Q&A 87—A Guide to Implementation of Statement 87 on Employers' Accounting for Pensions: Questions and Answers

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Authored by: Joan Lordi Amble and Jules M. Cassel *(1)

Introduction


The Board does not, and some suggest should not, try to anticipate all the implementation questions that may arise for a particular Statement and provide answers to those questions when the Statement is issued. Accordingly, questions of implementation are often raised with the FASB staff by preparers, auditors, and others. Because of the unusually high number of inquiries received and the inherent complexities of pension accounting, the FASB staff determined that this Special Report should be issued as an aid in understanding and implementing Statement 87.

The questions and answers in this Special Report are organized by the paragraphs in Statement 87 to which they relate. Illustrations are included as necessary to supplement the answers.

Questions and Answers 1-20

1. Q—Does FASB Statement No. 87, Employer's Accounting for Pensions, apply to employers that are:

   a. State and local governmental units

   A—a. The Governmental Accounting Standards Board (GASB) issued GASB Statement No. 5, Disclosure of Pension Information by Public Employee Retirement Systems and State and Local Governmental Employers, which established requirements for pension disclosures by public employee retirement systems and by state and local government employers. GASB Statement No. 27, Accounting for Pensions by State and Local Governmental Employers, establishes requirements for pension accounting by state and local government employers. Paragraph 4 of GASB Statement 27 states that:

      The requirements of this Statement apply to the financial statements of all state and local governmental employers that provide or participate in pension plans, including general purpose governments, public benefit corporations and authorities, utilities, hospitals and other healthcare providers, colleges and universities, and public employee retirement systems that are employers. . . .

      Paragraph 5 states that GASB Statement 27 supersedes the portions of GASB Statement 5 applicable to employer disclosures. [Revised 12/98.]
b. The Federal Accounting Standards Advisory Board (FASAB) was established in October 1990 by the Secretary of the Treasury, the Director of the Office of management and Budget (OMB), and the Comptroller General of the United States, to consider and recommend accounting standards and principles for the Federal Government. Statements of Federal Financial Accounting Standards (SFFASs) must be followed by federal agencies and cover most transactions. In December 1995 the FASAB issued SSFAS No. 5, Accounting for Liabilities of the Federal Government, the scope of which included two Interpretations related to pensions: Interpretation No. 3, Measurement Date for Pension and Retirement Health Care Liabilities (August 1997) and Interpretation No. 4, Accounting for Pension Payments in Excess of Pension Expense (December 1997). [Revised 12/98.]

2. Q—Does Statement 87 apply to a non-U.S. pension plan that provides death and disability benefits that are greater than the incidental death and disability benefits allowed in U.S. tax-qualified pension plans? [7, 8, 72]

A—Yes, if the non-U.S. pension plan is, in substance, similar to a U.S. pension plan. The relative level of death and disability benefits paid by a plan that provides primarily pension benefits should not, in itself, cause the pension plan to be "in substance" different from a U.S. pension plan.

3. Q—Does Statement 87 amend or supersede ♦ paragraphs 6-8 of Opinion 12 3(3) (regarding deferred compensation contracts)? [7, 9]

A—No. Opinion 12 addresses the accounting for the cost of deferred compensation contracts with individual employees that, taken together, are not equivalent to a pension plan. Statement 87 does not amend the description of those "other deferred compensation contracts" as discussed in paragraph 6 of Opinion 12. An employer that, prior to initial application of Statement 87, appropriately determined that its deferred compensation contracts were not equivalent to a pension plan and accordingly followed the accounting in Opinion 12 rather than that in Opinion 8 4(4) should not change its accounting for those contracts because of Statement 87.

4. Q—How should an employer with regulated operations account for the effects of applying Statement 87 for financial reporting purposes if another method of accounting for pensions is used for determining allowable pension cost for rate-marketing purposes? [7, 36, 210]

A—Statement 87 applies to employers with regulated operations. Paragraph 210 of Statement 87 states:

For rate-regulated enterprises, FASB Statement No. 71, Accounting for the Effects of Certain Types of Regulation, may require that the difference between net periodic pension cost as defined in this Statement and amounts of pension 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 pension cost as an expense; they do not otherwise affect the requirements of this Statement.

Accordingly, if Statement 71 applies to the employer, and the amount of net periodic pension cost determined under the method used for rate-making purposes differs from that determined under Statement 87, the difference would be (a) an asset if the criteria in ♦ paragraph 9 of Statement 71 are met or (b) a liability if the situation is as described in ♦ paragraph 11(b) of Statement 71.

Usually, continued use of different methods for rate-making purposes and general purpose
external financial reporting purposes would result in either the criteria in paragraph 9 of Statement 71 being met or the situation described in paragraph 11(b) of Statement 71. However, if pension cost determined in accordance with Statement 87 exceeds pension cost determined in accordance with the method used in setting current rates, the criteria in paragraph 9 of Statement 71 would not be met if (a) it is probable that the regulator soon will accept a change for rate-making purposes so that pension cost is determined in accordance with Statement 87 and (b) it is not probable that the regulator will provide revenue to recover the excess cost that results from the use of Statement 87 for financial reporting purposes during the period between the date that the employer adopts Statement 87 and the rate case implementing the change.

Similarly, if pension cost determined in accordance with the method used in setting current rates exceeds pension cost determined in accordance with Statement 87, the situation would not be as described in paragraph 11(b) of Statement 71 if it is probable that (a) the regulator soon will accept a change for rate-making purposes so that pension cost is determined in accordance with Statement 87, (b) the regulator will not hold the employer responsible for the costs that were intended to be recovered by the current rates and that have been deferred by the change in method, and (c) the regulator will provide revenue to recover those same costs when they are eventually recognized under the method required by Statement 87.

Because a regulator cannot eliminate a liability that was not imposed by its actions, the need to record a minimum liability under ♦ paragraph 36 of Statement 87 is unaffected by regulation.

Refer to Illustration 1 for an example of the employer's accounting when paragraphs 9 and 11(b) of Statement 71 apply.

Illustration 1—Accounting for Pensions by an Employer with Regulated Operations
[Revised 12/98; 12/03.]

An employer with regulated operations sponsors a defined benefit pension plan which is accounted for pursuant to Statement 87. To simplify the illustration, it is assumed that there are no remaining differences between amounts previously recognized as net periodic pension cost and amounts allowable for rate-making purposes. The employer's determination of net periodic pension cost (NPPC) under Statement 87, however, differs from that allowable for rate-making purposes. The following schedule shows the amounts under both bases for the year 20X0-20X3.

<table>
<thead>
<tr>
<th>Year</th>
<th>NPPC under Statement 87</th>
<th>Allowable for Rate-Making</th>
<th>Difference for the Period</th>
</tr>
</thead>
<tbody>
<tr>
<td>20X0</td>
<td>120</td>
<td>200</td>
<td>(80)</td>
</tr>
<tr>
<td>20X1</td>
<td>200</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>20X2</td>
<td>170</td>
<td>140</td>
<td>30</td>
</tr>
<tr>
<td>20X3</td>
<td>120</td>
<td>200</td>
<td>(80)</td>
</tr>
</tbody>
</table>

Journal Entries

Year 20X0

In 20X0, the amount allowable for rate-making purposes exceeds net periodic pension cost determined under Statement 87. In that case, ♦ paragraph 11(b) of Statement 71 requires the amount determined under Statement 87 ($120) to be recognized as net periodic pension cost in the employer's financial statements.

The difference ($80) between net periodic pension cost determined under Statement 87 ($120) and that allowable for rate-making purposes ($200) is recognized as a liability (unearned revenue) and
represents an amount collected or collectible for recovery of future pension cost. When that pension cost is incurred for financial reporting purposes, the liability (unearned revenue) should be eliminated and revenue should be recognized.

The journal entries to account for the accrual of net periodic pension cost and the contribution made to the pension plan during the year are as follows:

**Journal Entry 1**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net periodic pension cost</td>
<td>120</td>
</tr>
<tr>
<td>Revenue</td>
<td>80</td>
</tr>
<tr>
<td>(Unfunded accrued) prepaid pension cost</td>
<td></td>
</tr>
<tr>
<td>Unearned revenue</td>
<td>120</td>
</tr>
<tr>
<td>(Unfunded accrued) prepaid pension cost</td>
<td>80</td>
</tr>
</tbody>
</table>

To record net periodic pension cost for the period and the liability created by actions of the regulator.

**Journal Entry 2**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Unfunded accrued) prepaid pension cost</td>
<td>200</td>
</tr>
<tr>
<td>Cash</td>
<td></td>
</tr>
</tbody>
</table>

To record contribution to pension plan.

No modifications of the disclosures generally required by Statement 87 are required in this case because the accounting required by Statement 71 does not change the amount of net periodic pension cost recognized under Statement 87. (Refer to Table 2.)

**Year 20X1**

In 20X1, the amount allowable for rate-making purposes is less than net periodic pension cost determined under Statement 87 by $100. Of that amount, $80 was allowable for rate-making purposes in 20X0. Therefore, the 20X0 unearned revenue of $80 is recognized as revenue for 20X1. Paragraph 9 of Statement 71 requires the remaining portion of the $100 difference ($20) to be capitalized as an incurred cost for which future recovery is assured by actions of the regulator.

The journal entries to account for the accrual of net periodic pension cost and the contribution made to the pension plan during the year are as follows:
In this case, the accounting required by Statement 71 changes the amount of net periodic pension cost that otherwise would have been recognized under Statement 87 requiring modification of the disclosure required by paragraph 5(h) of FASB Statement No. 132 (revised 2003), Employers' Disclosures and Pensions and Other Postretirement Benefits. (Refer to Table 2.)

**Year 20X2**

In 20X2, the amount allowable for rate-making purposes is less than net periodic pension cost determined under Statement 87 by $30. None of that amount was allowable for rate-making purposes in prior years. Paragraph 9 of Statement 71 requires the $30 to be capitalized as an incurred cost for which future recovery is assured by actions of the regulator.

The journal entries to account for the accrual of net periodic pension cost and the contribution made to the pension plan during the year are as follows:

**Journal Entry 1**

Net periodic pension cost 140  
Capitalized cost for future recovery 30  
(Unfunded accrued) prepaid pension cost  

To record net periodic pension cost for the period and the asset created by actions of the regulator

**Journal Entry 2**

(Unfunded accrued) prepaid pension cost 140  
Cash  

To record contribution to pension plan
The situation in 20X2 is similar to that in 20X1, necessitating additional disclosure. (Refer to Table 2.)

**Year 20X3**

In 20X3, the amount allowable for rate-making purposes exceeds net periodic pension cost determined under Statement 87 by $80. In prior years (20X1 and 20X2), $50 of that amount was recognized as a capitalized cost.

Accordingly, that capitalized cost ($50) is expensed in 20X3. Additionally, paragraph 11(b) of Statement 71 requires recognition of a liability (unearned revenue) equal to the remaining portion ($30) of the amount allowable for rate-making purposes in excess of net periodic pension cost determined under Statement 87 \([($200 - $120) - $50 = $30]\). When that pension cost is incurred for financial reporting purposes, the $30 liability (unearned revenue) should be eliminated and revenue should be recognized.

The journal entries to account for the accrual of net periodic pension cost and the contribution made to the pension plan during the year are as follows:

**Journal Entry 1**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net periodic pension cost</td>
<td></td>
</tr>
<tr>
<td>Revenue</td>
<td></td>
</tr>
<tr>
<td>Capitalized cost for future recovery</td>
<td></td>
</tr>
<tr>
<td>(Unfunded accrued) prepaid pension cost</td>
<td></td>
</tr>
<tr>
<td>Unearned revenue</td>
<td></td>
</tr>
</tbody>
</table>

To record net periodic pension cost for the period and the liability created by actions of the regulator.

**Journal Entry 2**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Unfunded accrued) prepaid pension cost</td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td></td>
</tr>
</tbody>
</table>

To record contribution to pension plan.

The situation in 20X3 is similar to that in 20X1 and 20X2, necessitating additional disclosure. (Refer to Table 2.)

**Table 1**

The following illustrates the reconciliation of the pension plan's funded status with amounts recognized in the employer's statement of financial position at year-end. To simplify the illustration, it is assumed that there is no unrecognized net asset or net obligation at the date of initial application of Statement 87 and there are no gains or losses for the four-year period.
Table 2

The following illustrates the disclosure of the components of net periodic pension cost for 20X0-20X3. As noted earlier, it is assumed that there is no unrecognized net asset or net obligation at the date of initial application of Statement 87 and there are no gains or losses for the four-year period.

<table>
<thead>
<tr>
<th>20X0</th>
<th>20X1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Actuarial present value of benefit obligations:</td>
<td></td>
</tr>
<tr>
<td>Accumulated benefit obligation *</td>
<td>$20,000</td>
</tr>
<tr>
<td>Projected benefit obligation</td>
<td>$(500)</td>
</tr>
<tr>
<td>Plan assets at fair value</td>
<td>580</td>
</tr>
<tr>
<td>Projected benefit obligation (in excess of) less than plan assets</td>
<td>80</td>
</tr>
<tr>
<td>Unrecognized net (gain) loss</td>
<td>0</td>
</tr>
<tr>
<td>Prepaid pension cost (pension liability) recognized in the statement of financial position</td>
<td>$80</td>
</tr>
</tbody>
</table>

* Amounts are excluded for illustrative purposes only.

5. **Q**—If an employer has a pension plan that also provides postemployment health care benefits, should Statement 87 apply to those benefits? [8]

**A**—No. Accounting for postemployment health care benefits is covered by FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other than Pensions*. [Revised 12/98.]
6. Q—Does footnote 4 of Statement 87 (which states that "the interest cost component of net periodic pension cost shall not be considered to be interest for purposes of applying FASB Statement No. 34, Capitalization of Interest Cost") prescribe the capitalization of the interest cost component of net periodic pension cost when employee compensation is capitalized as part of the cost of inventory or other assets? [16]

A—No. A fundamental aspect of Statement 87 is to combine or aggregate the various pension cost components (service cost; interest cost; expected return on plan assets; and amortization of (a) unrecognized net asset or net obligation existing at the date of initial application of Statement 87, (b) prior service cost, and (c) net gain or loss). In the aggregate, net periodic pension cost is viewed and an element of employee compensation. Therefore, when it is appropriate to capitalize employee compensation in connection with the construction or production of an asset, the net periodic pension cost applicable to the pertinent employees for the period, not individual components of that amount, is the relevant amount.

