6. Accounting changes adopted to conform to the provisions of this issue paper shall be accounted for in accordance with *Issue Paper No. 3—Accounting Changes*. In the year the principle is adopted, recognition of the liability for postemployment benefits at the time of adoption that has not previously been recorded shall be recognized through a direct charge to surplus.

## **Consolidated/Holding Company Plans**

7. The employees of many reporting entities are eligible for certain postemployment benefits granted by a parent company or holding company. An entity with employees who are eligible for those benefits and is not directly liable for those related obligations shall recognize an expense equal to its allocation from the parent company or holding company of the benefits earned during the period. A liability shall be established for any such amounts due, but not yet paid. Furthermore, the reporting entity shall disclose in the notes to the financial statements that its employees participate in a plan sponsored by the holding company for which the reporting entity has no legal obligation. The amount of expense incurred and the allocation methodology utilized by the provider of such benefits shall also be disclosed. If the reporting entity is directly liable for postemployment benefit obligations, then the requirements outlined in paragraphs 3 to 6 above shall be applied.

# DISCUSSION

8. Paragraphs 3 - 6 of the Summary Conclusion above adopt FASB Statement No. 112, Employers' Accounting for Postemployment Benefits: an amendment of FASB Statements No. 5 and 43 (FAS 112), and the provisions of FASB Statement No. 88, Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits (FAS 88), that address termination benefits, both with a modification to adopt the principles in accordance with Issue Paper No. 3—Accounting Changes.

9. The Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts) states under the concept of recognition that "Liabilities require recognition as they are incurred" and "Accounting treatments which tend to defer expense recognition do not generally represent acceptable SAP treatment". In addition, the Statement of Concepts states under the concept of conservatism that "In order to provide a margin of protection for policyholders, the concept of conservatism should be followed when developing estimates as well as establishing accounting principles for statutory reporting". Requiring reporting entities to follow the guidance in FAS 112 and the termination benefit provisions of FA

that postemployment benefits are generally not as significant as pension or other postretirement benefits. The Board concluded that a provision for delayed recognition was not needed to mitigate the financial statement impact of immediately recognizing the transition amount when this Statement is adopted. That provision would have added unnecessary complexity to the application of this Statement, reduced financial statement comparability, and been inconsistent with Statements 5 and 43, which do not provide for delayed recognition at transition.

This issue paper adopts this immediate recognition concept.

## **Drafting Notes/Comments**

- Accounting for postemployment benefits incurred in connection with a restructuring is addressed in a separate issue paper addressing restructuring costs and EITF 94-3.
  - Accounting for pensions is discussed in *Issue Paper No.* 8—Accounting for Pensions.
- Accounting for compensated absences is addressed in *Issue Paper No. 11—Compensated Absences*.
- Accounting for postretirement benefits other than pensions is addressed in *Issue Paper No. 14— Employers' Accounting for Postretirement Benefits Other Than Pensions.*
- Holding company obligations are addressed in a separate issue paper.

## RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

### **Statutory Accounting**

12. The Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies, Chapter 17, *Other Liabilities*, contains the following with respect to liabilities for benefits for employees and agents:

### Liabilities for Benefits for Employees and Agents

A company may be required or desire to establish a liability for certain benefits to employees and agents which are not provided for in other accounts. Examples include:

- 1. It may be desirable to hold the liability or a nonqualified pension plan in this category in order to assist the tax department in adjusting their tax deductions.
- 2. The company may wish to set up a liability for the salary for accrued but unused vacation hours since vacation hours can legitimately be viewed as "earned" at the end of the work periods for which they are granted.

## **Generally Accepted Accounting Principles**

13. FAS 112, requires employers to recognize the obligation to provide postemployment benefits in accordance with *FASB Statement No. 43*, *Accounting for Compensated Absences* (FAS 43), if the obligation is attributable to employees' services already rendered, employees' rights to those benefits accumulate or vest, payment of the benefits is probable, and the amount of the benefits can be reasonably estimated. If those four conditions are not met, the employer should account for postemployment benefits when it is probable that a liability has been incurred and the amount can be reasonably estimated in accordance with *FASB Statement No. 5*, *Accounting for Contingencies* (FAS 5). If an obligation for postemployment benefits is not accrued in accordance with FAS 5 or FAS 43 only because the amount cannot be reasonably estimated, the financial statements shall disclose that fact.

