care plan that change the amount of a defined dollar cap be anticipated as part of the substantive plan? [17, 23–25]

A—Yes, if the conditions in paragraphs 24 and 25 are satisfied. A defined dollar cap is part of an employer's cost-sharing arrangement under which the employer limits the amount it will spend for retiree benefits by defining the maximum dollar amount for each retiree or the retiree group to be applied by the employer toward the cost of retiree benefits. For example, a plan with a defined dollar cap may stipulate that the employer will pay for all retiree health care costs in a year up to a specified dollar limit. A past practice of regular increases (or decreases) in that defined dollar cap may indicate that the cost-sharing provisions of the substantive plan differ from the extant written plan.

F7. *Q*—Is a postretirement health care plan with a defined dollar cap considered to be a plan that provides benefits defined in terms of monetary amounts as discussed in paragraph 26? [16, 17, 26]

A—No. Changes in monetary benefits provided by one plan or changes in the amount of a defined dollar cap on cost sharing for a different plan may need to be anticipated as part of determining what are the substantive plans. However, the nature of the promises for the two plans differs. Benefits for the first plan are defined in monetary amounts, for example, a stipulated dollar amount of life insurance coverage, whereas benefits offered under the defined dollar capped plan are not defined in monetary amounts. Although the cap on the employer's contribution is defined in monetary terms, the benefits are the specified eligible medical claims with payment by the employer being no greater than the amount of that cap. Changes in the types of benefits or the types of health care costs covered by a plan cannot be anticipated.

Measurement Assumptions

F8. *Q*—Should the assumed discount rates used to measure an employer's postretirement benefit obligation be the same rates used to measure its pension benefit obligation under Statement 87? [31, 31A, 186–188]

A—The rates may be the same, or they may not be for various reasons. Similar to the provisions in Statement 87, the assumed discount rates under this Statement should reflect the rates at which an amount invested at the measurement date in a portfolio of high-quality debt instruments would provide the necessary future cash flows to pay benefits when due. However, differences could occur between the discount rates used to measure the pension benefit obligation and the discount rates used to measure the postretirement benefit obligation. For example, the expected timing of postretirement benefit payments may differ from the expected timing of pension benefit payments. Those differences could occur particularly if the participants in each plan are different. In addition, rates implicit in current prices of annuity contracts might be used to measure the pension benefit obligation, and no similar contracts may be available to settle the postretirement benefit obligation. (Refer to the question in paragraph F40.)

F9. *Q*—An employer sponsors a health care plan that provides benefits to both active employees and pre-age-65 retirees. The plan requires active employees and retirees to contribute to the plan. Can the contributions of active employees ever be used to reduce the employer's cost of providing benefits to retirees? [35]

A—Yes, but only if the amount contributed by active employees over their service periods exceeds the cost of providing their health care benefits while they are employed and the employer has no obligation to refund that excess. In that case, the excess would be applied to reduce the cost of the retirees' benefits. If active employee contributions do not exceed the cost of active benefits, the full amount of the active employees' contributions should be applied to the cost of their active benefits. The cost of providing health care benefits to active employees should be measured assuming only active employees are covered by the plan.

F10. *Q*—An employer has a contributory health care plan covering active employees and retirees under which retirees pay 100 percent of the average cost of benefits determined based on the combined experience of active employees and retirees. The employer pays all of the remaining cost. The active employees do not contribute to the plan. Under this arrangement, does the employer have an obligation under this Statement? [35]

A—Yes, if the actual cost of providing benefits to the retirees is greater than their contributions. In that case, the employer is subsidizing a portion of the cost of the retirees' benefits. Footnote 14 to paragraph 35 states:

> In some cases, retiree contributions are established based on the average per capita cost of benefit coverage under an employer's health care plan that provides coverage to both active employees and retirees. However, the medical cost of the retirees may cause the average per capita cost of benefit coverage under the plan to be higher than it would be if only active employees were covered by the plan. In that case, the employer has a postretirement benefit obligation for the portion of the expected future cost of the retiree health care benefits that are not recovered through retiree contributions, Medicare, or other providers of health care benefits.

Thus, the employer would have an obligation for the difference between the expected cost of providing the retirees' benefits and the retirees' expected contributions, whether those contributions are established at 100 percent of the average cost or at a lesser amount.

F11. *Q*—Are there any circumstances in which an employer may measure its postretirement health care benefit obligation by projecting the cost of premiums for purchased health care insurance? [36–39]

A—Yes. For a plan that stipulates that the benefit to be provided is the payment of certain health insurance premiums for retirees rather than the payment of their health care claims, the employer should project the cost of those future premiums in measuring its benefit obligation. That projection requires an assessment of how future health care costs will affect future premiums.

For a plan that stipulates that the benefit to be provided is the payment of retirees' health care claims, the cost of premiums for insurance that an employer expects to purchase to finance its obligation may be used to measure the obligation if it produces a reasonable estimate of the future cost of benefits covered by the plan. In some situations, such as in a community-rated insurance plan that provides the type of benefits covered by the employer's plan and in which the premium cost to the employer is based on the experience of all participating employers, the claims experience of a single employer generally will have little impact on its premiums. Accordingly, in those situations a projection of future premiums based on the current premium structure and expected changes in the general level of health care costs may provide a reasonable estimate of the employer's obligation. However, if premiums are adjusted for the actual claims experience or the age and sex of the plan's participants (an experience-rated plan), the foregoing projection of the employer's obligation may not produce a reasonable estimate of the future cost of the underlying benefits of the plan.

F12. *Q*—If an employer has measured its postretirement health care benefit obligation by projecting the cost of premiums for purchased health care insurance, does that reduce or eliminate the applicability of any provisions of this Statement, for example, calculating and disclosing service and interest cost? [6, 46]

A—No. The employer should follow this Statement in its entirety including calculating and disclosing the components of net periodic postretirement benefit cost, which would still include service cost for active employees and interest cost.

F13. *Q*—Should employers assume a trend of decreasing (or increasing) Medicare reimbursement rates if Medicare has consistently reduced (or increased) the portion of benefits it will cover? For example, certain health care costs may have increased by 15 percent last year but Medicare may have only covered a smaller increase, which increased the employer's or retirees' share of the cost of benefits. Should an employer assume that such a reduction in Medicare coverage would continue when determining its postretirement benefit obligation? [40]

A—Changes in Medicare coverage should be projected only if those changes result from currently enacted legislation or regulations. For instance, to the extent that certain coverage under Medicare changes as a result of applying a legislated formula or historical administrative practice, an employer should consider the effects of those changes in projecting Medicare coverage in future years. Doing so may result in a higher or lower amount of coverage. Future legislation that would change the portion of costs covered by Medicare should not be anticipated even though a historical trend of those changes may be apparent.