7. Q—May an employer have net periodic pension cost that is a net credit (that is, net periodic pension income)? [16, 20]

A—Yes. Net periodic pension cost is an aggregation of various pension cost components, some of which are expenses or losses (which increase net periodic pension cost) and some of which are revenues or gains (which decrease net periodic pension cost). It is possible for the revenue or gain components to exceed the expense or loss components, resulting in net periodic pension income. For example, a pension plan may have an expected return on plan assets or amortization of an unrecognized net asset existing at the date of initial application of Statement 87 that exceeds the other net periodic pension cost components.

8. Q—If an employer has net periodic pension cost that is a net credit (that is, net periodic pension income), how should that be treated if employee compensation is capitalized as part of the cost of inventory or other assets? [16, 20]

A—If a cost allocation process capitalizes net periodic pension cost as part of the cost of inventory or other assets, net periodic pension income also should be capitalized, thereby reducing the total employee compensation and other costs being capitalized.

9. Q—If an employer sponsoring a pension plan that is overfunded has net periodic pension cost that is a net credit (that is, net periodic pension income) and the employer makes no contribution to the pension plan because it cannot currently deduct that amount for tax purposes, is the difference between net periodic pension income and the tax deductible amount a timing difference as discussed in paragraphs 10-11 of Statement 109? [5] If it is a temporary difference, when and how will it reverse? [16, 20] [Revised 12/98.]

A—Yes. The difference between net periodic pension income and the tax deductible amount represents the origination or reversal of a portion of the overall temporary difference related to a pension plan for which deferred taxes should be provided. Ultimately, the employer's cost of providing pension benefits to employees equals the net amount funded, which is equal to the total benefits paid less earnings on plan assets. Thus, cumulative pension cost for accounting purposes will equal the cumulative amount recognized for tax purposes. [Revised 12/98; 5/03.]

The overall temporary difference will reverse in one of two ways. First, at some future time the pension plan may not be so overfunded because of poor investment performance or because of increases in the obligation due to (a) a decline in interest rates, (b) additional pension benefits earned for future years of service, or (c) amendments to the pension plan that increase pension benefits. In this case, net periodic pension cost for future years would eventually exceed amounts
funded in those years. Second, if the pension plan remains overfunded and continually generates investment returns in excess of increases in the pension obligation, the employer may terminate the pension plan to recapture excess assets. In this case, the gain for accounting purposes from the pension plan termination would be less than the taxable amount resulting from that event. Although the reversal of the temporary difference may be far in the future and may be somewhat under the employer's control, there is a temporary difference for which deferred taxes should be provided. [Revised 12/98; 5/03.]

10. Q—If transferable securities issued by the employer are included in plan assets, should the measurement of plan assets also include the interest accrued but not yet received on those securities? [19]

A—Yes. The exclusion from plan assets in ♦ paragraph 19 of Statement 87 of "amounts accrued by the employer but not yet paid to the plan" is intended to relate to unfunded accrued pension costs.

11. Q—If an employer has a nonqualified pension plan (for tax purposes) that is funded with life insurance policies owned by the employer, should the cash surrender value of those policies be considered plan assets for purposes of applying Statement 87? [19, 62]

A—No. If the employer is the owner or beneficiary, the life insurance policies do not qualify as plan assets and the accounting for those policies should be in accordance with Technical Bulletin 85-4. 6(6)

12. Q—If the actual return on plan assets for a period is a component of net periodic pension cost, how does the expected return on plan assets affect the determination of net periodic pension cost? [23, 30-34]

A—the expected return on plan assets generally will be different from the actual return on plan assets for the year. Statement 87 provides for deferral of that difference (an unrecognized net gain or loss). The deferred amount is also a component of net periodic pension cost for the current period. Thus, the deferred amount and the actual return on plan assets, when aggregated, equal the expected return on plan assets. The deferred amount affects future net periodic pension cost through subsequent amortization, if any, of the unrecognized net gain or loss.

13. Q—If an employer has a substantive commitment to have a formula greater than the pension plan's written formula, how should the difference between the effects of a retroactive plan amendment that were anticipated as part of that substantive commitment and the effects of the actual retroactive plan amendment be accounted for? [24-34, 41]

A—If that difference results from an intended modification of the formula for which there is a substantive commitment, the accounting should be that prescribed in ♦ paragraphs 24-28 of Statement 87 for a retroactive plan amendment. Otherwise, that difference is a gain or loss subject to the accounting specified in ♦ paragraphs 29-34 of Statement 87.

14. Q—Once a schedule of amortization of unrecognized prior service cost from a specific retroactive plan amendment has been established, should that schedule remain the same or is it subject to revision on a periodic basis? [24-28, 167]

A—the FASB initial schedule should be revised only if a curtailment occurs (♦ paragraphs 6 and 12 of Statement No. 88, Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits) or if events indicate that (a) the period during which the employer expects to realize future economic benefits from the retroactive plan amendment giving rise to the prior service cost is shorter than originally estimated or (b) the
future economic benefits have been impaired. The schedule should not be revised because of ordinary variances in expected service lives of employees. Statement 87 proscribes revising the schedule so that the unrecognized prior service cost would be recognized more slowly.

15. **Q**—If the acquiring employer in a business combination includes the employees of the acquired employer in its pension plan and grants them credit for prior service (the acquired employer did not have a pension plan), should the credit granted for prior service be treated as unrecognized prior service cost or as part of the cost of the acquisition? [24-27, 74] [Revised 9/01.]

**A**—The answer to this question depends on an analysis of all the facts and circumstances surrounding the acquisition. If the acquiring employer's granting of credit for prior service to the employees is required by the seller as part of the consummation of the acquisition, then it should be considered as part of the cost of the acquisition. Otherwise, the credit granted for prior service should be accounted for as a retroactive plan amendment.

If the credit granted for prior service is considered part of the cost of the acquisition, the debit offsetting the increase in the projected benefit obligation should be an adjustment of the goodwill otherwise determined for the acquisition. If the credit granted for prior service is accounted for as a retroactive plan amendment, the unrecognized prior service cost is subject to delayed recognition as specified in paragraphs 24-27 of Statement 87. The effects of the alternatives on the balance sheet and income statement could differ. [Revised 9/01.]

16. **Q**—In determining the periods for (a) amortization of unrecognized prior service cost, (b) minimum amortization of unrecognized net gain or loss, or (c) amortization of the unrecognized net asset or net obligation existing at the date of initial application of Statement 87, is it necessary to include the service periods of employees who are expected to receive only a return of their contributions (plus interest, if applicable) to a contributory defined benefit pension plan in determining the future service periods of employees expected to receive benefits under that pension plan? [24-26, 32, 77]

**A**—No. Only the future service periods of those employees who are expected to receive an employer-provided benefit should be included.

17. **Q**—Are the service periods of employees expected to terminate before their benefits are vested included in the determination of the average remaining service period of employees expected to receive benefits under the pension plan? [24, 26, 32, 77]

**A**—No. Only the service periods of those employees working as of the date for which the determination is made and who are expected to actually receive employer-provided benefits are included.

18. **Q**—Is there a specific threshold for determining if a pension plan has "almost all" inactive participants for purposes of selecting the amortization period for certain components of net periodic pension cost? [25, 26, 32, 77]

**A**—No. The threshold for using the average life expectancy of inactive participants requires judgment based on the facts and circumstances of the particular pension plan.

19. **Q**—May an employer adopt and accounting policy to recognize immediately the cost of all plan amendments that grant increased benefits for services rendered in prior periods (prior service cost)? [26, 27]

**A**—No. An accounting policy to recognize immediately the cost of all plan amendments that grant increased benefits for services rendered in prior periods is not permitted. Immediate recognition of prior service cost due to a retroactive plan amendment is appropriate only if, based on an
assessment of the facts and circumstances, the employer does not expect to realize any future economic benefits from that retroactive plan amendment. 8(7) (Refer to paragraph 27.) Adopting an accounting policy to recognize immediately prior service cost would preclude making that assessment for future plan amendments as they occur. [Revised 5/03.]

The Board did not intend to include immediate recognition among those alternative amortization methods for prior service cost permitted by ♦ paragraph 26 of Statement 87. Rather, the permissibility of adopting an alternative method as an accounting policy was intended to be responsive to respondents’ concerns that the method defined in paragraph 25 9(8) of Statement 87 would be unnecessarily complex and would require employers to maintain detailed records for long periods. The Board agreed to allow alternative methods of amortization that would simplify computations and record keeping but with the intent that such methods would consider employees' service lives (or inactive participants' remaining lives, if applicable) and would not have the effect of delaying recognition of prior service cost to a greater extent than the method defined in paragraph 25 of Statement 87.

20. **Q**—If an employer has a history of granting retroactive plan amendments every three years, should the resulting unrecognized prior service costs be amortized over a three-year period? [27]

   **A**—One of the objectives of Statement 87 is to amortize the cost of a retroactive plan amendment over the period benefited if that period is shorter than the employees' remaining service period. If an employer has a history of granting retroactive plan amendments every three years, for example, as part of union negotiations, the period benefited may be three years. If employees expect the pattern to continue, the future economic benefits to be obtained from a retroactive plan amendment may not continue if the pattern is broken; effectively, the future economic benefit of each retroactive plan amendment may expire over the period of the union contract (in this case, three years). In that situation, amortization of unrecognized prior service cost over a three-year period would be appropriate. Whether three years is the appropriate amortization period for a retroactive plan amendment that is part of a three-year amendment pattern should be determined based on the facts and circumstances of the particular situation.

Questions and Answers 21-40

21. **Q**—If an employer grants a retroactive plan amendment that reduces the projected benefit obligation (a negative retroactive plan amendment), what method should be used to reduce any existing unrecognized prior service cost when several prior retroactive plan amendments in the aggregate have resulted in unrecognized prior service costs that exceed the effects of the negative retroactive plan amendment? [28]

   **A**—Unless the retroactive plan amendment that reduces benefits can be specifically related to a prior retroactive plan amendment, any systematic and rational method (for example, Last-In, First-Out; First-In, First-Out; or pro rata), applied on a consistent basis, is acceptable.

22. **Q**—If an employer amends a pension plan to delete a provision that a percentage of the employee's accumulated benefits be paid to the employee's spouse upon death of the employee prior to a specified age, should the reduction in benefits be accounted for as a retroactive plan amendment? [28]

   **A**—Yes.

23. [Question deleted because the effective date of Statement 87 has passed.]

   **Q**—If an employer initially applies Statement 87 on January 1, 1987 but during 1987 changes its final-pay pension plan to a career-average-pay pension plan effective January 1, 1987, should the
employer adjust the pension plan's unrecognized net asset or net obligation existing at the date of initial application of Statement 87 to reflect the reduction in the projected benefit obligation? [28, 77]

**A—** No. The reduction in the projected benefit obligation should be recognized as a retroactive plan amendment, the amendment occurred during the 1987 fiscal year and, as such, should not be treated differently from other events affecting the pension plan during that year.

24. **Q—** Should the amount and timing of pension plan contributions and benefit payments expected to be made during the year be considered in determining the expected return on plan assets for that year? [30]

**A—** Yes. The expected return on plan assets should take into consideration the availability of all plan assets for investment throughout the year. For example, if the employer's pension plan contribution for the year is expected to be made two months before the next measurement date, then the expected return on plan assets should include an amount related to the expected return on that contribution only for those two months.

25. [Question deleted because the effective date of Statement 87 has passed]

**Q—** May the market-related value of plan assets at the date of initial application of Statement 87 be other than the fair value of those assets for purposes of determining the expected return on plan assets? [30]

**A—** Yes. An employer may use a market-related value of plan assets to determine the expected return on plan assets for the first year under Statement 87 if the method for determining market-related value complies with Statement 87. However, there are both practical and theoretical reasons, as follow, why an employer may prefer to start with the fair value of plan assets at the date of initial application of Statement 87.

The practical reason is that the computations are more complex if the employer starts with a market-related value of plan assets. The unrecognized net asset or net obligation existing at the date of initial application of Statement 87 is determined using the fair value of plan assets and is subsequently amortized as part of net periodic pension cost. If an employer uses a market-related value of plan assets to determine the expected return on plan assets, care needs to be exercised not to double count the difference between fair value and market-related value of plan assets at the date of initial application of Statement 87. For example, assume the following facts at the date Statement 87 is initially applied:

- Projected benefit obligation $600
- Fair value of plan assets $1,000
- Five-year-moving-average value of plan assets $850
- Unfunded accrued or prepaid pension cost $0
- Employee average remaining service period 15 years

The unrecognized net asset existing at the date of initial application of $400 ($1,000 - $600) should be amortized over the average remaining service period of employees expected to receive benefits under the pension plan. That amount already incorporates the $150 difference ($1,000 - $850) between the fair value of plan assets and the five-year-moving-average value of plan assets. As the employer adjusts the five-year-moving-average value of plan assets over the next five years, that $150 difference could be erroneously reflected as an actuarial gain or as a return on...
plan assets, and, thus, the potential for double counting exists. Accordingly, care must be exercised to be sure that the original $150 difference that is being amortized as a separate component of net periodic pension cost is excluded from other components of net periodic pension cost.

The *theoretical* reason to start with the fair value of plan assets rather than a market-related value of plan assets is that Statement 87 represents a "fresh start" on pension accounting. All previously unrecognized net gains or losses (including those based on the fair value of plan assets) and unrecognized prior service cost lose their identity in the unrecognized net asset or net obligation existing at the date of initial application of Statement 87. Thus, there is support to start with the fair value of plan assets.