14. FAS 88 has provisions that address accounting for benefits provided to employees in connection with their termination of employment. Special termination benefits are defined as those that are offered only for a short period of time and contractual termination benefits are defined as those required by the terms of a plan only if a specified event, such as a plant closing, occurs. FAS 88 requires an employer that offers special termination benefits to employees to recognize a liability and a loss when the employees accept the offer and the amount can be reasonably estimated. It also requires an employer that provides

contractual termination benefits to recognize a liability and loss when it is probable that employees will be entitled to benefits and the amount can be reasonably estimated. The cost of the termination benefits recognized shall include the amount of any lump-sum payments and the present value of any expected future payments.

## **OTHER SOURCES OF INFORMATION**

15. The draft discussion material from previous Life codification projects, Chapter 17, *Other Liabilities*, modified the above language:

## Liabilities for Benefits for Employees and Agents

A company must establish a liability for certain benefits to employees and agents which are not provided for in other accounts. Examples include deferred compensation and nonqualified benefit plans for employees and agents.

16. The NAIC Technical Resource Group proposed draft Life codification Chapter 22, *General Expenses and Taxes, Licenses and Fees*, contains the following guidance:

## Employee Termination Benefits

For a variety of reasons, companies pay compensation to employees at termination. Such benefits include disability benefits, death benefits, severance payments, unemployment benefits, etc. These benefits are paid after an employee terminates but are typically based on service previously rendered.

The cost of such post-employment benefits must be spread over the working lives of those expected to receive the benefit. These benefits include all benefits paid to or for former or inactive employees (including their beneficiaries and/or dependents) after employment.

Such compensation must be accrued during an employee's working life if:

- a. the benefit to be paid is earned for service previously rendered;
- b. the right to those benefits accumulates, vests or;
- c. the payment of the benefits is probable; and
- d. the amount can be reasonably estimated.

17. The draft discussion material from previous Property/Casualty codification projects, Chapter 23, *Non-Claim Operating Expenses*, contains the following language:

# Salaries, and Employee Relations and Welfare (Including Post Employment Retirement and Other Benefits)

Salaries and payroll related expenses are usually the second largest expense for most insurance companies. SAP requires that salaries and related expenses be accounted for under the accrual basis of accounting (i.e., expense recorded when incurred and not when paid). Pensions and other post retirement benefit plans for which there is no promulgated SAP should be accounted for in accordance with GAAP as promulgated by the Financial Accounting Standards Board (FASB). (The preceding may need revision based on final outcome of the FASB 106 Task Force.)

Employee compensation and post retirement benefits include, among other things, the following:

- 1. Salaries and wages
- 2. Pension plans.
- 3. Post retirement benefits other than pensions.
- 4. Compensated absences.
- 5. Stock purchase and option plans.
- 6. Other deferred compensation

18. In addition, the draft discussion materials from previous Property/Casualty codification projects discusses deferred compensation and special termination benefits specifically and states the following:

#### Other Deferred Compensation

The accounting for other deferred compensation arrangements, which do not constitute pension plans is governed by APB Opinion No. 12, "Omnibus Opinion." APB 12 provides that deferred compensation contracts should be accounted separately for each employee on the accrual basis.

## **State Regulations**

No additional guidance obtained from state statutes or regulations.

## **Other Sources of Information**

- NAIC Technical Resource Group proposed draft Life codification, Chapter 22, *General Expenses and Taxes*, Licenses and Fees
- Draft discussion material from previous Property/Casualty codification projects, Chapter 23, *Non-Claim Operating Expenses*, subcaption Pension Plans
- Draft discussion material from previous Life codification projects, Chapter 17, *Other Liabilities*, subcaption Liabilities for Benefits for Employees and Agents, page 17.2