Attribution

F14. *Q*—An employer modifies the eligibility requirements under its postretirement benefit plan by changing the plan's credited service period from "25 years of service after age 40" to "15 years of service after both (a) reaching age 50 and (b) rendering 10 years of service." What is the beginning of the attribution period? [44]

A—The attribution period begins at the date of hire because the plan has an undefined credited service period. The amended plan still requires 25 years of credited service. However, it grants credit for 10 years of service before age 50 and those years of service are not defined. The effect of the change in eligibility requirements is to lengthen the attribution period for employees hired prior to age 40.

F15. *Q*—An employer provides retiree health care and life insurance benefits under one plan. Employees are eligible for health care and death benefits upon attaining age 55 and having rendered 20 years of service; however, the life insurance benefits are based on final pay. Does basing the life insurance benefits on final pay extend the full eligibility date to a plan participant's expected retirement date? For example, if an employee is expected to fulfill the 20-year service requirement before age 55 and is expected to retire at age 62 with salary increases in all years of service, is the employee's full eligibility date the date he or she reaches age 62? [21, 44]

A—Yes, provided the incremental increase in the life insurance benefits offered under the plan for an employee's service after age 55 is not trivial in relation to the total benefits expected to be received by the employee under that plan. The full eligibility date is defined as the date at which an employee has rendered all of the service necessary to have earned the right to receive all of the benefits expected to be received by that employee under the plan. Paragraph 21 states that "determination of the full eligibility date is affected by plan terms that provide incremental benefits expected to be received by or on behalf of an employee for additional years of service, *unless those incremental benefits are trivial*" (emphasis added). The plan described has an indefinite credited service period, since the qualifying 20-year period is unspecified. Accordingly, the attribution period for that plan begins at the date of hire and ends on the full eligibility date.

F16. *Q*—Would the answer to the question in paragraph F15 be different if the benefits are provided and accounted for under two separate plans, one providing life insurance benefits and the other providing health care benefits? [21, 44, 76]

A—Yes. If the life insurance and health care benefits are provided and accounted for under two separate plans, the full eligibility date for participants in the life insurance plan would not influence the determination of the full eligibility date for participants in the health care plan.

F17. *Q*—If the terms of the plan in the question in paragraph F15 specified which 20-year service period constituted the credited service period, for example, the first 20 years after date of hire, or the first 20 years of service after age 35, would basing life insurance benefits on final pay still extend the full eligibility date to the expected date of retirement? [21, 43, 44]

A—Yes, assuming the incremental life insurance benefits after the defined 20 years of service are nontrivial. If the plan formula specifies the first 20 years as the credited service period, the employer needs to assess whether that results in a frontloaded benefit as described in paragraph 43. If that provision results in a frontloaded benefit, the benefit obligation should not be attributed ratably to each year of service in the attribution period but should be attributed in accordance with the plan's benefit formula.

F18. *Q*—Under what conditions would a plan be considered a frontloaded plan? [43, 44, 412]

A—A plan with a benefit formula that attributes all or a disproportionate share of the expected postretirement benefit obligation (EPBO) to employees' early years of service in the credited service period is frontloaded. For that type of plan, the EPBO should not be attributed ratably to each year of service in the credited service period but should be attributed in accordance with the benefit formula. Whether a plan is frontloaded is determined by considering the active participants as a group rather than applying the benefit formula to each individual participant. Paragraph 412 contains an example of a benefit formula that results in a frontloaded benefit for a plan that provides only postretirement death benefits.

A frontloaded plan may provide two or more benefits, such as health care and life insurance benefits, that are earned under different benefit formulas. For example, assume the typical participant covered by the plan described in the question in paragraph F15 is an individual hired at age 20 who is expected to retire at age 62 with 42 years of service. If the EPBO at age 40 for that employee is $39,405 ($28,500

for health care benefits and $10,905[39] for life insurance benefits), a ratable (1/42) allocation of the EPBO to each year of service would result in an accumulated postretirement benefit obligation (APBO) of $18,764[40] ($13,571[41] for health care benefits and $5,193[42] for life insurance benefits) at the end of the 20th year. However, if the plan's benefit formulas for both health care and life insurance benefits stipulate that employees are not required to render additional service after their first 20 years in order to receive those benefits, the aggregate benefits under the plan may be frontloaded, even though life insurance benefits increase for additional years of service beyond the 20th year.

If the combined values of both health care and life insurance benefits earned based on their respective benefit formulas after 20 years are significantly greater than the APBO that would result from a ratable allocation of the EPBO, a disproportionate share of the EPBO is attributable under the benefit formulas to the employee's early years of service. In that case, the attribution of the obligation for both benefits under the plan should follow their respective benefit formulas. Following the benefit formulas in this example, the APBO for health care and for life insurance benefits for the hypothetical employee at the end of 20 years is $28,500 and $3,728,[43] respectively. Accordingly, the APBO for that employee at the end of the first 20 years of service should be $32,228 rather than $18,764; that is, the plan is frontloaded and benefits should be attributed following the benefit formula.

F19. *Q*—An employer has a retiree health care plan that bases benefits on length of service and requires employees to render a minimum of 10 years of service after attaining age 45 to be eligible for any benefits. However, upon attaining age 45, employees receive credit for 3 percent of the maximum benefit for each year of service before age 45. For example, at age 45 an employee hired at age 25 receives credit for 60 percent (3 percent × 20 years) of the plan's postretirement health care benefits. When does the credited service period begin? [44]

A—The credited service period begins at the date of hire because the amount of total benefits is based on the years of service rendered after that date.

F20. *Q*—An employer requires an employee to participate in its contributory active health care plan in order to be eligible to participate in its retiree health care plan. An employee can join the active plan at any time prior to retirement but must have worked 10 years and attained age 55 while in service to be eligible for benefits under the retiree plan. When does the attribution period begin? [44]

A—The attribution period for an employee who is or is expected to be a participant in the active plan begins at the date of hire because the plan's eligibility requirements do not specify which 10 years of service must be rendered in exchange for the benefits. That an employee must participate in the contributory active plan does not affect the determination of the attribution period. However, an employee would not be considered a plan participant if the employer expects that the employee will never contribute to the active plan and, therefore, will not be eligible to participate in the retiree plan.

F21. *Q*—Should an employer's annual accrual for the service cost component of net periodic postretirement benefit cost relate to only those employees who are in their credited service periods? [44, 47]

A—Generally, yes. However, if the credited service period begins later than the date of hire and is considered nominal relative to the employees' average total expected years of service to full eligibility, employees expected to receive benefits under the retiree plan should be considered plan participants at the date of hire, and the expected obligation for their benefits should be accrued from that date.