Refer to Illustration 2 for an example of how an employer may use a market-related value of plan assets at the date of initial application of Statement 87 to determine the expected return on plan assets.

**Illustration 2**—[Illustration deleted because the effective date of Statement 87 has passed.]

**Use of Market-related Value of Plan Assets at the Date of Initial Application of Statement 87**

**Determination of Market-related Value of Plan Assets**

An employer elects to apply Statement 87 for its financial statements for the year ended December 31, 1986 and to measure pension-related amounts as of year-end. The employer also elects to determine the market-related value of plan assets using an asset valuation method that adjusts for 20 percent of each of the last 5 years' asset gains or losses. That asset valuation method, which is an acceptable methodology under paragraph 30 of Statement 87, was previously used in applying Opinion 8.

The market-related value of plan assets as of the beginning of 1986 is the market-related value of plan assets as of December 31, 1985.

A $100,000 experience gain on plan assets occurred during 1985. (For simplicity, no gains or losses are assumed to have occurred during the period January 1, 1981 through December 31, 1984.) The determination of the market-related value of plan assets at December 31, 1985 is as follows (in thousands):  

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market-related value at beginning of 1985</td>
<td>$ 636</td>
</tr>
<tr>
<td>Expected return on plan assets</td>
<td>64</td>
</tr>
<tr>
<td>Contributions</td>
<td>92</td>
</tr>
<tr>
<td>Benefits paid</td>
<td>(92)</td>
</tr>
<tr>
<td>20% of each of the last 5 years' asset gains (losses)</td>
<td>20</td>
</tr>
<tr>
<td>Market-related value at end of 1985</td>
<td>$ 720</td>
</tr>
</tbody>
</table>

As of December 31, 1985, $20,000 of the 1985 gain is included in the market-related value of plan assets, causing a difference of $80,000 between the fair market value and the market-related value of plan assets at the date of initial application of Statement 87.

**Determination of Minimum Amortization of Unrecognized Net Gain or Loss**

Paragraph 32 of Statement 87 requires a minimum amortization of the unrecognized net gain or loss as of the beginning of the period in determining net periodic pension cost. Assuming the pension plan has a $1,000,000 projected benefit obligation as of December 31, 1985 and the average remaining service life of employees expected to receive benefits under the pension plan is
10 years, the minimum amortization of the unrecognized net gain or loss in subsequent years is determined as follows (in thousands):

**1986**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unrecognized net (gain) loss at beginning of year * (9)</td>
<td></td>
</tr>
<tr>
<td>Plus asset gain or less asset loss not yet reflected in market-related value of plan assets at beginning of year</td>
<td>80</td>
</tr>
<tr>
<td>Less asset gain or plus asset loss not yet reflected in market-related value of plan assets at beginning of year, but included in the transition amount</td>
<td>(80)</td>
</tr>
<tr>
<td>Unrecognized net (gain) loss subject to amortization at beginning of year</td>
<td></td>
</tr>
<tr>
<td>Corridor = 10% of the greater of the projected benefit obligation ($1,000) or market-related value of plan assets ($720) at beginning of year</td>
<td></td>
</tr>
<tr>
<td>Unrecognized net gain (loss) outside the corridor</td>
<td></td>
</tr>
<tr>
<td>x 1/average remaining service life (1/10)</td>
<td></td>
</tr>
<tr>
<td>Amortization</td>
<td></td>
</tr>
</tbody>
</table>

The amount of asset gain included in the fair value of plan assets but not yet reflected in the market-related value of plan assets at the date of initial application of Statement 87 ($80,000) should be tracked carefully until that entire amount has been fully reflected in the market-related value of plan assets. For 1987, the amount of asset gain at the date of initial application of Statement 87 not yet reflected in the market-related value of plan assets is $60,000. That difference will be reduced by $20,000 in each subsequent year until the year ending December 31, 1990 when the full amount should have been reflected in the market-related value of plan assets.

**26. Q—** May an employer that has several pension plans with similar plan assets use different asset valuation methods to determine the market-related value of those plan assets? [30]

**A—** An employer should use different asset valuation methods for similar plan assets only if the pension plans' inherent facts and circumstances justify the difference in methodology. Otherwise, the use of a variety of asset valuation methods for similar plan assets is inconsistent with Statement 87's objective of enhancing the comparability of reported pension information.

**27. Q—** Is there a limitation on the number of classes into which plan assets may be divided for purposes of selecting asset valuation methods for determining the market-related value of plan assets? [30]

**A—** No. However, the asset valuation method selected for each class should accomplish the objective of recognizing changes in the fair value of those plan assets in a systematic and rational manner over not more than five years. Once that method is selected, it should be applied consistently for that class of plan assets as should the method for dividing plan assets into classes.

**28. Q—** Is the following an acceptable asset valuation method for determining the market-related value of plan assets?

The market-related value of plan assets is determined with a total return-on-plan asset component consisting of three layers:

a. An expected return-on-plan asset component based on the beginning-of-year market-related value of plan assets, cash flow during the year, and the expected long-term rate of return on plan assets

b. An amount equal to the change in the accumulated benefit obligation that resulted from any change during the year in the assumed discount rates used to determine the accumulated
benefit obligation (The amount is reduced pro rata if plan assets are less than the accumulated benefit obligation.)

c. A variance component equal to a percentage (for example, 20 percent if a five-year-averaging period is used) of the difference between the actual return on plan assets based on the fair values of those plan assets and the expected return on plan assets derived from components (a) and (b). [30]

A—No. The method described introduces a factor (refer to layer (b)) that can be unrelated to the change in the fair value of plan assets. For a method to meet Statement 87’s criteria of being systematic and rational, it should reflect only the changes in the fair value of plan assets between various dates.

The use of a market-related value of plan assets was developed as a response to suggestions to reduce the asset-related volatility of net periodic pension cost. The method described appears intended to accomplish an objective that the use of a market-related value was not designed to achieve, namely, to smooth further the effects of changes in assumed discount rates.

29. Q—How does the use of a market-related value of plan assets affect the determination of net periodic pension cost? [30-32]

A—The use of a market-related value of plan assets affects the determination of net periodic pension cost in two ways. First, the market-related value of plan assets is the basis on which the expected return on plan assets is computed. Second, to the extent that unrecognized gains or losses based on the fair value of plan assets are not yet reflected in the market-related value of plan assets, such amounts are excluded from the unrecognized net gain or loss subject to amortization beginning in the following year. Although those excluded gains or losses eventually affect net periodic pension cost, their impact is delayed through use of a market-related value of plan assets.

30. Q—If an employer uses a market-related value of plan assets in determining net periodic pension cost, is the determination of an additional minimum liability also based on that value of plan assets? [30, 36]

A—No. ♦ Paragraph 36 of Statement 87 states that "if the accumulated benefit obligation exceeds the fair value . . . that is at least equal to the unfunded accumulated benefit obligation." (Emphasis added.) The objective of that paragraph is to provide a measure of the pension plan's minimum underfunded status as of a particular point in time. For that purpose, the most relevant measure of plan assets is their fair value. The use of fair value of plan assets also enhances the comparability of information reported for similarly situated pension plans. The objective of using a market-related value of plan assets, on the other hand, is only to smooth the effects on earnings of the changes in the fair value of plan assets.

31. Q—If all or almost all of a pension plan's participants are inactive due to a temporary suspension of the pension plan (that is, for a limited period of time, employees will not earn additional defined benefits), should the minimum amortization of an unrecognized net gain or loss be determined based on the average remaining life expectancy of the temporarily inactive participants? [32]

A—No. The minimum amortization of an unrecognized net gain or loss should be determined based on the average remaining service period of the temporarily inactive participants expected to receive benefits under the pension plan.

32. Q—If all employees covered by a pension plan are terminated but not retired, should the minimum amortization of an unrecognized net gain or loss be determined based on the average
remaining life expectancy of the inactive participants? [32]

A—Yes. The situation described could arise, for example, if a division with its own pension plan is sold by the employer thus terminating the related employees, but the pension plan remains in existence and it retains the obligation for benefits accrued to the date of sale. In that situation, the minimum amortization of an unrecognized net gain or loss should be determined based on the average remaining life expectancy of the inactive participants.

33. Q—May an employer immediately recognize gains and losses instead of delaying their recognition? [33, 54]

A—Yes. Immediate recognition of gains and losses is permitted if (a) that method is applied consistently, (b) the method is applied to all gains and losses (on both plan assets and obligations), and (c) the method used is disclosed in accordance with ♦ paragraph 5(o) of Statement 132(R). [35, 36, 52]. [Revised 12/98; 12/03.]

34. Q—If an employer recognized an additional minimum liability at its prior fiscal year-end, what balance sheet pension account(s) should be affected during subsequent interim periods for the accrual of net periodic pension cost or for contributions made to the pension plan? [35, 36, 52]

A—The accounting for interim net periodic pension cost accruals and contributions made to the pension plan should be reflected in the unfunded accrued or prepaid pension cost account balance. That balance should be combined with the additional minimum liability account balance for presentation in the statement of financial position.

35. Q—May an employer recognize an additional pension asset for an overfunded pension plan beyond that which results from (a) funding more than the amount of net periodic pension cost or (b) recognizing net periodic pension income? [35, 74]

A—No. Although Statement 87 acknowledges that, in concept, a pension asset should be recognized for any pension plan with plan assets in excess of the projected benefit obligation, it does not permit recognition of an additional pension asset on a discretionary basis. Such an asset is recognized on a delayed basis when the item giving rise to that excess is amortized as a component of net periodic pension cost (income). (Note, however, that Statement 87 requires recognition of such an additional pension asset in a business combination.) [Revised 9/01.]

36. Q—If a pension plan has fixed-income investments (such as guaranteed investment contracts or bonds) that it intends to hold until they mature, should the determination of the additional minimum liability be based on the amortized cost or fair value of those fixed-income investments? [36, 49, 62]

A—For purposes of determining the additional minimum liability, the fixed-income investments should be measured at their fair value. The intent of Statement 87 is to provide pension information based on the current values of the pension obligations and plan assets. The assumed discount rates used to determine the pension obligations are to reflect the interest rates inherent in the price at which the pension benefits could be effectively settled—currently. The fair value used to measure plan assets is also a current determination of the value of those assets. The notion of measuring bonds intended to be held to maturity at their fair value is not new. That methodology was required in providing Statement 36 10(10) pension disclosure information and continues to be a requirement under Statement 35. 11(11) The Basis for Conclusions of Statement 35 provides additional discussion of the issue.

37. Q—How should an employer determine whether an additional minimum liability is required if it has a financial report date of December 31 and a measurement date of September 30? [36, 52]
A—the determination should be based on the funded status of the pension plan as of September 30, the measurement date, compared with the accrued or prepaid pension cost recognized by the employer as of December 31 excluding amounts contributed to the plan during the period after the measurement date and prior to year-end—in this case, the fourth quarter. The accrued or prepaid pension cost is not adjusted to exclude the effect of the net periodic pension cost recognized by the employer during the period from September 30 to December 31 because that amount is reflected in the funded status as of September 30. Refer to Illustration 3. [Revised 12/98; 10/02.]

As of September 30, 20X2 the accumulated benefit obligation, projected benefit obligation, and fair value of plan assets of a defined benefit pension plan sponsored by an employer are (in thousands):

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount (in thousands)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accumulated benefit obligation</td>
<td>$(880)</td>
</tr>
<tr>
<td>Projected benefit obligation</td>
<td>(975)</td>
</tr>
<tr>
<td>Plan assets at fair value</td>
<td>800</td>
</tr>
</tbody>
</table>

The employer uses a September 30 measurement date in accounting for its pension plan in its financial statements for the year ending December 31. Based on the amount of the unfunded accumulated benefit obligation, a minimum liability of $80,000 must be recognized in the financial statements. At December 31, 20X2, the employer has a recognized prepaid pension cost (an asset) of $151,000, which includes (a) a fourth-quarter pension cost accrual of $24,000 and (b) a fourth-quarter contribution to the pension plan of $100,000. At September 30, 20X2, the employer has an unrecognized net loss of $156,000 and unrecognized prior service cost of $70,000.

The reconciliation of the pension plan's funded status at September 30, 19X2 to the balance sheet amount (before giving effect to any additional minimum liability) at December 31, 19X2 follows (in thousands):

<table>
<thead>
<tr>
<th>Actuarial present value of benefit obligations at September 30, 20X2:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accumulated benefit obligation</td>
</tr>
<tr>
<td>Projected benefit obligation</td>
</tr>
<tr>
<td>Plan assets at fair value at September 30, 20X2</td>
</tr>
<tr>
<td>Projected benefit obligation in excess of plan assets</td>
</tr>
<tr>
<td>Unrecognized net loss</td>
</tr>
<tr>
<td>Unrecognized prior service cost</td>
</tr>
<tr>
<td>Prepaid pension cost before fourth-quarter contribution</td>
</tr>
<tr>
<td>Amount contributed to plan during fourth quarter 20X2</td>
</tr>
<tr>
<td>Prepaid pension cost recognized in the statement of financial position at December 31, 20X2</td>
</tr>
</tbody>
</table>

The determination of the additional minimum liability to be recognized at December 31, 20X2, follows (in thousands):
Journal entry required to reflect minimum liability at December 31, 20X2:

\[
\begin{align*}
\text{Intangible asset} & \quad 0 \\
\text{Other comprehensive income} & \quad 61 \\
\text{Additional minimum liability} & \quad \text{To record an additional liability to reflect the required minimum liability. (For financial statement presentation, the additional liability [$131] is combined with the prepaid pension cost [$151], and the net amount [$20] is presented as an asset.)}
\end{align*}
\]

38. [Question deleted because the effective date of Statement 87 has passed.]

