Statutory Issue Paper No. 14

Employers' Accounting for Postretirement Benefits Other Than Pensions

STATUS
Finalized December 6, 1999

Current Authoritative Guidance for Postretirement Benefits Other Than Pensions: SSAP No. 92
This issue paper may not be directly related to the current authoritative statement.

Original SSAP from Issue Paper: SSAP No. 14

Type of Issue:
Common Area

SUMMARY OF ISSUE

1. Postretirement benefits include all forms of benefits, other than retirement income, provided by an employer to retirees. Those benefits may be defined in terms of specified benefits 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 specifi

Consolidated/Holding Company Plans

6. The employees of many reporting entities are eligible for certain postretirement benefits other than pensions provided by a parent company or holding company. A reporting 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 of the benefits earned during the period. A liability shall be established for any such amounts due, but not yet paid. 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 the postretirement benefit expense incurred and the allocation methodology shall also be disclosed in the financial statements. If the reporting entity is directly liable for certain postretirement benefits other than pensions, then the requirements outlined in paragraphs 4 and 5 of this issue paper shall be applied.

DISCUSSION

7. Current statutory accounting and the accounting codified within this issue paper adopt FAS 106, FAS 132 and *Accounting Principles Board Opinion No. 12*, *Omnibus Opinion–1967*, paragraphs 6 through 8 with the following modifications:

a. Any asset which results from an excess of the fair value of plan assets over the postretirement benefit obligation shall be recorded as a nonadmitted asset.

b. Calculation of the postretirement benefit obligation shall exclude non-vested employees. Partially vested employees are included only to the extent of their vested amounts.

c.

11. The Statement of Concepts states under the recognition concept 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 existing statutory guidance relative to accounting for postretirement benefits other than pensions is consistent with the recognition and conservatism concepts in the Statement of Concepts.

Drafting Notes/Comments

- Federal income taxes are addressed in a separate issue paper.
- Holding company obligations are addressed in a separate issue paper.
- Accounting for pensions is addressed in *Issue Paper No. 8—Accounting for Pensions*.
- Accounting for postemployment benefits is addressed in *Issue Paper No. 13—Employers' Accounting for Postemployment Benefits*.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

Statutory Accounting

12. The following is an excerpt from the Accounting Practices and Procedures Manuals for Life and Accident and Health [Chapter 17] and for Property and Casualty [Chapter 13] Insurance Companies:

> Postretirement Benefits Other Than Pensions
>
> Postretirement benefits are all forms of benefits, other than retirement income, provided by an employer to retirees. Those benefits may be defined in terms of specified benefits 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.
>
> An employer shall account for its postretirement benefits on an accrual basis. The postretirement benefit obligation for current retirees and fully eligible or vested employees at transition (initial

that period. If a plan calls for contributions for periods after an individual retires, the estimated costs shall be accrued at retirement date.

Effective Date:

This policy shall be effective for the first quarter financial statements dated March 31, 1993,

16. The Annual Statement Instructions also provide guidance on information to be included in the notes to the financial statements:

> 6. Retirement Plans, Deferred Compensation and Other Postretirement Benefit Plans
> Instruction:
>
> c. Postretirement Benefit Plans
> Include the following:
>
> A description of the plan(s).
>
> A description of the plan's policy.
>
> The method of determination and the amount of postretirement benefit expense.
>
> The amount of the postretirement benefit obligation for retirees and fully eligible or vested employees and the fair value of the plan assets valued as of the most recent actuarial valuation date.
>
> The amount of the postretirement benefit obligation included on Page 3, Line 13 [Life and Accident and Health] or Lines 2 and 4 [Property and Casualty].
>
> The amount of the postretirement obligation for non vested employees as of the most recent actuarial date.
>
> The discount and health care cost trend rate used in the estimations.
>
> The effect of a one-percentage-point increase in the assumed health care cost trend rates for each future year on (1) the aggregate of the estimated eligibility and interest cost components of net periodic postretirement benefit cost and (2) the postretirement benefit obligation for health care benefits (for purposes of this disclosure, all other assumptions shall be held constant and the effects shall be measured based upon the substantive plan that is the basis of accounting).
>
> Significant matters affecting the year-to-year comparability of the plan information.
>
> An employer who is a member of a multi-employer plan shall disclose a description of the plan(s), the method of determination and the amount of postretirement benefit expense for the employer/member and the unfunded postretirement benefit obligation.
>
> Postretirement Defined Contribution Plans
> Include the following:
>
> A description of the plans, including employee groups covered.
>
> The basis for determining contributions.
>
> The nature and effect of significant matters affecting comparability of information for all periods presented.
>
> The amount of cost recognized during the period.

Sample disclosure is also provided.

17. The NAIC Annual Statement Instructions for Property and Casualty Insurance Companies includes the following language with respect to Underwriting and Investment Exhibit - Part 4 - Expenses:

> The total management fees and the method(s) used for allocation shall be disclosed in the Notes to Financial Statements. The company shall use the same allocation method(s) on a consistent basis.
>
> Line 9 - Employee Relations and Welfare
>
> Include: The net periodic postretirement benefit cost.

Generally Accepted Accounting Principles

18. The following summary from FAS 106, describes the GAAP methodology and concepts:

> 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.
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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

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.