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[39] $10,905 equals the actuarial present value of life insurance benefits based on final pay, assuming the employee was hired at a salary of $15,000 that increases by 5 percent annually, a life expectancy of 75 years, and a discount rate of 7 percent.

[40] 20/42 × $39,405 = $18,764.

[41] 20/42 × $28,500 = $13,571.

[42] 20/42 × $10,905 = $5,193.

[43] Assumed life insurance benefit equal to year 20 salary of $39,799 discounted at 7 percent for 35 years = $3,728.

F22. *Q*—In determining the attribution period, what is considered a nominal credited service period? [44]

A—Judgment is required to determine whether a credited service period is nominal. Generally, a nominal credited service period is a period that is very short compared to employees' average total expected years of service prior to full eligibility.

Negative Plan Amendments and Curtailments

F23. *Q*—An employer's previous accounting for postretirement benefits has considered the written plan to be the substantive plan. On July 1, 20X1, its board of directors approves a negative plan amendment (that is, an amendment that reduces benefits attributable to prior service) that will be effective on January 1, 20X3. The employer intends to announce the negative plan amendment to plan participants on July 1, 20X2. When should the effects of the negative plan amendment be considered for accounting purposes? [23, 55]

A—The effects of the negative plan amendment should be accounted for as of July 1, 20X2 when it is communicated to plan participants and not as of July 1, 20X1, the date of the board's approval. The effects of a plan amendment, whether positive or negative, should be considered at the date the amendment is adopted only if it is communicated to plan participants at that time or within a reasonable period of time thereafter; that is, within the time period that would ordinarily be required to prepare information about the amendment and disseminate it to employees and retirees. The amendment in this instance will not be communicated within a reasonable period of time after its adoption. Therefore, the extant unamended written plan continues to be the substantive plan that should be accounted for because it represents the last plan whose terms were mutually understood by the employer and the plan participants.

F24. *Q*—Is it important to distinguish between a reduction in the accumulated postretirement benefit obligation (APBO) caused by a negative plan amendment and a reduction caused by a curtailment? [55, 98, 99]

A—Yes. Unless the plan is being terminated, a reduction in the APBO caused by a negative plan amendment that exceeds any transition obligation or prior service cost included in accumulated other comprehensive income is not immediately recognized as a reduction of current postretirement benefit costs. On the other hand, a reduction in the APBO caused by a curtailment is potentially recognizable as a current component of income.

F25. *Q*—What is the difference between a negative plan amendment and a curtailment that reduces the accumulated postretirement benefit obligation (APBO)? [55, 96, 98, 99]

A—A negative plan amendment is a change in existing plan terms that reduces or eliminates benefits attributed to employee services already rendered. A curtailment is an event that significantly reduces the expected years of future service of active plan participants, such as a plant closing, or eliminates future accruals of additional benefits for some or all of the future services of a significant number of active plan participants. If a curtailment reduces the expected postretirement benefit obligation, the associated reduction in the APBO is potentially recognizable as a current component of income. The following examples illustrate the difference between a negative plan amendment and a curtailment. The answer to the question in paragraph F30 provides additional illustrations.

Example 1—Negative Plan Amendment

On December 31, 20X1, Company A changes the terms of its retiree health care plan to require current and future retirees to contribute $100 per month toward the cost of benefits provided by the plan. The plan was previously noncontributory. As a result of the change, the APBO for both active employees and retirees at December 31, 20X1 decreases by $500,000. That reduction is a negative plan amendment because the change in plan terms has reduced the benefits under the plan attributed to employee service already rendered. A curtailment has not occurred because there has been no reduction in the expected years of future service of active plan participants and the plan continues to provide additional benefits for future services.

Example 2—Curtailment

On December 31, 20X1, Company B changes the terms of its retiree life insurance plan for future retirees from a death benefit equal to 5 percent of final pay for each year of service to a death benefit equal to 5 percent of the pay rate in effect at December 31, 20X1 for each year of service prior to that date. Because Company B switched the terms under which benefits are based to provide benefits only for services rendered prior to December 31, 20X1, the company will no longer provide benefits for future service and there will be no increases in retiree life insurance for any employee services rendered after that date. That change constitutes a curtailment because accruals of death benefits for future employee service are no longer required (that is, the change eliminates the need for future accruals of death benefits for all of the future services of the active plan participants). However, the change in plan terms does not result in a termination of the plan because there is a continuing obligation to pay the future death benefits already earned by employees and current retirees. Only the accrual of additional death benefits for employees' future services has been eliminated.

Because this plan was previously a final-pay plan, the APBO at December 31, 20X1 before the amendment included an amount based on projected future employee pay levels. In this case, that amount equaled $400,000. Thus, the APBO at December 31, 20X1 decreases by $400,000 as a result of the plan amendment because increases in employees' future pay levels will no longer increase their death benefits under the plan. That reduction is potentially a currently recognizable curtailment gain.

F26. *Q*—Why is the $400,000 in Example 2 of the question in paragraph F25 "potentially" a currently recognizable curtailment gain? [97–99]

A—Whether any or all of the $400,000 should be recognized currently as a component of net periodic postretirement benefit cost depends on the existence and amount of any net loss included in accumulated other comprehensive income that must be offset before that curtailment gain can be recognized. Any prior service cost or transition obligation included in accumulated other comprehensive income also will enter into determining the net curtailment gain or loss. (Refer to the question in paragraph F27.)

F27. *Q*—Should the accounting for a curtailment always consider any prior service cost or transition obligation included in accumulated other comprehensive income? [97]

A—Yes. A reduction of the expected years of future service of the work force, for example, termination of active plan participants who are not yet eligible for benefits or elimination of future accruals of defined postretirement benefits for a significant number of active plan participants, raises doubt about the continued existence of the future economic benefits of prior service cost included in accumulated other comprehensive income. Accordingly, this Statement requires recognition in net periodic postretirement benefit cost of any related prior service cost included in accumulated other comprehensive income. For purposes of accounting for a curtailment, any transition obligation remaining in accumulated other comprehensive income is considered to be prior service cost.