**Q**—In determining the unrecognized net asset or net obligation and the additional minimum liability existing at the date of initial application of Statement 87, is it necessary to make adjustments for amounts contributed to the pension plan by the employer during the period between the beginning measurement date and the beginning of the financial reporting year if those dates are different? [36, 52, 77]

**A**—Yes. Illustration 3 provides an example of the necessary adjustments.

**Illustration 3**—[Illustration deleted because the effective date of Statement 87 has passed.]

**Determination of Minimum Pension Liability When Measurement Date Precedes Reporting Date**

[Revised 12/98; 10/02]

In Case 1, an employer has an overfunded pension plan. In Case 2, an employer has an underfunded pension plan.

**Case 1—Calculation of Unrecognized Net Asset Existing at the Date of Initial Application (Overfunded Pension Plan)**

As of September 30 and December 31, 1985, respectively, the projected benefit obligation and the fair value of plan assets of a defined benefit pension plan sponsored by an employer are (in thousands):

\[
\begin{array}{ccc}
\text{September 30} & \text{December 31} \\
\text{Projected benefit obligation} & $(700) & $(750) \\
\text{Plan assets at fair value} & 800 & 820 \\
\text{Overfunded obligation} & $100 & $70 \\
\end{array}
\]
The employer elects to apply Statement 87 for its financial statements for the year ending December 31, 1986 using a measurement date of September 30. At September 30, 1985, there is no unfunded accrued or prepaid pension cost in the employer's statement of financial position (that is, all amounts accrued as net periodic pension cost have been contributed to the pension plan). At December 31, 1985, the employer has a recognized prepaid pension cost (an asset) of $27,000, which represents (a) the fourth quarter pension cost accrual of $13,000 and (b) the fourth quarter funding of $40,000.

The unrecognized net asset existing at the date of initial application of Statement 87 is $113,000, determined as follows (in thousands):

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Plan assets in excess of projected benefit obligation at September 30, 1985</td>
<td>$100</td>
</tr>
<tr>
<td>Plus fourth quarter contribution</td>
<td>40&lt;sup&gt;a(12)&lt;/sup&gt;</td>
</tr>
<tr>
<td>Less prepaid pension cost at December 31, 1985</td>
<td>27</td>
</tr>
<tr>
<td>Unrecognized net asset</td>
<td>$113</td>
</tr>
</tbody>
</table>

Assuming the employer elects to provide comparative disclosures in the 1986 annual report, the reconciliation of the pension plan's funded status to the balance sheet amount at the beginning of the year should appear as follows (in thousands):

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vest benefit obligation</td>
<td></td>
</tr>
<tr>
<td>Accumulated benefit obligation</td>
<td></td>
</tr>
<tr>
<td>Projected benefit obligation</td>
<td></td>
</tr>
<tr>
<td>Plan assets at fair value at September 30, 1985</td>
<td></td>
</tr>
<tr>
<td>Plan assets in excess of projected benefit obligation at September 30, 1985</td>
<td></td>
</tr>
<tr>
<td>Amount contributed to plan during fourth quarter 1985</td>
<td></td>
</tr>
<tr>
<td>Unrecognized net asset at date of initial application of Statement 87</td>
<td></td>
</tr>
<tr>
<td>Prepaid pension cost recognized in the statement of financial position at December 31, 1985</td>
<td></td>
</tr>
</tbody>
</table>

Case 2—Calculation of Unrecognized Net Pension Obligation Existing at the Date of Initial Application (Underfunded Pension Plan)

As of September 30 and December 31, 1985, respectively, the projected benefit obligation and fair value of plan assets of a defined benefit pension plan sponsored by an employer are (in thousands):

<table>
<thead>
<tr>
<th>Description</th>
<th>September 30</th>
<th>December 31</th>
</tr>
</thead>
<tbody>
<tr>
<td>Projected benefit obligation</td>
<td>$(950)</td>
<td>$(974)</td>
</tr>
<tr>
<td>Plan assets at fair value</td>
<td>800</td>
<td>820</td>
</tr>
<tr>
<td>Unfunded obligation</td>
<td>$(150)</td>
<td>$(154)</td>
</tr>
</tbody>
</table>

The employer elects to apply Statement 87 for its financial statements for the year ending December 31, 1986 using a measurement date of September 30. At September 30, 1985, there is no unfunded accrued or prepaid pension cost in the employer's statement of financial position (that is, all amounts accrued as net periodic pension cost have been contributed to the pension plan). At
December 31, 1985, the employer has a recognized prepaid pension cost (an asset) of $6,000, which represents (a) the fourth quarter pension cost accrual of $24,000 and (b) the fourth quarter funding of $30,000.

The unrecognized net obligation existing at the date of initial application of Statement 87 is $126,000, determined as follows (in thousands):

Obligation is excess of plan assets at September 30, 1985
Plus fourth quarter contribution
Less prepaid pension cost at December 31, 1985
Unrecognized net obligation

Assuming the employer elects to provide comparative disclosures in the 1986 annual report, the reconciliation of the pension plan’s funded status to the balance sheet amount at the beginning of the year should appear as follows (in thousands):

Actuarial present value of benefit obligations at September 30, 1985:
   Vested benefit obligation
   Accumulated benefit obligation
   Projected benefit obligation
Plan assets at fair value at September 30, 1985
Projected benefit obligation in excess of plan assets at September 30, 1985
Amount contributed to plan during fourth quarter 1985
Unrecognized net obligation at date of initial application of Statement 87
Prepaid pension cost recognized in the statement of financial position at December 31, 1985

The determination of the additional minimum liability to be recognized as of the beginning of the period is shown below (in thousands):

Prepaid pension cost recognized in statement of financial position at December 31, 1985
Amount contributed to the plan during fourth quarter 1985
Required minimum liability (unfunded accumulated benefits)

Journal entry required to reflect minimum liability at the beginning of the year:

Intangible asset
Additional liability
To record an additional liability to reflect the required minimum liability (For financial statement presentation, the additional liability [$56] is combined with the prepaid pension cost [$6], and the net amount [$50] is presented as a liability.)

39. **Q**—In determining whether an additional minimum liability is required, may an employer compare the fair value of plan assets to a measure of the pension obligation greater than the accumulated benefit obligation (such as the projected benefit obligation)? [36, 74]

**A**—No. Statement 87 does not permit recognition of an additional minimum liability that would
result in a net balance sheet liability greater than the unfunded accumulated benefit obligation. (Note, however, that paragraph 74 requires recognition of a net liability or asset based on a comparison of the projected benefit obligation to plan assets.) [Revised 9/01; 5/03.]

40. Q—If an acquiring employer has accounted for a business combination by the purchase method under Opinion 16 before that Opinion was amended by FASB Statement No. 96, Accounting for Income Taxes, and FASB Statement No. 109, Accounting for Income Taxes, and before the Opinion was superseded by FASB Statement No. 141, Business Combinations, should that employer's determination of any additional minimum liability consider the remaining portion of (a) the net-of-tax pension asset or pension liability or (b) the gross pension asset or pension liability determined at the date of the acquisition? [36, 74] [Revised 12/98; 9/01.]

A—The determination of any additional minimum liability should consider the remaining portion of the gross pension liability or pension asset, not the net-of-tax amount.

Questions and Answers 41-60

41. Q—If an employer recognizes an additional minimum liability and an equal amount as an intangible asset, should those amounts be classified as current or noncurrent in the statement of financial position? [37]

A—The criteria for current or noncurrent classification of the additional minimum liability or the intangible asset are the same as for any other liability or asset. If it is assumed that the additional minimum liability will not be funded in the next 12 months (or operating cycle, if longer), then it should be classified as noncurrent. If, however, it is expected that a part or all of the additional minimum liability will be funded in the next 12 months (or operating cycle, if longer), the amount to be funded should be classified as current.

The intangible asset should be classified as noncurrent since it represents an amount that is being amortized over future years, either unrecognized prior service cost or an unrecognized net obligation existing at the date of initial application of Statement 87.

42. Q—If an employer recognizes an additional minimum liability and an equal amount as an intangible asset, is the intangible asset subject to separate amortization over a specified period? [37]

A—No. The intangible asset results from either (a) unrecognized prior service cost or (b) the remaining portion of the unrecognized net obligation existing at the date of initial application of Statement 87. Those amounts are amortized as part of the net periodic pension cost determination, thereby effectively amortizing the intangible asset.

43. [Question deleted because the effective date of Statement 87 has passed.]

Q—For the year 1988 in Illustration 5, Case 2, of Statement 87, shouldn't an intangible asset have been recognized for the entire amount of the additional minimum liability ($128,000), rather than an intangible asset of $92,000 and a charge to equity of $36,000, since a portion of the unrecognized net obligation existing at the date of initial application of Statement 87 remains as of December 31, 1988? [37, 261]

A—Yes. There is an error in the illustration. Illustration 4 is the corrected illustration that appears in the 1986-1987 editions of CurrentText and Original Pronouncements. It also should be noted that to simplify the illustration, any deferred income tax effects that would result from classifying the charge to equity as a timing difference for purposes of applying Opinion 11 were not considered.
**Revised Case 2—Minimum Liability in Excess of Unrecognized Prior Service Cost** (Refer to pages 108 and 109 of Statement 87.)

Company L elected to apply the provisions of this Statement, including those requiring recognition of minimum liability, for its 1986 financial statements. The funded status of its plan for the years 1988 and 1989 is shown below (in thousands).

<table>
<thead>
<tr>
<th>As of December 31, 1988</th>
</tr>
</thead>
<tbody>
<tr>
<td>FUNDED STATUS—COMPANY L</td>
</tr>
<tr>
<td>Assets and obligations:</td>
</tr>
<tr>
<td>Accumulated benefit obligation</td>
</tr>
<tr>
<td>Plan assets at fair value</td>
</tr>
<tr>
<td>Unfunded accumulated benefits</td>
</tr>
<tr>
<td>Overfunded accumulated benefits</td>
</tr>
<tr>
<td>Projected benefit obligation</td>
</tr>
<tr>
<td>Plan assets at fair value</td>
</tr>
<tr>
<td>Items not yet recognized in earnings:</td>
</tr>
<tr>
<td>Unrecognized net obligation (net asset) at January 1, 1986</td>
</tr>
<tr>
<td>Unrecognized prior service cost</td>
</tr>
<tr>
<td>Unrecognized net loss</td>
</tr>
<tr>
<td>(Accrued)/prepaid pension cost</td>
</tr>
</tbody>
</table>

**DETERMINATION OF AMOUNTS TO BE RECOGNIZED**

(Accrued)/prepaid pension cost at beginning of year |  |
Net periodic pension cost |  |
Contribution |  |

(Accrued)/prepaid pension cost at end of year |  |
Required minimum liability (unfunded accumulated benefits) |  |
Adjustment required to reflect minimum liability:
| Additional liability | a(19) | $ |
| Intangible asset (not to exceed unrecognized prior to service cost) |  |
| Charge to equity (excess of additional pension liability over unrecognized prior service cost) |  |
Balance of additional liability | $ |
Balance of intangible asset |  |
Balance of equity account |  |
44. **Q—**If a career-average-pay pension plan has a formula that provides pension benefits equal to 1 percent of each year's salary for that year's service and prospective (flat-benefit) plan amendments are granted every three years as part of union negotiations (for example, a negotiated increase may provide that additional benefits of $360 per year are earned for each of the following three years of service), should the projected unit credit method be used for both the career-average-pay and the flat-benefit portions of the pension benefits provided under the pension plan? [39, 40]

**A—** No. The projected unit credit method should be used to attribute the career-average-pay portion of the pension benefits over employees' service periods, and the unit credit method should be used for the flat-benefit portion for the limited service period, which, for this example, is three years.

45. **Q—**If an employer has a pension plan that provides a pension benefit of 1 percent of final pay for each year of service up to a maximum of 20 years of service and final pay is frozen at the 20th year, should the employer attribute the total projected benefits under the pension plan for an employee over the employee's expected service period even if that service period is anticipated to exceed the 20-year limitation? [39, 40]

**A—** No. ♠ Footnote 8 (paragraph 40) of Statement 87 limits the attribution period to the 20-year period for an employee anticipated to work beyond that period.

Although total projected benefits ordinarily should be attributed to years of service based on the pension plan's formula, ♠ paragraph 42 of Statement 87 explains that some pension plans have formulas that attribute a disproportionate share of those pension benefits to later years of service and requires attribution of those pension benefits ratably over the service period (which would be faster than the pension plan formula). However, no basis exists for attribution of pension benefits to years of service more slowly than the pension plan's formula. For this example, the service cost component of net periodic pension cost for the employee should be zero after year 20. However, interest cost should continue to accrue on the projected benefit obligation.

46. **Q—**Would the answer to ♠ Question 45 be different if the pension plan's formula provided a pension benefit of 1 percent of final pay for each year of service up to a maximum of 20 years of service and final pay is not frozen at the 20th year? [39, 40]

**A—** No, except to note that gains or losses will occur after the 20-year period if experience is different from that assumed regarding the final level of compensation.

47. **Q—**How should an employer determine the accumulated and projected benefit obligations if a pension plan has more than one formula and an employee's pension benefits are determined based on the formula that provides the greatest pension benefit at the time the employee terminates or retires (for example, if the employee terminates in year 10, the pension plan's flat-benefit formula provides a greater pension benefit than does the pension plan's pay-related formula, while if the employee terminates in year 11, the pension plan provides that same employee with a greater benefit under its pay-related formula than under its flat-benefit formula)? [39, 40]

**A—** This question relates to a pension plan that effectively has a formula that defines different benefits for different years of service and accordingly, an attribution approach that does not assign the same amount of pension benefit to each year of an employee's service may be required.

Under Statement 87, the accumulated benefit obligation cannot exceed the projected benefit obligation. If a pension plan has more than one formula, the accumulated benefit obligation should be based on the greatest of the pension benefits determined by applying each of the plan's formulas to service to date. The projected benefit obligation should be determined based on the
same formula until an allocation of incremental pension benefits for the remaining expected service period using another formula provides a greater pension benefit allocated to service in the current year. As indicated previously, that may result in differing levels of benefits attributed to different years of an employee's service.