19. FAS 132 sets forth disclosure requirements:

Disclosures about Pensions and Other Postretirement Benefits

5. An employer that sponsors one or more defined benefit pension plans or one or more defined benefit postretirement plans shall provide the following information:

a. A reconciliation of beginning and ending balances of the benefit obligation[2] showing separately, if applicable, the effects during the period attributable to each of the following: service cost, interest cost, contributions by plan participants, actuarial gains and losses, foreign currency exchange rate changes[3], benefits paid, plan amendments, business combinations, divestitures, curtailments, settlements, and special termination benefits

[2] For defined benefit pension plans, the benefit obligation is the projected benefit obligation—the actuarial present value as of a date of all benefits attributed by the pension benefit formula to employee service rendered prior to that date. For defined benefit postretirement plans, the benefit obligation is the accumulated postretirement benefit obligation—the actuarial present value of benefits attributed to employee service rendered to a particular date.

[3] The effects of foreign currency exchange rate changes that are to be disclosed are those applicable to plans of a foreign operation whose functional currency is not the reporting currency pursuant to *FASB Statement No. 52*, *Foreign Currency Translation*.

b. A reconciliation of beginning and ending balances of the fair value of plan assets showing separately, if applicable, the effects during the period attributable to each of the following: actual return on plan assets, foreign currency exchange rate changes[4], contributions by the employer, contributions by plan participants, benefits paid, business combinations, divestitures, and settlements

[4] Refer to footnote 3.

c. The funded status of the plans, the amounts not recognized in the statement of financial position, and the amounts recognized in the statement of financial position, including:
   (1) The amount of any unamortized prior service cost
   (2) The amount of any unrecognized net gain or loss (including asset gains and losses not yet reflected in market-related value)
   (3) The amount of any remaining unamortized, unrecognized net obligation or net asset existing at the initial date of application of Statement 87 or 106
   (4) The net pension or other postretirement benefit prepaid assets or accrued liabilities
   (5) Any intangible asset and the amount of accumulated other comprehensive income recognized pursuant to paragraph 37 of Statement 87, as amended

d. The amount of net periodic benefit cost recognized, showing separately the service cost component, the interest cost component, the expected return on plan assets for the period, the amortization of the unrecognized transition obligation or transition asset, the amount of recognized gains and losses, the amount of prior service cost recognized, and the amount of gain or loss recognized due to a settlement or curtailment

e. The amount included within other comprehensive income for the period arising from a change in the additional minimum pension liability recognized pursuant to paragraph 37 of Statement 87, as amended

f. On a weighted-average basis, the following assumptions used in the accounting for the plans: assumed discount rate, rate of compensation increase (for pay-related plans), and expected long-term rate of return on plan assets

g. The assumed health care cost trend rate(s) for the next year used to measure the expected cost of benefits covered by the plan (gross eligible charges) and a general description of the direction and pattern of change in the assumed trend rates thereafter, together with the ultimate trend rate(s) and when that rate is expected to be achieved

h. The effect of a one-percentage-point increase and the effect of a one-percentage- point decrease in the assumed health care cost trend rates on (1) the aggregate of the service and interest cost components of net periodic postretirement health care benefit cost and (2) the accumulated postretirement benefit obligation for health care benefits (For purposes of this disclosure, all other assumptions shall be held constant, and the effects shall be measured based on the substantive plan that is the basis for the accounting.)

i. If applicable, the amounts and types of securities of the employer and related parties included in plan assets, the approximate amount of future annual benefits of plan participants covered by insurance contracts issued by the employer or related parties, and any significant transactions between the employer or related parties and the plan during the period

j. If applicable, any alternative amortization method used to amortize prior service amounts or unrecognized net gains and losses pursuant to paragraphs 26 and 33 of Statement 87 or paragraphs 53 and 60 of Statement 106

k. If applicable, any substantive commitment, such as past practice or a history of regular benefit increases, used as the basis for accounting for the benefit obligation

l. If applicable, the cost of providing special or contractual termination benefits recognized during the period and a description of the nature of the event

m. An explanation of any significant change in the benefit obligation or plan assets not otherwise apparent in the other disclosures required by this Statement.

Amounts related to the employer's results of operations shall be disclosed for each period for which an income statement is presented. Amounts related to the employer's statement of financial position shall be disclosed for each balance sheet presented.

Employers with Two or More Plans

6. The disclosures required by this Statement may be aggregated for all of an employer's defined benefit pension plans and may be aggregated for all of an employer's defined benefit postretirement plans or may be disaggregated in groups if that is considered to provide the most useful information or is otherwise required by paragraph 7. Disclosures about pension plans with

assets in excess of the accumulated benef

Multiemployer Plans

10. An employer shall disclose the amount of contributions to multiemployer plans during the period. An employer may disclose total contributions to multiemployer plans without disaggregating the amounts attributable to pensions and other postretirement benefits. The disclosures shall include a description of the nature and effect of any changes affecting comparability, such as a change in the rate of employer contributions, a business combination, or a divestiture.

11. Paragraph 70 of Statement 87 and paragraph 83 of Statement 106 are carried forward without reconsideration. Paragraphs 70 and 83 read as follows:

> In some situations, withdrawal from a multiemployer plan may result in an employer's having an obligation to the plan for a portion of its unfunded benefit obligations. If withdrawal under circumstances that would give rise to an obligation is either probable or reasonably possible, the provisions of FASB Statement No. 5,

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