F28. *Q*—Does a curtailment result only from events that occur outside a postretirement benefit plan? [55, 96–99]

A—No. Although many curtailments may result from events that occur outside a plan, such as closing a plant, discontinuing a component of an entity, or otherwise terminating employees, a curtailment also can result from a plan amendment (including a negative plan amendment) that has the effect of eliminating the accrual of defined benefits for some or all of the future services of a significant number of active plan participants. (Refer to the question in paragraph F25, Example 2.) If such an amendment occurs, accounting for a curtailment should be applied to (a) any decrease in the accumulated postretirement benefit obligation (APBO) representing the reduction or elimination of benefits attributable to future service, which may result in a curtailment gain, (b) any increase in the APBO resulting from employees retiring earlier than expected as a result of the amendment, which may result in a curtailment loss, and (c) any prior service cost or any transition obligation remaining in accumulated other comprehensive income attributable to the future years of service of the employee group for which future accrual of benefits has been eliminated. Accounting for a curtailment is not applied to any newly created prior service cost. (Refer to the question in paragraph F30, Example 3 and footnote i to Example 5.)

F29. *Q*—Does a gain result if at the time of a curtailment there exists negative prior service cost included in accumulated other comprehensive income due to a previous plan amendment that reduced benefits under the plan? [55, 97]

A—Yes. Under paragraph 55, negative prior service cost included in accumulated other comprehensive income that results from an amendment that reduces benefits under the plan is treated the same as prior service cost that results from an amendment that improves benefits. For purposes of measuring the effect of a curtailment, prior service cost included in accumulated other comprehensive income includes any negative prior service cost from a prior plan amendment. Thus, the *negative* prior service cost included in accumulated other comprehensive income associated with the future years of service that are affected by the curtailment is a gain. That gain, to the extent it is not offset by any other effects of the curtailment, is currently recognized as a component of income.

F30. *Q*—What are examples of the accounting for a negative plan amendment that results in a curtailment? [55, 96–99]

A—The following examples illustrate the accounting in three different situations. Example 3 illustrates the accounting for a negative plan amendment that results in a curtailment gain. Example 4 illustrates the accounting for a negative plan amendment that results in a curtailment loss. Example 5 illustrates the accounting for a negative plan amendment and a curtailment that results in recognition as a component of net periodic postretirement benefit cost of prior service cost included in accumulated other comprehensive income.

Example 3—Negative Plan Amendment and Curtailment Gain

Company A sponsors an unfunded postretirement benefit plan whose only benefit is life insurance coverage equal to an employee's final pay. On December 31, 20X1, Company A amends its plan to eliminate that benefit for active employees who are not 40 years of age or older, which is a significant portion of its work force. The resulting reduction in the accumulated postretirement benefit obligation (APBO) consists of two components: $150,000 represents benefits based on past pay and service already rendered by employees under age 40 (a negative plan amendment), and $250,000 represents that portion of the APBO based on a projection of those employees' future pay. Because the change in plan terms eliminates the accrual of additional benefits for those employees, the $250,000 is potentially a currently recognizable curtailment gain.

	December 31, 20X1				
	Before Negative Plan Amendment	Negative Plan Amendment	After Negative Plan Amendment	Curtailment	After Curtailment
APBO (recognized liability)	$(750,000)	$ 150,000	$(600,000)	$ 250,000	$(350,000)
Amounts recognized in accumulated other comprehensive income:					
Prior service cost	$ 50,000	$ (50,000)[a]	$ 0		
Transition obligation	70,000	(70,000)[a]	0		
Net loss	100,000		100,000	$ (100,000)[b]	
Negative prior service cost		(30,000)	(30,000)		$ (30,000)
	$ 220,000	$(150,000)	$ 70,000	$ (100,000)	$ (30,000)

The journal entry to record the negative plan amendment is:

Postretirement benefit liability	$150,000	
Other comprehensive income		$150,000

The journal entry to record the curtailment gain is:

Postretirement benefit liability	$250,000	
Other comprehensive income		$100,000
Curtailment gain		150,000[c]

[a]The decrease in the APBO due to a negative plan amendment is used first to reduce any existing prior service cost recognized in accumulated other comprehensive income, then to reduce any transition obligation recognized in accumulated other comprehensive income.

[b]The decrease in the APBO due to a curtailment is used first to reduce any net loss recognized in accumulated other comprehensive income at the date of the curtailment.

[c]The curtailment gain is not a component of net periodic postretirement benefit cost and should be disclosed separately.

The negative plan amendment results in negative prior service cost because it reduces the APBO by an amount that exceeds the prior service cost and the remaining transition obligation included in accumulated other comprehensive income. The negative prior service cost of $30,000 is recognized in net periodic postretirement benefit cost by amortizing it over future periods beginning January 1, 20X2[d] in accordance with paragraph 52. Only those participants who are active at the date of the amendment and who are not yet fully eligible for benefits (that is, participants who are 40 years of age or older) are considered in applying paragraph 52 to the net negative prior service cost that results from this plan amendment.

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[d]If Company A had instead amended the plan on October 31, 20X1 and it had a calendar-year fiscal year-end, the effects of the negative plan amendment in determining net periodic postretirement benefit cost for 20X1 would be recognized prospectively starting from November 1, 20X1. The net periodic postretirement benefit cost for the first 10 months of the year would reflect the terms of the plan prior to the plan amendment.

Example 4—Negative Plan Amendment and Curtailment Loss

Company B sponsors an unfunded postretirement health care benefit plan covering employees at five locations. On December 1, 20X1, Company B amends its plan so that any employee at location X who does not retire by the end of 20X1 will not be entitled to receive benefits. Those employees at location X who retire by December 31, 20X1 will receive benefits under the plan terms. Employees at the other four locations are not affected by the amendment and will continue to earn benefits.

As a result of the amendment, Company B's APBO is reduced by $400,000, representing the elimination of benefits attributable to years of service already rendered by active employees who are not eligible to retire and those eligible employees who choose not to retire (a negative plan amendment). The remaining employees at location X decide to take early retirement on December 31, 20X1 (a curtailment). The unexpected early retirements cause a $200,000 increase in the APBO that is accounted for as part of the curtailment.[44] The previously expected remaining years of service associated with all employees at location X who were plan participants at the date of transition represent 20 percent of the previously expected remaining years of service of all plan participants at the date of transition. As a result, $100,000 (20 percent × $500,000) is recognized representing accelerated amortization of the transition obligation remaining in accumulated other comprehensive income. Because the prior service cost included in accumulated other comprehensive income is eliminated by the negative plan amendment, it does not enter into the accounting for the curtailment.

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[44]Unlike the terms of the plan described in Example 3, benefits under this plan are not pay related. Thus, the accounting for the curtailment does not include any gain for the elimination of the effects of a projection of final pay.