Refer to Illustration 5 for an example of how an employer should determine the accumulated and projected benefit obligation for a pension plan that has more than one benefit formula.

**Illustration 5—Determination of Benefits for a Pension Plan with a Flat-Benefit and a Pay-Related Formula**

An employer has a pension plan that provides a pension benefit that is the greater of two formulas. Formula A provides a flat benefit of $450 for each of the first 20 years of an employee's service, but no additional benefits are earned for years of service beyond 20 years; Formula B provides a benefit equal to 1 percent of final pay for each year of service. In the following cases, it is assumed that an employee starts at a salary of $11,000 in year 1 and receives a $1,000 increase in salary for each year of service. To simplify the illustration, the actuarial present values of the accumulated benefit obligation (ABO) and projected benefit obligation (PBO) have not been determined. Rather, those obligations are expressed in terms of the annual pension benefits that begin when the employee retires.

**Case 1—30-Year Service Period**

It is assumed that an employee will retire at the end of year 30 with a final salary of $40,000. For that employee, Formula A provides an annual pension benefit of $9,000 for 30 years of service ($450 for each of the first 20 years of service and no additional benefits for years of service 21-30); Formula B provides an annual pension benefit of $12,000 for 30 years of service (30 x 1% x $40,000 or $400 for each year of service). The attribution of pension benefits to years of service for Formulas A and B is presented in Chart I.

**Chart I**

<table>
<thead>
<tr>
<th>Attribution</th>
<th>Formula A vs. Formula B</th>
</tr>
</thead>
</table>

[Chart I has been deleted in the electronic version of Statement 87 Questions and Answers. If there is a need to reference this chart, please refer to the printed version of Statement 87 Questions and Answers.]

Chart II shows the increase in accumulated and projected benefits for each year of service for the employee under Formulas A and B. As can be seen, Formula A provides a greater accumulated and projected benefit for years 1-20.

**Chart II**

<table>
<thead>
<tr>
<th>Accumulated and Projected Benefit Obligation</th>
<th>Formula A vs. Formula B</th>
</tr>
</thead>
</table>

[Chart II has been deleted in the electronic version of Statement 87 Questions and Answers. If there is a need to reference this chart, please refer to the printed version of Statement 87 Questions and Answers.]

Beginning in year 21, no additional pension benefits are provided under Formula A. At that point, Formula B begins to provide a portion of the total projected benefit attributed to years 21-30. The additional pension benefit expected to be provided under Formula B for service in years 21-30 is $3,000 ($9,000 accumulated benefit at year 20 under Formula A as compared with $12,000 accumulated benefit at year 30 under Formula B); that additional pension benefit is attributed to...
service ratably over years 21-30 ($300 per year). Note that although no additional pension benefits are "earned" in years 21 and 22 (refer to projected benefit obligation in Chart II) because the projected benefit under Formula B in those years is less than $9,000, pension benefits are attributed to those years of service based on the total incremental pension benefit for years 21-30. Attribution of total projected benefits to years of service is illustrated in Chart III.

Chart III
Attribution of Benefits over Service

[Chart III has been deleted in the electronic version of Statement 87 Questions and Answers. If there is a need to reference this chart, please refer to the printed version of Statement 87 Questions and Answers.]

Thus, while the accumulated benefit obligation at any point in time represents the greater of the pension benefits determined under Formulas A and B, the projected benefit obligation is determined on the basis of the formula providing the greater pension benefit (Formula A) until an allocation of incremental pension benefits for the remaining service period using another formula provides a greater pension benefit allocated to service in the current year. In this example, the allocation of $3,000 of incremental benefits to years 21-30 under Formula B provides a greater benefit allocated to service in those years ($300 per year) than Formula A would allocate ($0). Chart IV presents the increase in the accumulated benefit obligation and projected benefit obligation when the plan benefits are the greater of those determined under Formulas A and B.

Chart IV
Accumulated and Projected Benefit Obligation
Greater of Benefit under Formulas A and B

[Chart IV has been deleted in the electronic version of Statement 87 Questions and Answers. If there is a need to reference this chart, please refer to the printed version of Statement 87 Questions and Answers.]

The accumulated and projected benefit obligation for years 1–30 are as follows:
Case 2—20-Year Service Period

It is assumed that an employee will retire at the end of year 20 with a final salary of $30,000. For that employee, Formula A provides an annual pension benefit of $9,000 ($450 for each year of service); Formula B provides an annual pension benefit of $6,000 (20 x 1% x $30,000 or $300 for each year of service). Since Formula A provides the greater benefit in each year, attribution will be determined under Formula A. The accumulated benefit obligation and projected benefit obligation will be equal in years 1-20 since Formula A is not pay-related.

Case 3—40-Year Service Period

It is assumed that an employee will retire at the end of year 40 with a final salary of $50,000. For that employee, Formula A provides an annual pension benefit of $9,000 for 40 years of service ($450 for each of the first 20 years of service and no additional benefits for service in years 21-40); Formula B provides an annual pension benefit payable at retirement of $20,000 for 40 years of service (40 x 1% x $50,000 or $500 for each year of service). Since Formula B provides the greater pension benefit in each year, attribution of the projected benefit obligation will be determined under Formula B for all years of service. The accumulated benefit obligation, however, continues to be determined for each year of service by the formula that provides the greater accumulated benefit.

48. Q—Is it possible for a pension plan to have an accumulated benefit obligation that exceeds the projected benefit obligation? [39-40, 42]

A—No. Under the attribution approach described in paragraphs 40 and 42 of Statement 87, the projected benefit obligation should always equal or exceed the accumulated benefit obligation. Under certain plans (typically non-U.S. plans), however, the actuarial present value of the benefits to which an employee is entitled if the employee terminates immediately may exceed the actuarial
present value of the benefits to which the employee is entitled at the employee's expected date of separation based on service to date. In those situations, the Emerging Issues Task Force (EITF) reached a consensus in EITF Issue No. 88-1, "Determination of Vested Benefit Obligation for a Defined Benefit Pension Plan," that the employer may record either the actuarial present value of vested benefits to which the employee is entitled if the employee separates or the actuarial present value of the vested benefits to which the employee is currently entitled based on the employee's expected date of separation or retirement. The SEC Observer noted that the method used should be disclosed. [Revised 12/98]

49. Q—How is the projected benefit obligation attributed to a qualified pension plan (for tax purposes) and an excess benefit (top-hat) pension plan during an employee's service period if the employee is expected to receive a pension benefit under the excess benefit pension plan (that is, the employee's pension benefit at retirement is expected to exceed the Section 415 limitations of the U.S. Internal Revenue Code)? [39, 40, 46, 47, 55]

A—The projected benefit obligation should be attributed to the qualified pension plan (for tax purposes) until it equals the assumed benefit limitations imposed by Section 415. (Refer to the answer to ♦ Question 63.) Any incremental projected benefits for subsequent years of service should then be attributed to the excess benefit pension plan.

Under Statement 87, net periodic pension cost, liabilities, and assets are determined on a plan-by-plan basis. Until an employee's projected benefits for service already rendered reach the benefit limitations of the underlying qualified pension plan, the employee is not eligible for benefits under an excess benefit pension plan and no cost or obligation should be attributed to that pension plan.

Refer to Illustration 6 for an example of attribution of pension benefits to a qualified pension plan (for tax purposes) and an excess benefit pension plan.

Illustration 6—Attribution of Pension Benefits to a Qualified and an Excess Benefit Pension Plan

A pension plan's formula is an annual pension benefit of 2 percent of final pay for each year of service. It is assumed than an employee starts at a salary of $200,000 in year 1, receives annual salary increases of $15,000, and retires at the end of 21 years at a salary of $500,000. It is further assumed that the Section 415 limitation for annual pension benefit payments is $90,000 in year 1 and that the limitation under the existing law will increase to permit annual pension benefit payments of $120,000 for all the years the employee will receive benefit payments.

Attribution of the accumulated benefit obligation (ABO) and projected benefit obligation (PBO) for the employee is as follows. To simplify the illustration, the actuarial present values of the accumulated and projected benefit obligation have not been determined. Rather, those obligations are expressed in terms of the annual pension benefits that begin when the employee retires.
50. Q—If a pension plan's formula provides an annual pension benefit equal to 1 percent of each year's salary (that is, it does not base pension benefits for the current year on any future salary level), should the projected unit credit method be used to attribute the service cost component of net periodic pension cost over employees' service periods? [39, 40, 143]

A—Yes. Statement 87 requires use of the projected unit credit method for pay-related pension plans. A pension plan that describes the pension benefits earned as 1 percent of current pay for each year of service is the same as a pension plan that describes the pension benefits earned as 1 percent of total career pay. Both are, in effect, a career-average-pay pension plan. Because similar pension benefits could be provided by a final-pay pension plan that includes almost the entire service period (for example, service period minus the first year) in determining the average final pay on which pension benefits are based, the line between career-average-pay and final-pay pension plans would need to be an arbitrary one if the two types of formulas were to be treated differently. The Board decided to treat all pay-related pension plans the same; therefore, the projected unit credit method should be used for both final-pay and career-average-pay pension plans.

51. Q—What is intended by the fourth sentence of paragraph 143 of Statement 87 which states the following: "The Board perceives a difference between an employer's promise to pay a benefit of 1 percent of an employee's final pay and a promise to pay an employee a fixed amount that happens to equal 1 percent of the employee's current pay"? Is the Board referring to a career-average-pay
A—No. The intent of the sentence was to differentiate a final-pay pension plan from a flat-benefit pension plan (not a career-average-pay pension plan). In reading the sentence, the emphasis should be on the word "happens." To illustrate the distinction the sentence is intending to make, assume that an employee's current salary is $30,000 and the employee's final salary will be $50,000. If future salary levels were not considered in measuring the current obligation of a 1 percent final-pay pension plan, the pension benefits promised for the current year of service for that employee would be $300. If the plan were a flat-benefit pension plan that promises $300 of pension benefits for each year of service, the measure of the obligation would be the same. The Board perceives a difference regarding the employer's promise under the two pension plans. Including the future salary variable on which the obligation in the first case is based results in recognizing that difference (a projected annual benefit of $500 under the final-pay pension plan as compared to a $300 projected benefit under the flat-benefit pension plan).

52. Q—What constitutes a "substantive commitment" requiring recognition of pension benefits beyond those defined in the pension plan's written formula? [39, 41]

A—♦ Paragraph 41 of Statement 87 states that "in some situations a history of regular increases in non-pay-related benefits or benefits under a career-average-pay plan and other evidence may indicate that an employer has a present commitment to make future amendments and that the substance of the plan is to provide benefits attributable to prior service that are greater than the benefits defined by the written terms of the plan." The determination of whether a substantive commitment exists to provide pension benefits for employees beyond the written terms of the pension plan's formula requires careful consideration of all the facts and circumstances surrounding the pension plan. Actions of the employer, including communications to the employees, can demonstrate the existence of that commitment. (For example, paragraph 41 of Statement 87 requires disclosure of the commitment in the financial statements.) However, a history of retroactive plan amendments is not enough, in isolation, to establish a substantive commitment. Absent other evidence of a substantive commitment, such a history should be considered in applying ♦ paragraph 47 of Statement 87.

53. Q—Should an employer's accounting for its pension plan anticipate a retroactive plan amendment that is not part of a series of retroactive plan amendments necessary to effect a substantive commitment to have a formula greater than its written form? [39, 41]

A—No.

54. Q—Is it always necessary for assumed compensation levels to change each time assumed discount rates (and expectations of future inflation rates inherently contained in the assumed discount rates) change? [39, 43, 46, 202]

A—No. Statement 87 requires that assumed compensation levels be consistent with assumed discount rates only to the extent that both incorporate expectations of the same future economic conditions. It does not require that both assumptions contain the same future inflation component unless that would be appropriate under the circumstances to reflect the best estimate of the pension plan's future experience. For example, an employer that competes with significant foreign enterprises may not increase its assumed compensation levels even though assumed discount rates increase because the employer expects that it could not successfully compete in the future if its labor costs increased at a rate greater than that already assumed. Another employer would increase its assumed compensation levels if assumed discount rates increased because changes in that employer's labor costs over time have been highly correlated with changes in inflation rates and the employer expects that correlation to continue.
55. Q—May an employer determine a range of discount rates each year based, for example, on the Pension Benefit Guaranty Corporation's interest rates and high-quality bond rates and continue to use the prior year's assumed discount rates as long as those rates fall within the range? [39, 44]

A—No. Paragraph 44 of Statement 87 states:

Assumed discount rates shall reflect the rates at which the pension benefits could be effectively settled. It is appropriate in estimating those rates to look to available information about rates implicit in current prices of annuity contracts that could be used to effect settlement of the obligation. . . . In making those estimates, employers may also look to rates of return on high-quality fixed-income investments currently available and expected to be available during the period to maturity of the pension benefits.

The intent of Statement 87 is for the assumed discount rates to reflect the interest rates inherent in the price at which the pension benefits could be effectively settled—currently. Each year those rates should be reevaluated to determine whether they reflect the best estimate of the current effective settlement rates. If interest rates generally decline or rise, the assumed discount rates should change.

56. Q—May an employer determine a range of discount rates as described in Question 55 and then arbitrarily select the assumed discount rates from within that range? [39, 44]

A—No. An employer should not select arbitrarily the assumed discount rates from within a range but should select the best estimate of the interest rates at which the pension benefits could be effectively settled at that point in time.