	December 31, 20X1				
	Before Negative Plan Amendment	**Negative Plan Amendment**	**After Negative Plan Amendment**	**Curtailment**	**After Curtailment**
APBO (recognized liability)	$(950,000)	$ 400,000	$(550,000)	$(200,000)	$(750,000)
Amounts recognized in accumulated other comprehensive income:					
Prior service cost	$ 100,000	$ (100,000)[e]	$ 0		
Transition obligation	800,000	(300,000)[e]	500,000	$(100,000)	$ 400,000
Net gain	(150,000)		(150,000)	150,000[f]	0
	$ 750,000	$ (400,000)	$ 350,000	$ 50,000	$ 400,000

The journal entry to record the negative plan amendment is:

	Debit	Credit
Postretirement benefit liability	$400,000	
Other comprehensive income		$400,000

The journal entry to record the curtailment loss is:

	Debit	Credit
Curtailment loss	$150,000[g]	
Other comprehensive income	50,000	
Postretirement benefit liability		$200,000

[e]Refer to footnote a.

[f]The increase in the APBO due to a curtailment is used first to reduce any net gain recognized in accumulated other comprehensive income at the date of the curtailment.

[g]The curtailment loss is not a component of net periodic postretirement benefit cost and should be disclosed separately.

Example 5—Negative Plan Amendment and Curtailment That Results in Recognition of Prior Service Cost as a Component of Net Periodic Postretirement Benefit Cost

Company C sponsors an unfunded postretirement health care benefit plan. Benefits under the plan are not pay related; thus, no assumption is required about employees' future pay levels in measuring the APBO. When it adopted this Statement, Company C immediately recognized its transition obligation in net income. On December 31, 20X1, the company changes the plan's eligibility requirements from the attainment of age 65 while in service and 20 years of service to 20 years of service to be rendered after attaining age 45. The new credited service period is not deemed to be nominal in relation to employees' average total years of service prior to their full eligibility dates. This change reduces the APBO for benefits attributable to past service (a negative plan amendment) by $300,000 for employees hired before age 45.

Because a significant number of employees previously expected to receive benefits under the plan are under age 45, the change in plan terms also meets the definition of a curtailment because it eliminates those employees as active participants under the plan. Their remaining years of expected service represent 15 percent of the previously expected remaining years of service of all plan participants at the date of a prior plan amendment that increased benefits. Because no portion of the APBO includes any amounts attributed to future pay levels, the impact of accounting for the curtailment is limited to accelerating the recognition in net periodic postretirement benefit cost of the portion of remaining prior service cost included in accumulated other comprehensive income (15 percent × $100,000) related to those employees' future years of service.

	December 31, 20X1				
	Before Negative Plan Amendment	Negative Plan Amendment	After Negative Plan Amendment	Curtailment	After Curtailment
APBO (recognized liability)	$(850,000)	$ 300,000	$(550,000)		$(550,000)
Amounts recognized in accumulated other comprehensive income:					
Prior service cost	$ 400,000	$ (300,000)[h]	$ 100,000	$ (15,000)[i]	$ 85,000
	$ 400,000	$ (300,000)	$ 100,000	$ (15,000)	$ 85,000

The journal entry to record the negative plan amendment is:

Postretirement benefit liability	$300,000	
Other comprehensive income		$300,000

The journal entry to record the curtailment loss is:

Curtailment loss	$15,000	
Other comprehensive income		$15,000

[h] Refer to footnote a.

[i] A portion of prior service cost is recognized as a component of net periodic postretirement benefit cost because the net balance of $100,000 arose from a previous amendment and the current employees under age 45 who were participants at the date of the previous amendment are no longer participants. Accordingly, their future service has been eliminated as a basis for delayed recognition of the prior service cost as a component of net periodic postretirement benefit cost. If the negative prior service cost from the new amendment exceeded the prior service cost recognized in accumulated other comprehensive income from the previous amendment, *none* of the net negative prior service cost would be recognized as a component of net periodic postretirement benefit cost currently. The net negative prior service cost would be amortized over active participants' expected future service periods to full eligibility.

F31. *Q*—An employer adopts an amendment to its postretirement health care plan that has the dual effect of expanding the plan's coverage and increasing the deductible. Should the increase in the deductible be measured and recognized separately from the benefit improvement? [51–53, 55]

A—No. When a plan amendment results in numerous changes to a plan that both increase and decrease benefits attributed to prior service, the net effect of all those changes should be considered at the same time to determine whether there has been a net positive or negative plan amendment. If the combined effect of all the changes is a net increase in benefits (a positive plan amendment), the resulting prior service cost should be accounted for in accordance with paragraph 52 or 53. If the combined effect is a net decrease in benefits (a negative plan amendment), the effect should be accounted for in accordance with paragraph 55.

Gains and Losses

F32. *Q*—In applying the provisions of paragraph 59 or 60 for the recognition of gains and losses as a component of net periodic postretirement benefit cost, is it appropriate for an employer to elect annually a new method of amortization of gains and losses included in accumulated other comprehensive income? [59, 60]

A—No. An employer should select an amortization method and apply it consistently from period to period as long as the resulting amortization equals or exceeds the minimum amortization specified by paragraph 59. Any change in the method selected would be subject to FASB Statement No. 154, *Accounting Changes and Error Corrections.* To satisfy the requirements of Statement 154, the preferability of the change in accounting would need to be demonstrated.

F33. *Q*—An employer sponsors a contributory postretirement health care plan that has an annual limitation on the dollar amount of the employer's share of the cost of benefits (a defined dollar capped plan). The cap on the employer's share of annual costs and the retirees' contribution rates are increased 5 percent annually. Any amount by which incurred claims costs exceed the combined employer and retiree contributions is initially borne by the employer but is passed back to retirees in the subsequent year through supplemental retiree contributions for that year. In 20X1, incurred claims costs exceed the combined employer and retiree contributions requiring a supplemental retiree contribution in 20X2. If the employer decides in 20X2 to absorb the excess that arose in 20X1 rather than pass it on to the retirees, when should the employer recognize as a component of net periodic postretirement benefit cost the loss due to that temporary deviation from the substantive plan? [61]

A—The employer should recognize the loss as a component of net periodic postretirement benefit cost in 20X2 when it makes the decision to deviate from the substantive plan.