57. Q—If an employer changes its basis of estimating assumed discount rates, for example, by using high-quality bond rates for one year and annuity rates for the following year, is that a change in method of applying an accounting principle? [39, 44]

A—No. The purpose of paragraph 44 of Statement 87 is to describe the objective of selecting assumed discount rates, namely, to determine the interest rates inherent in the price at which the pension benefits could be effectively settled—currently. If an employer that previously used double A bond rates believes in a subsequent year that, in consideration of its pension plan's particular facts and circumstances, the interest rates that would be inherent in an effective settlement of the pension benefits are now more closely reflected by the rates implicit in current prices of annuity contracts, then those rates should be used and the change is viewed as a change in estimate (the estimate's being the determination of the effective settlement rates). The key is that the employer is using the rates implicit in current prices of annuity contracts as the basis to determine the best estimate of the effective settlement rates. The decision to use a particular methodology in a particular year does not mean that the employer must use that methodology in subsequent years. A change in the facts and circumstances may warrant the use of a different source that better reflects the rates at which the obligation could be effectively settled—currently. A position that holds such a change as a change in accounting principle would lend credence to the view that there are two or more acceptable alternatives. That is not the case. The objective is to select the best estimate of the effective settlement rates.

Another aspect of this issue is determining when to change the basis of estimation from one particular methodology (for example, double A bond rates) to another (for example, rates implicit in current prices of annuity contracts). There is no prescribed mathematical formula for making that decision. As indicated above, the emphasis in selecting assumed discount rates should be the
use of the best estimate. Changes in the methodology used to determine that best estimate should be made when facts or circumstances change (for example, a general decline or rise in interest rates that has not, as yet, been reflected in the rates implicit in the current prices of annuity contracts). If the facts and circumstances do not change from year to year, it would be inappropriate to change the basis of selection, particularly if the intent in changing the basis is to avoid a change in the assumed discount rates.

58. Q—If a pension plan has a bond portfolio that was dedicated at a yield significantly higher or lower than current interest rates, may the historical rates of return as of the dedication date be used in discounting the projected and accumulated benefit obligations to their present value? [39, 44]

A—No. Although it is acceptable in selecting the assumed discount rates for an employer to look to "rates of return on high-quality fixed-income investments," it is the current rates of return on those investments (not historical rates of return as of the dedication date) that are relevant.

Use of assumed discount rates based on historical rates of return is inconsistent with Statement 87's requirement to value plan assets at fair value. If interest rates decline or rise, the effect of Statement 87's requirement to use current rates is to increase or decrease the present value of the projected benefit obligation. That increase or decrease in the obligation is a loss or gain that would be offset to the extent of the gain or loss in the fair value of the plan's dedicated portfolio of fixed-income investments. Any net gain or loss is subject to amortization as a component of net periodic pension cost.

59. Q—May the assumed discount rates used to discount the vested, accumulated, and projected benefit obligations be different? [39, 44]

A—Yes, if the employer can justify such differences in terms of Statement 87's requirement to make the best estimate of the assumed discount rates. For example, different rates should be used to measure the pension obligations for active and retired employees if necessary to reflect differences in the maturity and duration of pension benefit payments. The assumed discount rates for pension benefits that mature in a particular year should not differ, however, regardless of whether the obligation for those pension benefits is presently classified as a vested, accumulated, or projected benefit obligation.

60. [Question deleted because the effective date of Statement 87 has passed.]

Q—What assumed discount rates and expected long-term rate of return on plan assets should be used to determine (a) the unrecognized net asset or net obligation at the date of initial application of Statement 87 and (b) net periodic pension cost, if an employer with a September 30, 1986 fiscal year-end elected in its fourth quarter to apply Statement 87 early and restate its prior interim reports? [39, 44, 45, 52, 77]

A—The assumptions that would be appropriate as of the beginning measurement date for the fiscal year should be used.

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61. Q—Because a current settlement of the portion of the projected benefit obligation that relates to future compensation levels is unlikely, may an employer use those interest rates implicit in current prices of annuity contracts to determine the accumulated benefit obligation, and use interest rates expected to be implicit in future prices of annuity contracts to determine the pension obligation in excess of the accumulated benefit obligation? [39, 44, 191]

A—No. The use of rates implicit in future annuity prices is not consistent with Statement 87. The
assumed discount rates used to determine the projected, accumulated, and vested benefit obligations should reflect the interest rates inherent in the price at which the pension benefits could be effectively settled—currently. It is acknowledged that ordinarily an employer would not want to purchase annuities for that portion of the pension benefit obligation related to future compensation levels and that an insurance company would be unwilling to undertake an unconditional obligation based on future compensation levels without charging increased premiums for the additional risk. However, under Statement 87, how the accumulated benefit obligation or the projected benefit obligation (before discounting) is determined, that is, whether assumptions as to future inflation or compensation levels are considered, is not relevant in selecting discount rates.

Statement 87 requires an explicit approach to assumptions. Those factors that are relevant for determining the timing and amount of estimated future annuity payments should not be reflected by an implicit approach to selecting discount rates. Once the estimated future annuity payments are determined, the discounting process using an explicit approach does not consider anything other than the time value of money for purposes of determining the single sum which, if invested at the measurement date, would generate the necessary cash flows to pay the pension benefits when due (the sum necessary to settle effectively the pension obligation assuming no future experience gains or losses).

The purpose of the guidance in paragraph 44 of Statement 87 is to direct the employer to the proper sources for selecting assumed discount rates. Its intent is not necessarily to arrive at a discounted amount that would be the price an insurance company would charge to assume the same pension benefit promise to employees. Many factors affect the price at which an insurance company would undertake a particular obligation. The insurance company's assessment of the risks related to mortality obviously affect that price as does the profit margin the insurance company hopes to achieve. Had Statement 87 intended to arrive at the insurer's price, it would have stated that the actuarial present value of the projected benefit obligation be the best estimate of the price at which the insurance company would assume the employer's obligations. In that case, the approach to selecting various assumptions would be to select those inherent in annuity prices rather than those that "reflect the best estimate of the plan's future experience" (paragraph 191, emphasis added.) Instead, Statement 87 identifies as one source for selecting assumed discount rates, the (explicit) rates implicit in current prices of annuity contracts. The rates inherent in a dedicated high-quality bond portfolio (for example, zero-coupon treasury securities) is another identified source. Paragraphs 186-188 of Statement 106 provide additional guidance on selecting the discount rate(s). [Revised 12/98.]

62. Q—Should the expected return on future years' contributions to a pension plan be considered in determining the expected long-term rate of return on plan assets? [39, 45]

A—No. The expected long-term rate of return on plan assets should reflect long-term earnings expectations only on existing plan assets and those contributions expected to be received during the current year. The words "to be invested" in the first sentence of paragraph 45 of Statement 87 were intended to refer only to the reinvestment of returns on existing plan assets.

63. Q—Should changes under existing law in benefit limitations, such as those currently imposed by Section 415 of the U.S. Internal Revenue Code, that would affect benefits provided by a pension plan be anticipated in measuring the service cost component of net periodic pension cost and the projected benefit obligation? [39, 46]

A—Yes. If the existing law provides for indexing or has a schedule of changes inherent in it, those effects should be considered in determining the service cost component of net periodic pension cost and the projected benefit obligation to the extent consistent with other assumptions (that is,
salary and inflation). However, possible amendments of the law should not be considered in determining those pension measurements.

64. **Q**—If Section 415 of the U.S. Internal Revenue Code is incorporated by reference into a pension plan's formula thereby limiting certain participants' accumulated benefits, should determination of the pension plan's *accumulated* benefit obligation reflect the current limitation if (a) the pension plan's formula requires automatic increases in accumulated benefits as each change in the limitation under existing law occurs and (b) future service is not a prerequisite for participants to receive those increases? [39, 47, 48]

**A**—No. The determination of the pension plan's accumulated benefit obligation should not reflect the current limitation but should reflect those increases in the limitation under existing law that would be consistent with the pension plan's other assumptions. As described, the pension plan formula incorporates the type of automatic benefit increases addressed in ¶ paragraph 48 of Statement 87. However, if employees would not automatically receive those pension benefit increases should they retire or terminate their service, then ¶ paragraph 47 of Statement 87 would proscribe anticipating those increases and, therefore, the current limitation would be used in determining the *accumulated* benefit obligation in that situation.

64A. **Q**—In June 2001, the U.S. Congress enacted the Economic Growth and Tax Relief Reconciliation Act ("EGTRRA" or "the Act"). The Act increased the amount of benefits that a qualified defined benefit plan can pay under the terms of U.S. Internal Revenue Code (IRC) Section 415(b). However, that legislation is set to expire (or "sunset") after 2010. That is, after December 31, 2010, the provisions of and amendments made by EGTRRA (including increases to annual benefit payments) will no longer apply. However, IRC Section 411(d)(6) generally prohibits a plan amendment that has the effect of decreasing a participant's accrued benefits under the plan ("anti-cutback provisions"). For actuarial valuations of pension plans, it is necessary to estimate the benefits payable in future years. In performing that estimate, which of the following three alternative interpretations of the impact of the "sunset" provision is appropriate?

1) Treat the sunset provision as having full impact. That is, estimate the benefits payable in years after 2010 as if EGTRRA had never increased the Section 415(b) limits.

2) Treat the sunset provision as being subject to the anti-cutback provisions of IRC Section 411(d)(6).

3) Treat the sunset provision as having no impact—that is, assume that the sunset provision will be repealed prior to its effective date.

**A**—The provisions of EGTRRA, including the sunset provision, represent enacted law. The answer to Question 63 indicates that "…possible amendments of the law should not be considered in determining…pension measurements." As such, alternative 3 is not an acceptable alternative as it anticipates future legislation or changes to existing law. Whether alternative 1 or alternative 2 is appropriate depends on a determination as to whether the anti-cutback provisions would apply and mitigate the reduction in benefits otherwise triggered by the sunset provision. Making that determination may require consultation with legal counsel. Disclosure of the determination made is voluntary. However, if significant diversity in interpretation of existing law develops, the staff may express at a later date its views as to whether certain disclosures should be required. [Added 4/02]

65. **Q**—If an actuarial valuation is made as of a pension plan's year-end and that date precedes the employer's measurement date for the pension plan, is it always necessary to have another actuarial valuation made as of the measurement date? [52, 53]

**A**—No. Statement 87 requires that the projected benefit obligation reflect the actuarial present value of all benefits attributed to employee service rendered prior to the measurement date. The
measurement of that obligation should be based on actuarial assumptions appropriate for the measurement date (for example, turnover, mortality, discount rates, and so forth) and census data as of that date. However, if an employer is assured that the reliability of the measurement of that obligation determined by rolling forward data based on a valuation prior to the measurement date is sufficiently high so that the amount of the pension obligation is substantially the same as would be determined by an actuarial valuation as of that date, then another actuarial valuation is not required. This is analogous to the acceptability of having an annual physical inventory taken as of a date prior to the financial report date if it has been demonstrated that reliance can be placed on perpetual records or another system that reflects subsequent events.

66. Q—How should net periodic pension cost for the year be determined if it is necessary to have an actuarial valuation as of the measurement date (for example, December 31) in addition to the actuarial valuation made as of the pension plan's preceding year-end (for example, June 30)? [52, 53]

A—Measurement of net periodic pension cost should be based on the most recent measurements of plan assets and obligations. If actuarial valuations are made as of June 30 and December 31, net periodic pension cost for the year should be the sum of two six-month measurements (January 1-June 30, determined as of the preceding December 31; July 1-December 31, determined as of the preceding June 30).

67. Q—If an employer that has a December 31 financial report date and that uses a December 31 measurement date measures its plan assets and obligations as of an interim date during its fiscal year, for example, because of a significant retroactive plan amendment, should net periodic pension cost for the subsequent interim periods be based on those measurements? [52, 53]

A—Yes. Net periodic pension cost for the remainder of the fiscal year should be based on the most recent pension measurements. Paragraph 53 of Statement 87 states that "measurements of net periodic pension cost for both interim and annual financial statements shall be based on the assumptions used for the previous year-end measurements unless more recent measurements of both plan assets and obligations are available...."

68. Q—Under the circumstances described in ♦ Question 67, should net periodic pension cost for the preceding interim periods be adjusted? [52, 53]

A—No.

69. Q—If an employer uses a measurement date of September 30 but does not complete the actual measurements until some time later in the year, for example, in December, should the determination of the pension obligations be based on the assumed discount rates and other actuarial assumptions as of December? [52, 53]

A—No. The employer should use the actuarial assumptions (including assumed discount rates) that were appropriate as of the measurement date of September 30 because the objective is to determine the various pension measurements (including plan assets) as of that date.

70. Q—If an employer has several pension plans with varying measurement dates, should the pension disclosures be segregated by measurement date? [52, 56]

A—No. The use of different measurement dates by an employer for its various pension plans, in itself, does not necessitate the segregation of pension disclosures by measurement date. However, disclosure should be made of the different measurement dates used.
Q—Should an employer that uses a measurement date that is 3 months prior to its financial report date have 12 months of net periodic pension cost in the first year of initial application of Statement 87? [52, 76]

A—Yes. If, for example, an employer that has a December 31 fiscal year-end initially applies Statement 87 for 1986 and the employer elects to use a measurement date of September 30, the employer should have net periodic pension cost for the year of initial application (1986) that reflects the pension plan's operations from September 30, 1985 through September 30, 1986. (Refer to Illustration 3 which accompanies the answer to Question 38 and illustrates the transition issues related to the 1985 fourth quarter.)

72. [Question deleted because the disclosure (as part of "Plan Description") is no longer required by Statement 132 or Statement 132(R).]

73. [Renumbered 12/98 as Question 88A.]

74. Q—If the pension asset or pension liability recognized by the acquiring employer in a business combination accounted for by the purchase method under Opinion 16, before that Opinion was amended by Statements 96 and 109, and superseded by Statement 141, reflects estimates of future tax effects, does that affect the reconciliation required by paragraph 5(c) of Statement 132 (R)? [74] [Revised 12/98; 9/01; 12/03.]

A—Yes. That valuation adjustment will be another item disclosed in the reconciliation of the funded status of the pension plan with amounts reported in the employer's statement of financial position.