F34. *Q*—If an employer previously projected that health care costs under a defined dollar capped plan would exceed the cap in 20X1 but actual claims in that year do not exceed the cap, does that result in a gain that should be recognized immediately as a component of net periodic postretirement benefit cost in 20X1 in accordance with paragraph 61? [56, 61]

A—No. The change in the accumulated postretirement benefit obligation due to experience different from that assumed results in a gain or loss that should be recognized in accumulated other comprehensive income in accordance with paragraph 56. Paragraph 61 addresses the recognition of a temporary deviation from provisions of the substantive plan that increases or decreases the employer's share of the benefit costs incurred in the current or past periods. A situation that would result in a gain or loss that should be recognized immediately as a component of net periodic postretirement benefit cost is one in which an employer has a past practice of changing the cap to reduce its share of expenses such that that practice constitutes the cost-sharing provision of the substantive plan. If, as a result of perceived economic adversity affecting the retiree population, the employer decides in 20X1 and for that year alone not to change the cap to further reduce its share of expenses in 20X1 as had been anticipated in the

substantive plan, that action would give rise to a loss that would be required to be recognized immediately as a component of net periodic postretirement benefit cost in 20X1.

F35. *Q*—What situation would result in a gain that would be recognized immediately as a component of net periodic postretirement benefit cost in accordance with paragraph 61? [61]

A—A gain that would be recognized immediately as a component of net periodic postretirement benefit cost would occur if participants voluntarily agreed to bear a one-time higher share of costs for a past or current period. For example, if retirees agreed to make a contribution to the plan in one year that is larger than the contribution amount called for by the plan and future contributions would comply with the existing terms of the plan, the employer would recognize immediately as a component of net periodic postretirement benefit cost a one-time gain for the excess of the new retiree contribution amount over the old retiree contribution amount.

Plan Assets

F36. *Q*—May an employer include in plan assets the assets of a "rabbi trust" (so named because the first grantor trust to receive a favorable ruling from the Internal Revenue Service was one formed for a rabbi)? [63, 64]

A—No. The assets of a rabbi trust do not qualify as plan assets because they are explicitly available to the employer's creditors in the event of bankruptcy. Under this Statement, assets must be segregated and restricted (usually in a trust) to be used for the payment of benefits in order to qualify as plan assets. 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 the employer's intent to use those assets to provide postretirement benefits. In EITF Issue No. 93-3, "Plan Assets under FASB Statement No. 106," the Emerging Issues Task Force reached a consensus that it is not necessary to determine that a trust is bankruptcy-proof for the assets of the trust to qualify as plan assets under this Statement. The Task Force also reached a consensus that assets held in a trust that explicitly provides that such assets are available to the general creditors of the employer in the event of the employer's bankruptcy would not qualify as plan assets under this Statement.

F37. *Q*—An *insurance contract*[45] with a captive insurance company does not qualify as a plan asset. However, can an investment contract with a captive insurance company qualify as a plan asset if it meets the criteria in paragraph 63? [63, 64, 67]

A—Yes. To qualify as a plan asset, an investment contract[46] with a captive insurance company must be segregated and restricted for the payment of postretirement benefits. In addition, because a plan's investment contract with a captive insurance company represents an obligation of the employer to pay cash to be used to pay benefits and because amounts accrued by the employer to pay benefits are not plan assets, that contract should be considered an employer debt security for purposes of this Statement and, therefore, must be currently transferable to be included in plan assets. (Refer to the question in paragraph F38.)

F38. *Q*—If an employer issues its own debt or equity securities directly to its postretirement benefit trust, may those securities be included in plan assets under this Statement? [63]

A—Yes, provided the securities are currently transferable. To be transferable the securities held by the postretirement benefit trust must be legally and unconditionally transferable to unrelated third parties at any time, for any reason, and without economic penalties. Thus, the trustee of the postretirement benefit trust must have the unilateral right and ability to legally and unconditionally sell, transfer, or otherwise dispose of the securities. Securities that are not transferable in their present state do not meet the transferability requirement even though they can be converted into securities that are transferable or can otherwise be made transferable through other means, such as through future registration of the securities for trading in a public market. For example, if an employer issues to its postretirement benefit trust nontransferable convertible preferred stock that can be converted into transferable common stock of the employer, the convertible preferred stock would not meet the criterion of currently transferable and, thus, would not be included in plan assets.

Disclosures

F39. [This question has been deleted. See Status page.]

F40. *Q*—Should an employer's disclosure of the weighted average of the assumed discount rates for its postretirement benefit obligation be the same as that disclosed for its pension benefit obligation?

A—Not necessarily, for reasons stated in the answer to the question in paragraph F8. Even if the assumed discount rates are the same, the weighted average of those rates that is disclosed for the postretirement benefit obligation may not be the same as that disclosed for the pension benefit obligation

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[45]An *insurance contract* is defined in this Statement as follows:

> A contract in which an insurance company unconditionally undertakes a legal obligation to provide specified benefits to specific individuals in return for a fixed consideration or premium. An insurance contract is irrevocable and involves the transfer of significant risk from the employer (or the plan) to the insurance company. If the insurance company providing the contract is 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 insurance contract for purposes of this Statement.

[46]Paragraphs 7 and 8 of FASB Statement No. 97, *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments,* describe investment contracts:

> Long-duration contracts that do not subject the insurance enterprise to risks arising from policyholder mortality or morbidity are referred to in this Statement as investment contracts. A mortality or morbidity risk is present if, under the terms of the contract, the enterprise is required to make payments or forgo required premiums contingent upon the death or disability (in the case of life insurance contracts) or the continued survival (in the case of annuity contracts) of a specific individual or group of individuals. A contract provision that allows the holder of a long-duration contract to purchase an annuity at a guaranteed price on settlement of the contract does not entail a mortality risk until the right to purchase is executed. If purchased, the annuity is a new contract to be evaluated on its own terms.
>
> Annuity contracts may require the insurance enterprise to make a number of payments that are not contingent upon the survival of the beneficiary, followed by payments that are made if the beneficiary is alive when the payments are due (often referred to as *life-contingent payments*). Such contracts are considered insurance contracts under this Statement and Statement 60, [*Accounting and Reporting by Insurance Enterprises*] unless (a) the probability that life-contingent payments will be made is remote or (b) the present value of the expected life-contingent payments relative to the present value of all expected payments under the contract is insignificant. [Footnote references omitted.]

because the weighted average is influenced by the timing and pattern of benefits to be provided, which can differ between a pension and a postretirement benefit plan. For example, pension benefits are usually paid in fixed amounts throughout retirement. On the other hand, postretirement health care benefits tend to increase during retirement because retirees generally require more health care services as they age, although the net cost to employers after retirees reach age 65 is reduced by Medicare. If, as a result of the expected cost of health care, the timing or pattern of postretirement benefits differs from that for pension benefits, that difference should be reflected in the weighting of the assumed discount rates.

Employers with Two or More Plans

F41. *Q*—An employer has two legally separate postretirement benefit plans. Both plans are unfunded defined benefit plans covering the same employees. One plan provides postretirement medical care and the other provides postretirement dental care. May the employer account for the two plans as one plan? [76]

A—Yes. The first sentence of paragraph 76 states, "The data from all unfunded [defined benefit] postretirement health care plans may be aggregated for measurement purposes if (a) those plans provide different benefits to the same group of employees or (b) those plans provide the same benefits to different groups of employees." Thus, an employer that has two or more such plans is permitted, but not required, to account for those plans as a single plan. The last sentence of paragraph 76 reinforces the criterion that the plans must be unfunded: "However, a plan that has plan assets (as defined herein) shall not be aggregated with other plans but shall be measured separately."

F42. *Q*—When is it appropriate for the employer in the question in paragraph F41 to change from one-plan accounting to two-plan accounting; that is, to accounting for each plan separately? [76]

A—The change would be appropriate if the conditions of paragraph 76 are no longer satisfied. If the change is elective (that is, it is made even though the conditions of paragraph 76 are still satisfied), the employer would have to demonstrate the preferability of the change in accounting to satisfy the requirements of Statement 154, and its effects would be accounted for in accordance with that Statement.

Multiemployer Plans

F43. *Q*—An employer that has a single-employer postretirement benefit plan decides to provide health care benefits to its retirees through participation with several unrelated employers in a group postretirement health care benefit arrangement that does not result from collective bargaining. The arrangement is administered by an independent board of trustees and provides a uniform level of benefits to all retirees by utilizing group medical insurance contracts. Each participating employer is assessed an annual contribution for its share of insurance premiums, plus administrative costs, and may require its respective retirees to pay a portion of the annual assessment. Retirees whose former employer discontinues paying the annual assessment have the right to continue participation if they assume the cost of the annual premiums needed to maintain their existing benefits. Should the employer account for this arrangement as a multiemployer plan? [79, 84]

A—No. A characteristic of a multiemployer plan is that its obligation to retirees continues even if a former employer discontinues its participation in the plan. That characteristic is not present in the arrangement described.

F44. *Q*—May a multiemployer plan be considered a substantially equivalent replacement plan (a successor plan)[47] for an employer that terminates its single-employer defined benefit postretirement plan such that acceleration of the recognition as a component of net periodic postretirement benefit cost of prior service cost included in accumulated other comprehensive income is not required? [79, 97, 100]

A—No. The characteristics and the accounting for a multiemployer plan are sufficiently different from a single-employer plan that neither plan can be a successor plan for the other. The nature of the employer's promise is different in each plan. In a single-employer plan, the employer promises to provide defined benefits. In a multiemployer plan, the employer promises to make a defined contribution. That employees continue to render service is important only if the accounting for a defined benefit plan is being applied, which includes the deferred recognition in earnings of certain items. Because the unit of account is the individual plan, the termination of a single-employer defined benefit plan without replacing it with a successor defined benefit plan concludes the employer's ability to apply defined benefit plan accounting. Therefore, to continue to recognize the prior service cost as a component of net periodic postretirement benefit cost over future periods for the terminated plan in this situation is not appropriate.

Business Combinations

F45. [This question has been deleted. See Status page.]

Settlements

F46. *Q*—An employer that immediately recognized its transition obligation in income upon adopting this Statement subsequently amends its plan to eliminate its obligation for postretirement benefits and partially compensates affected participants by increasing their pension benefits. How should those events be accounted for? [90, 93, 100]

A—The employer has terminated its postretirement benefit plan and effectively settled its remaining postretirement benefit obligation by increasing its obligation to pay pension benefits. Because the cost to the employer of settling its postretirement benefit obligation is the increase in the obligation for pension benefits, the gain on the termination of the plan must be measured taking into account the cost of the pension benefit increase. That increase should be accounted for as an increase in a pension liability (or a decrease in a pension asset). The obligation for postretirement benefits should be eliminated. The difference is a gain on plan termination that should be recognized pursuant to FASB Statement No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits.*

Special Termination Benefits

F47. *Q*—What is the intent of paragraph 102 on special termination benefits? [102]

A—The intent of paragraph 102 is that an employer measure and account for the postretirement benefit incentive to be received by employees in exchange for early termination.

F48. *Q*—How should an employer measure the postretirement benefit incentive to be received by employees in exchange for early termination? [102]

A—That incentive is generally measured as the difference between the actuarial present value of (a) the accrued benefits for employees terminating with the enhanced benefits and (b) the accrued benefits for those employees assuming they terminated without the enhancements.

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[47]The question in paragraph C26 in Appendix C of FASB Statement No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits,* provides further discussion of a successor plan.

The following simplified examples address situations involving (a) a typical postretirement benefit plan under which participants become eligible for benefits upon attaining age 55 while in service and rendering 10 years of service and (b) a plan under which benefits are based on years of service. To simplify the examples further, discounting and health care cost trends have been ignored.

Example 6—A Typical 55 and 10 Plan

Under Company X's postretirement health care benefit plan, the annual cost of coverage is estimated to be $4,500 for retirees under age 65 and $1,500 for those 65 and older. The probability of employees retiring is 40 percent at age 57, 50 percent at age 62, and 10 percent at age 65. There is a 100 percent probability that retirees will die at age 75. Employees that retire on or after attaining age 55 while in service and rendering 10 or more years of service receive full employer-paid postretirement benefit coverage.

As part of an incentive package to encourage employees to retire early, Company X offers for a short period of time to add three years of age and three years of service to an employee's age and accumulated service credits to determine eligibility for postretirement benefits. Two employees, A and B, accept the offer. A is age 57 and has rendered 20 years of service. B is age 52 and has rendered 12 years of service.

The expected postretirement benefit obligation (EPBO) for A and B prior to the offer is $36,150 each, determined as follows:

Retirement Age	Benefits: Pre-Age 65		Benefits: Age 65 to 75		Probability of Retirement		EPBO
57	($4,500 × 8 yrs)	+	($1,500 × 10 yrs)	×	40%	=	$20,400
62	($4,500 × 3 yrs)	+	($1,500 × 10 yrs)	×	50	=	14,250
65			($1,500 × 10 yrs)	×	10	=	1,500
							$36,150

The accumulated postretirement benefit obligation (APBO) for A and B prior to the offer is $36,150 and $28,920, respectively, determined as follows:

Employee	EPBO		Years of Service Rendered to Total Required		APBO
A	$36,150	×	18/18[a]	=	$36,150
B	36,150	×	12/15[b]	=	28,920
	$72,300				$65,070

[a]A was hired at age 37 and, therefore, after 18 years of service has rendered the required 10 years of service and attained age 55 while in service to be fully eligible for benefits.

[b]B must render 3 more years of service to attain age 55 while in service to be fully eligible for benefits.