75. [Question deleted because the effective date of Statement 87 has passed.]

Q—May an employer restate certain pension disclosures for the prior year to make them comparable with disclosures for the initial year of application of Statement 87? [54, 76]

A—Yes. It is permitted, but not required, in comparative financial statements to restate certain pension disclosures for the year prior to initially applying Statement 87. For example, an employer that initially applies Statement 87 for calendar year 1986 and has a measurement date of December 31 may disclose either of the following to satisfy the previous year's (1985) disclosure requirements regarding the funded status of its pension plan:

a. The vested, accumulated, and projected benefit obligations, measured in accordance with Statement 87, and the fair value of plan assets as of December 31, 1985 (that is, the components of the funded status of the pension plan as of the date of initial application of Statement 87). The weighted-average assumed discount rate and, if applicable, the assumed rate of compensation increase should be disclosed. That information is readily available since it must be prepared to apply Statement 87.

b. The Statement 36 disclosures originally reported for 1985.

For either alternative, the pension cost for 1985 should be the Opinion 8 amount previously disclosed in the 1985 financial statements.

76. [Question deleted because the effective date of Statement 87 has passed.]

Q—For annual and interim reports for the year of initial application of Statement 87, should an employer follow paragraph 19(c) of Opinion 20, which requires disclosure of "the effect of adopting the new accounting principle on income before extraordinary items and on net income (and on the related per share amounts) of the period of the change"? [54, 76]

A—Yes. An employer should disclose those effects of initially applying Statement 87.
Q—For annual and interim reports for the year of initial application of Statement 87, should an employer follow paragraph 19(d) of Opinion 20, which requires that "income before extraordinary items and net income computed on a pro forma basis should be shown on the face of the income statements for all periods presented as if the newly adopted accounting principle had been applied during all periods affected"? (Footnote reference omitted.) [54, 76]

A—No. Statement 87 is to be applied prospectively in measuring net periodic pension cost due in part to the difficulty of its being applied retroactively to prior periods. Therefore, an employer is not required to provide the pro forma disclosures normally required by Opinion 20.

Q—If an employer elects to delay recognition of an additional minimum liability (paragraphs 36-38 of Statement 87) until 1989, to which balance sheet account should the funded status of the plan be reconciled in the periods prior to 1989? [54, 76]

A—Paragraph 54(c) of Statement 87 requires a reconciliation of the funded status of the pension plan with amounts reported in the employer's statement of financial position. Prior to applying the additional minimum liability provision, the pension amount reported in the statement of financial position is the unfunded accrued or prepaid pension cost and includes the items identified in the answer to Question 103.

Q—Should the assumptions disclosed be as of the beginning or ending measurement date? [FAS132, ¶5] [Revised 12/98.]

A—The disclosed weighted-average assumed discount rate and rate of compensation increase, if applicable, should be as of the year-end measurement date because that is the date for which the projected benefit obligation is presented. [Revised 12/98.]

The weighted-average expected long-term rate of return on plan assets is used to determine net periodic pension cost, and, therefore, in the absence of a subsequent interim measurement of both pension assets and obligations (refer to paragraph 53 of Statement 87), the disclosed rate is the rate determined as of the beginning of the year measurement date. However, if that rate changes because of a subsequent interim measurement of both pension assets and obligations, disclosure of the beginning and more recently assumed rate, or a properly weighted combination of the two, should be made.

Q—If an employer combines several of its pension plans and the assets of each predecessor pension plan are available to satisfy the previously existing obligations of the other, how should the combined pension plan be accounted for? [55] [Revised 12/98.]

A—Except for unrecognized prior service costs, similar unrecognized amounts of the predecessor pension plans should be aggregated, and a single amortization schedule for each of the combined amounts should be used. That is, (a) the amortization of the aggregate remaining portion of the unrecognized net asset or net obligation existing at the date of initial application of Statement 87 should reflect a reasonably weighted average of the remaining amortization periods used by the separate pension plans for that unrecognized item and (b) the minimum amortization of the aggregate unrecognized net gain or loss should reflect the average remaining service period of the combined employee group. The unrecognized prior service cost of each pension plan at the time of the combination should continue to be amortized as previously determined based on specific employee groups covered. The determination of any additional minimum liability should be made on a combined pension plan basis.
Refer to Illustration 7.

**Illustration 7—Combining of Two Plans [Revised 12/98.]**

An employer has two pension plans (Plan A and Plan B) that are combined at December 31, 20X0. The following shows the assumptions and methods of recognizing certain deferred pension amounts and the funded status of each pension plan reconciled to amounts reported in the employer’s balance sheet immediately before and after the combination of Plan A and Plan B.

**December 31, 20X0—Prior to Combination of Plan A and Plan B**

<table>
<thead>
<tr>
<th>Assumptions</th>
<th>Plan A</th>
<th>Plan B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Weighted-average discount rate</td>
<td>10%</td>
<td>9.25%</td>
</tr>
<tr>
<td>Expected long-term rate of return on plan assets</td>
<td>10%</td>
<td>10%</td>
</tr>
<tr>
<td>Average remaining service period</td>
<td>17 years</td>
<td>15 years</td>
</tr>
<tr>
<td>Number of employees as of December 31, 20X0 expected to receive benefits under the pension plan</td>
<td>300</td>
<td>420</td>
</tr>
</tbody>
</table>

Amortization method:

- Unrecognized prior service cost: Straight-line amortization over average remaining service period of employees expected to receive benefits (17 years) (15 years)

**Actuarial present value of benefit obligations:**

<table>
<thead>
<tr>
<th></th>
<th>Plan A</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vested benefit obligation</td>
<td>$(298)</td>
</tr>
<tr>
<td>Accumulated benefit obligation</td>
<td>$(339)</td>
</tr>
<tr>
<td>Projected benefit obligation</td>
<td>$(502)</td>
</tr>
<tr>
<td>Plan assets at fair value</td>
<td>804</td>
</tr>
<tr>
<td>Projected benefit obligation (in excess of) less than plan assets</td>
<td>302</td>
</tr>
<tr>
<td>Unrecognized net (gain) loss</td>
<td>(114)</td>
</tr>
<tr>
<td>Unrecognized prior service cost</td>
<td>120</td>
</tr>
<tr>
<td>Prepaid (accrued) pension cost</td>
<td>$ 308</td>
</tr>
</tbody>
</table>

**December 31, 20X0—Subsequent to Combination of Plan A and Plan B**

<table>
<thead>
<tr>
<th>Assumptions</th>
<th>Combined Plan AB</th>
</tr>
</thead>
<tbody>
<tr>
<td>Weighted-average discount rate</td>
<td>9.6%&lt;sup&gt;a(20)&lt;/sup&gt;</td>
</tr>
<tr>
<td>Expected long-term rate of return on plan assets</td>
<td>10%&lt;sup&gt;b(21)&lt;/sup&gt;</td>
</tr>
<tr>
<td>Average remaining service period</td>
<td>15.8 years&lt;sup&gt;c(22)&lt;/sup&gt;</td>
</tr>
</tbody>
</table>
Number of employees as of December 31, 20X0 expected to receive benefits under the pension plan: 720

Amortization method:
Unrecognized prior service cost

Unrecognized net gain or loss

Actuarial present value of benefit obligations:
Vested benefit obligation
Accumulated benefit obligation
Projected benefit obligation
Plan assets at fair value
Projected benefit obligation in excess of plan assets
Unrecognized net gain
Unrecognized prior service cost
Prepaid pension cost

Questions and Answers 81-100

81. Q—If an employer divides a pension plan into two or more separate pension plans subsequent to the date of initial application of Statement 87, how should (a) the remaining unrecognized net asset or net obligation existing at the date of initial application of Statement 87, (b) the unrecognized net gain or loss arising subsequent to initial application, and (c) any unrecognized prior service cost be allocated to each of the separate plans? [55]

A—Using Statement 87, 12(24) as guidance for this issue, an employer should allocate (a) the remaining unrecognized net obligation or net asset existing at the date of initial application of Statement 87 and (b) the unrecognized net gain or loss arising subsequent to initial application, in proportion to the projected benefit obligations of the two surviving plans. Unrecognized prior service cost should be allocated to the surviving plans based on the applicable individuals included in the employee groups covered.

Refer to Illustration 8.

Illustration 8—Division of One Pension Plan into Separate Pension Plans [Revised 12/98.]

An employer has a pension plan that covers employees of the parent company and its consolidated subsidiaries (Subsidiaries B and C). The employer divides its pension plan into three separate pension plans (Plan A, Plan B, and Plan C) that are sponsored by the parent company and Subsidiaries B and C, respectively.

The following shows the funded status of the pension plans immediately before and after the division.
### Actuarial present value of benefit obligations:

<table>
<thead>
<tr>
<th></th>
<th>(Parent) Plan ABC</th>
<th>(Parent) Plan A</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vested benefit obligation</td>
<td>$(50,000)</td>
<td>$(30,000)</td>
</tr>
<tr>
<td>Accumulated benefit obligation</td>
<td>$(72,000)</td>
<td>$(42,000)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>$(54,000)</td>
</tr>
<tr>
<td>Projected benefit obligation</td>
<td>$(90,000)</td>
<td>a(25)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>a(25)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>132,000</td>
</tr>
</tbody>
</table>

| Plan assets at fair value      | 160,000          | b(28)          |
| Projected benefit obligation (in excess of) less than plan assets | 70,000          | b(28)          |
|                               | 78,000           |                 |
|                               | (33,000)         |                 |
| Unrecognized net gain         | (55,000)         | c(31)          |
|                               |                   | c(31)          |
| Prior service cost not yet recognized in net periodic pension cost | 25,000          | d(34)          |
|                               |                   | d(34)          |
| Remaining unrecognized net asset existing at date of initial application | (40,000)       | c(37)          |
|                               |                   | c(37)          |
| (Unfunded accrued) prepaid pension cost | $ 0            | $ 38,500       |

### Journal Entries

The journal entries to account for the division of the pension plan are as follows:

**Parent Company**

- **Prepaid pension cost**: 38,500
  - Investment in Subsidiary B: 17,000
  - Investment in Subsidiary C: 21,500

  To record the transfer of pension assets, obligations, and net deferred amounts from the parent company to Subsidiaries B and C

**Subsidiary B**

- **Stockholder's equity *(40)**: 17,000
  - Unfunded accrued pension cost: 17,000

  To record the receipt of pension assets, obligations, and net deferred amounts from the parent company

**Subsidiary C**

- **Stockholder's equity *(41)**: 21,500
  - Unfunded accrued pension cost: 21,500

  To record the receipt of pension assets, obligations, and net deferred amounts
82. **Q**—Are annuity contracts defined differently in Statements 87 and 88? If so, how are the definitions different, and why? [57-61]

**A**—Yes. Annuity contracts are defined differently in Statements 87 and 88. The difference in the definition of annuity contracts is that footnote 1 of Statement 88 excludes from settlement accounting those annuity contracts purchased from *an enterprise that is controlled by the employer*, whereas footnote 14 of Statement 87 excludes from annuity contracts those purchased from a *captive insurer*. Therefore, an employer who purchases annuity contracts from an insurance company that it controls should not recognize any settlement gain or loss associated with the transaction (that is, the transaction should not qualify for settlement accounting under Statement 88). However, unless the insurance company is a captive insurer, the pension benefits covered by the annuity contracts should be excluded from the projected benefit obligation and the contracts should be excluded from plan assets (except for any participation rights) for purposes of applying Statement 87.

In Statement 88, the Board decided that the circumstances under which an employer should recognize previously unrecognized gains or losses should be limited and that such recognition should not occur if the settlement transaction is between an employer and an entity that it controls. In the Board's view, such a transaction merely shifts the risks from one part of the entity to another part of the same entity. In the Exposure Draft preceding Statement 87, the Board proposed to treat such contracts as plan assets. However, the Board was persuaded by constituents' views that the cost incurred to treat those contracts as plan assets and to include the related benefits in the measurement of the projected benefit obligation was too high to justify that accounting unless the contracts were with a captive insurer. The Board then concluded that disclosure of the approximate amount of annual benefits covered by annuity contracts issued by the employer and related parties should be required.

83. **Q**—Is a guaranteed investment contract an annuity contract? [62]

**A**—No. Guaranteed investment contracts are not annuity contracts because they transfer only investment risk to the insurer. The insurer does not unconditionally undertake a legal obligation to provide specified pension benefits to specific individuals.

84. **Q**—If a guaranteed investment contract is not considered an annuity contract, how should an employer value the contract if it has a specified maturity date and there is no intent to liquidate the contract before that date? [62]

**A**—Evidence of the fair value of a guaranteed investment contract might be obtained by looking to current yields on fixed-maturity securities having similar risk characteristics and duration.

85. **Q**—Should the market value adjustment in an immediate participation guarantee investment contract be considered in determining its fair value? [62]

**A**—Yes. In effect, the contract value adjusted for any such market value adjustment represents the "cash surrender value" referred to in paragraph 62 of Statement 87. If an immediate participation guarantee investment contract can be converted into an annuity contract, the conversion value of the contract should be considered in determining its fair value. The evidence noted in the answer to Question 84 also should be considered.

86. **Q**—If a not-for-profit organization has a defined benefit pension plan that covers employees at the national and all local chapters and (a) each chapter is required to contribute to the pension plan based on a predetermined formula (for example, on a percentage-of-salary basis), (b) plan assets
are not segregated or restricted on a chapter-by-chapter basis, and (c) if a chapter withdraws from the pension plan, the pension obligations for its employees are retained by the pension plan as opposed to being allocated to the withdrawing chapter, should that arrangement be accounted for as a single-employer or multiemployer pension plan? [67-68]

**A**—The arrangement should be accounted for as a single-employer pension plan in the not-for-profit organization's consolidated financial statements. In each chapter's separate financial statements, however, the arrangement should be accounted for as a multiemployer pension plan. It is unclear how an allocation of net periodic pension cost or any additional minimum liability would be made if each chapter were to view its respective participation as a single-employer pension plan because the assets are not segregated or restricted by chapter and obligations are not assumed by a withdrawing chapter. Accounting for the pension plan as a multiemployer pension plan requires that a chapter's contribution for the period (in this example, the amount required to be contributed to the pension plan based on a percentage of its employees' salaries) be recognized as net periodic pension cost. A liability would be recognized for any contributions due and unpaid. Each chapter should provide the disclosures required by paragraph 12 of Statement 132(R) as well as any related-party disclosures required by Statement 57. [Revised 12/98; 12/03.]