The special termination postretirement benefit is measured as the difference between the following two amounts:

a. The benefits attributed to past service based on what A and B receive if they retire at the earliest date at which they could retire and receive postretirement benefits under the plan, ignoring the special termination benefits. That date would be immediately for A and in 3 years (upon attaining age 55) for B.
b. The benefits A and B receive if they accept the special termination benefits offer and retire immediately.

The calculation of those two amounts follows.

Accrued Benefits Ignoring Special Termination Benefits and Assuming A Retires Immediately and B Retires at Age 55

	Benefits				Portion		Accrued
Employee	**Pre-Age 65**		**Age 65 to 75**		**Earned**		**Benefits**
A	(\$4,500 × 8 yrs)	+	(\$1,500 × 10 yrs)	×	18/18	=	\$51,000
B	(\$4,500 × 10 yrs)	+	(\$1,500 × 10 yrs)	×	12/15	=	48,000
							\$ 99,00

Accrued Benefits That Reflect Special Termination Benefits Assuming A and B Retire Immediately

	Benefits				Portion		Accrued
Employee	**Pre-Age 65**		**Age 65 to 75**		**Earned**		**Benefits**
A	(\$4,500 × 8 yrs)	+	(\$1,500 × 10 yrs)	×	100%	=	\$ 51,000
B	(\$4,500 × 13 yrs)	+	(\$1,500 × 10 yrs)	×	100	=	73,500
							\$124,500

Thus, the cost of the special termination postretirement benefits is \$25,500 (\$124,500 – \$99,000). If A and B represent a significant portion of Company X's work force, the increase in the APBO attributable solely to their early retirement, \$33,930 (\$99,000 – \$65,070, both calculated without regard to the special termination benefits), would be accounted for as a curtailment. Otherwise, the \$33,930 would be an experience loss.

Example 7—Benefits Based on Years of Service

The facts are the same as in Example 6 except that under the plan's terms retiring employees receive 2½ percent coverage for each year of service. Thus, prior to the acceptance of special termination benefits, the full eligibility dates for A and B would be their expected retirement dates.

The APBO for A and B prior to accepting the offer is $28,920, determined as follows:

At Retirement		Benefits										
Age	Years of Service	Pre-Age 65		Age 65 to 75		Benefit Coverage		Probability of Retirement		Service to Date/ Service to Retirement		APBO
Employee A												
57	20	($4,500 × 8 yrs)	+	($1,500 × 10 yrs)	×	50%	×	40%	×	20/20	=	$10,200
62	25	($4,500 × 3 yrs)	+	($1,500 × 10 yrs)	×	62½	×	50	×	20/25	=	7,125
65	28			($1,500 × 10 yrs)	×	70	×	10	×	20/28	=	750
												18,075
Employee B												
57	17	($4,500 × 8 yrs)	+	($1,500 × 10 yrs)	×	42½%	×	40%	×	12/17	=	6,120
62	22	($4,500 × 3 yrs)	+	($1,500 × 10 yrs)	×	55	×	50	×	12/22	=	4,275
65	25			($1,500 × 10 yrs)	×	62½	×	10	×	12/25	=	450
												10,845
												$28,920

The special termination postretirement benefit is measured in the same manner as in Example 6.

Accrued Benefits Ignoring Special Termination Benefits and Assuming A Retires Immediately and B Retires at Age 55

	Benefits				Benefit		Portion		Accrued
Employee	**Pre-Age 65**		**Age 65 to 75**		**Coverage**		**Earned**		**Benefits**
A	(\$4,500 × 8 yrs)	+	(\$1,500 × 10 yrs)	×	50%	×	20⁄20	=	\$25,500
B	(\$4,500 × 10 yrs)	+	(\$1,500 × 10 yrs)	×	37½	×	12⁄15	=	18,000
									\$43,500

Accrued Benefits That Reflect Special Termination Benefits Assuming A and B Retire Immediately

	Benefits				Benefit		Portion		Accrued
Employee	**Pre-Age 65**		**Age 65 to 75**		**Coverage**		**Earned**		**Benefits**
A	(\$4,500 × 8 yrs)	+	(\$1,500 × 10 yrs)	×	57½%	×	100%	=	\$29,325
B	(\$4,500 × 13 yrs)	+	(\$1,500 × 10 yrs)	×	37½	×	100	=	27,563
									\$56,888

Thus, the cost of the special termination postretirement benefits is \$13,388 (\$56,888 – \$43,500), and \$14,580 (\$43,500 – \$28,920) would be accounted for as a curtailment or an experience loss.

Defined Contribution Plans

F49. *Q*—An employer has two legally separate postretirement benefit plans—a defined benefit plan and a defined contribution plan. The terms of the defined benefit plan specify that the employer's obligation under that plan is reduced to the extent that a participant's account balance in the defined contribution plan shall be used to pay incurred health care costs covered by the defined benefit plan. Should those plans be considered a single plan or two plans for purposes of applying this Statement? [104]

A—Two plans. The defined benefit plan is commonly described as a "floor-offset" plan. As participants' account balances in the defined contribution plan grow, the employer's obligation under the defined benefit plan diminishes. However, the nature of the employer's obligation under each plan, how that obligation is satisfied, the availability of plan assets to pay benefits, and the accounting for a defined benefit versus a defined contribution plan are sufficiently dissimilar for the two plans that they cannot be considered a single plan for purposes of applying this Statement.

F50. *Q*—If there are any assets of the defined contribution plan described in the question in paragraph F49 that have not yet been allocated to participants' individual accounts, do they reduce the accumulated postretirement benefit obligation of the defined benefit plan? [63, 104]

A—No. The terms of the defined benefit plan require the payment of benefits that exceed those payable using participants' individual account balances in the defined contribution plan. Pursuant to those terms, assets of a defined contribution plan that have not yet been allocated to participants' individual accounts do not reduce the employer's present obligation under the defined benefit plan. Although an employer's intent may be to allocate the unallocated assets in the future so that participants can use those assets to pay health care costs, that intent is insufficient to offset the present defined benefit plan obligation. When the unallocated assets in the defined contribution plan are allocated, the benefits payable under that plan are increased and the obligation of the defined benefit plan is reduced. That reduction is recognized immediately in determining the net periodic postretirement benefit cost for the defined benefit plan.

Because the two plans are legally separate and, thus, the assets of one plan are not available to pay the benefits of the other, neither the allocated nor the unallocated assets of the defined contribution plan would be considered plan assets of the defined benefit plan.

Effective Date

F51–F54. [These questions have been deleted. See Status page.]

Transition

F55–F64. [These questions have been deleted. See Status page.]