87. **Q**—Does the answer provided to the previous question also apply to a similar parentsubsidiary arrangement if the subsidiaries issue separate financial statements? [67-68]

**A**—Yes. Each subsidiary should account for its participation in the overall single-employer pension plan as a participation in a multiemployer pension plan. The parent company should, of course, account for the pension plan as a single-employer pension plan in its consolidated financial statements.

Questions 88-94 address issues that relate to a business combination, accounted for by the purchase method under Opinion 16, in which the acquired enterprise sponsors a single-employer defined benefit pension plan at the date of the acquisition.

88. **Q**—If the acquired enterprise sponsors a single-employer defined benefit pension plan at the date of the acquisition, should the pension asset or pension liability recognized by the acquiring employer be separately amortized to income in periods subsequent to the acquisition? [74] [Revised 9/01.]

**A**—No. The pension asset or pension liability should not be separately amortized. Rather, it is affected by the accounting for the pension plan in future periods. A pension asset representing overfunding at the date of an acquisition will be reduced in each year in which (a) employer contributions to the pension plan are less than net periodic pension cost or (b) there is an asset reversion. A pension liability representing underfunding at the date of an acquisition will be reduced in each year in which (a) employer contributions to the pension plan are greater than net periodic pension cost or (b) there is net periodic pension income as a result of a settlement or curtailment gain.

88A. [Formerly Question 73.] **Q**—If an employer has (a) a qualified pension plan (for tax purposes) and (b) a nonqualified pension plan (which pays pension benefits in excess of the maximum allowed for the qualified pension plan by Section 415 of the U.S. Internal Revenue Code—an excess benefit [top-hat] pension plan) and the plans cover the same employees, may those pension plans be considered in substance a single pension plan under Statement 87? [55-56]

**A**—No. In most circumstances the plan assets of a qualified pension plan (for tax purposes) are segregated and restricted to provide pension benefits only under that pension plan. Therefore, unless an employer clearly has a legal right to use the plan assets of the qualified pension plan to pay directly the pension benefits of the nonqualified pension plan (a right that generally does not
exist), the determination of net periodic pension cost, including amortization periods and patterns for recognition of the cost of retroactive plan amendments and gains or losses, and any additional minimum liability should be on a plan-by-plan basis. Also, the disclosures required by paragraph 6 of Statement 132(R) may need to be made separately for each plan. The fact that an employer could (a) fund less to the qualified pension plan and use those withheld funds to pay the benefits of the nonqualified pension plan or (b) engage in an asset reversion transaction of the qualified pension plan and use those withdrawn funds to pay the pension benefits of the nonqualified pension plan does not, in itself, allow the pension plans to be reported as a single pension plan. [Revised 12/98; 12/03.]

An additional reason that excess benefit (top-hat) pension plans should be viewed as separate pension plans is that sometimes those pension plans cover employees of several different qualified pension plans, in which case it would not be possible to sustain a one-plan view.

89. [Question deleted 12/98 because the applicable provision of Opinion 16 was superseded by Statements 96 and 109.]

Q—Should the pension asset or pension liability recognized by the acquiring employer reflect estimates of future tax effects? (Refer to paragraph 89 of Opinion 16.)

A—Yes. If recovery of the pension asset or settlement of the pension liability would give rise to taxable or tax-deductible amounts, the pension asset or liability recognized by the acquiring employer should reflect estimates of future tax effects. Opinion 16 requires that the estimated future tax effects of differences between the tax basis and the amount otherwise appropriate to assign to an acquired asset or assumed liability be reflected in estimating the fair value of that asset or liability at the date of the acquisition. (Refer to the answer to Question 74.)

90. [Question deleted 12/98 because the effective date of Statement 87 has passed.]

Q—How should the acquiring employer record a purchase if it has elected to apply Statement 87 early but the acquired employer has not? [74, 76]

A—The acquiring employer should apply Statement 87 to the purchase and to the acquired pension plans.

91. [Question deleted 12/98 because the effective date of Statement 87 has passed.]

Q—Is the acquiring employer required to apply Statement 87 early for all of its domestic pension plans if, prior to the acquisition, the acquired employer elected to apply Statement 87 early for its domestic pension plans? [74, 76]

A—No. The acquiring employer is not required to apply Statement 87 early for all of its domestic pension plans. However, electing to do so is encouraged and would avoid the issues raised in Question 92.

92. [Question deleted 12/98 because the effective date of Statement 87 has passed.]

Q—If the acquiring employer is not required to apply Statement 87 early in the circumstances described in the preceding question:
   a. Must the accounting for the acquired pension plans revert to the accounting under Opinion 8?
   b. If accounting for the acquired pension plans is permitted to remain under Statement 87 while accounting for the other domestic pension plans continues to follow Opinion 8, is that considered piecemeal early application of Statement 87?
   c. How should the acquiring employer record the purchase? [74, 76]
A—a. No. The accounting for the acquired pension plans does not have to revert to Opinion 8; however, that alternative is not proscribed. The change back to the accounting under Opinion 8 is the least desirable alternative because (1) that accounting would be only for a short period of time, (2) Opinion 8 and unamended paragraph 88 of Opinion 16 are no longer the preferred accounting in this area, and (3) costs would be incurred to make the change.

b. No. The disparate practices are due to a business combination rather than to a desire to "phase in" Statement 87. Accordingly, applying Statement 87 to only the acquired pension plans is not considered early application on a piecemeal basis.

c. If the accounting for the acquired pension plans is not changed back to that required by Opinion 8, the assignment of the purchase price of the acquisition to assets and liabilities related to the acquired pension plans should be in accordance with paragraph 74 of Statement 87. That is consistent with accounting for the acquired pension plans under Statement 87. However, if the accounting for the acquired pension plans is changed back to that required by Opinion 8, then Opinion 16 (prior to its amendment by Statement 87) should apply.

93. [Question deleted 12/98 because the effective date of Statement 87 has passed.]

Q—Should the acquiring employer's determination of the unrecognized net asset or net obligation at the date of initial application of Statement 87 consider the remaining portion of (a) the net-of-tax pension asset or pension liability or (b) the gross pension asset or pension liability determined at the date of an acquisition? [74, 77]

A—The amount to be considered is the remaining portion of the gross pension asset or pension liability, not the net-of-tax amount.

94. [Question deleted 12/98 because the effective date of Statement 87 has passed.]

Q—Would the answers to ¶ Questions 88-93 change if either the acquiring or acquired employer were a foreign enterprise? [74, 76-77]

A—No.

95. [Question deleted 12/98 because the effective date of Statement 87 has passed.]

Q—Is it acceptable to apply the net periodic pension cost and disclosure requirements of Statement 87 early but wait until 1989 to apply the balance sheet requirements of ¶ paragraphs 36-38 of Statement 87? [76]

A—Yes.

96. [Question deleted 12/98 because the effective date of Statement 87 has passed.]

Q—Can an employer elect to apply Statement 87 early for some but not all of its U.S. pension plans? Can an employer elect to apply Statement 87 early for some but not all of its non-U.S. pension plans? [76]

A—The transition and effective date provisions of Statement 87 are considered broader in their application than other provisions of the Statement that apply on a plan-by-plan basis. Delayed application for non-U.S. pension plans gives employers time to make necessary arrangements to communicate the requirements of Statement 87 and to obtain the information necessary for initial application of that Statement. Although early application is encouraged, it is not the intent of Statement 87 that it be applied early on a selective basis only to certain plans.
An employer may elect to apply Statement 87 early on a country-by-country basis, which is consistent with an objective of Statement 87 of delaying the effective date for non-U.S. pension plans and not permitting selective early application within a country. Therefore, if early application is elected for some U.S. pension plans, then Statement 87 should be applied for all of the employer's U.S. pension plans. If early application is elected for some non-U.S. pension plans, that election can be on a country-by-country basis and Statement 87 should be applied to all pension plans in any country for which the election is made.

97. [Question deleted 12/98 because the effective date of Statement 87 has passed.]

**Q**—If an employer that has not elected to apply Statement 87 early establishes a new pension plan, can that pension plan be accounted for in accordance with Statement 87 if the employer continues to apply Opinion 8 in accounting for its previously existing pension plans located in the same country? [76]

**A**—No. As noted in the answer to ♦ Question 96, early application of Statement 87 should be on a country-by-country basis. For the new pension plan, however, an employer could apply those provisions of Statement 87 that are within the alternatives permitted by Opinion 8, such as selection of assumptions and attribution method.

98. [Question deleted 12/98 because the effective date of Statement 87 has passed.]

**Q**—If Statement 87 is not applied for U.S. pension plans until the fiscal year beginning after December 15, 1986, may that Statement be applied initially in later interim reporting periods of that fiscal year with restatement of prior interim reports? [76]

**A**—No. Statement 87 is effective for U.S. pension plans as of the beginning of the fiscal year beginning after December 15, 1986. Consequently, financial information for the first interim reporting period of that fiscal year should conform with Statement 87.

99. [Question deleted 12/98 because the effective date of Statement 87 has passed.]

**Q**—If Statement 87 is not applied for non-U.S. pension plans and for nonpublic enterprises that sponsor no defined benefit plans with more than 100 participants until the fiscal year beginning after December 15, 1988, may that Statement be applied initially in later interim reporting periods of that fiscal year with restatement of prior interim reports? [76]

**A**—No. Refer to the answer to ♦ Question 98.

100. [Question deleted 12/98 because the effective date of Statement 87 has passed.]

**Q**—If an employer disposes of a segment of a business including a related pension plan in the year of initial application of Statement 87, does Statement 87 apply to that pension plan for the interim period prior to its disposal? [76]

**A**—Yes. The disposal of a segment of a business does not change the effective date for applying Statement 87.

Questions and Answers 101-107

101. [Question deleted 12/98 because the effective date of Statement 87 has passed.]

**Q**—Do pension plans in Puerto Rico and other U.S. territories qualify as non-U.S. pension plans or as domestic pension plans? [76]
A—For segment reporting purposes, Technical Bulletin 79-4 states that operations in Puerto Rico qualify as domestic operations. By analogy, Puerto Rican pension plans (and pension plans in other U.S. territories) should qualify as U.S. pension plans for purposes of applying Statement 87.

102. [Question deleted 12/98 because the effective date of Statement 87 has passed.]

Q—If an employer has several pension plans and the average remaining service period of employees expected to receive benefits under each pension plan is less than 15 years, may it elect to use (a) a 15-year period to amortize the unrecognized net obligations of its underfunded pension plans existing at the date of initial application of Statement 87 and (b) the average remaining service period to amortize the unrecognized net assets of its overfunded pension plans existing at that date? [77]

A—One of the objectives of Statement 87 is to enhance the comparability of reported pension information. Accordingly, an employer should not use different amortization periods for pension plans with essentially similar employee groups without justification as to why the inherent facts and circumstances necessitate the difference in amortization periods. Whether an unrecognized net asset or net obligation exists at the date of initial application of Statement 87 should not, by itself, justify a different amortization period. The burden of proof essentially rests with the employer who chooses to use different amortization periods for similar employee groups.

103. [Question deleted 12/98 because the effective date of Statement 87 has passed.]

Q—In determining the unrecognized net asset or net obligation existing at the date of initial application of Statement 87, which pension items are included in the unfunded accrued or prepaid pension cost balance recognized in the employer's statement of financial position? [77]

A—All items related to the pension plan and recognized in the employer's statement of financial position are included in the previously recognized unfunded accrued or prepaid pension cost balance, including the following:
   a. Any amount representing the cumulative difference between amounts funded and amounts expensed under Opinion 8
   b. The remaining gross (not net-of-tax) amount of any pension asset or pension liability recognized as part of a business combination that is accounted for by the purchase method under Opinion 16
   c. Any unamortized credit resulting from an asset reversion transaction
   d. Any remaining portion of a liability for special termination benefits to be paid by the plan and recognized by the employer under Statement 74
   e. Any remaining portion of a pension liability recognized as part of the accounting for the disposal of a segment of a business.

104. [Question deleted 12/98 because the effective date of Statement 87 has passed.]

Q—If an employer has no unfunded accrued or prepaid pension cost recognized in its statement of financial position at the date of initial application of Statement 87, may it recognize a pension asset if plan assets exceed the projected benefit obligation? [77]

A—No. Any unrecognized net asset existing at the date of initial application of Statement 87 should be amortized as a reduction of future net periodic pension cost. Refer to the answer to Question 35.

105. [Question deleted 12/98 because the effective date of Statement 87 has passed.]
Q—If the average remaining service period of employees expected to receive benefits under the pension plan is more than 15 years at the date of initial application of Statement 87, can the unrecognized net asset or net obligation be amortized over a 15-year period? [77]

A—No. The 15-year period was provided as an alternative to a shorter average remaining service period. The alternative was included, in part, so as not to penalize those employers with significantly underfunded pension plans and short-average remaining service periods.

106. [Question deleted 12/98 because the effective date of Statement 87 has passed.]

Q—Does the alternative 15-year period noted in paragraph 77 of Statement 87 apply to a pension plan that has all or almost all inactive participants whose average remaining life expectancy is less than 15 years? [77]

A—No.

107. Q—If a pension plan curtailment occurs causing almost all of the pension plan's participants to become inactive, should the employer continue to amortize any remaining portion of the unrecognized net asset or net obligation existing at the date of initial application of Statement 87 using the same amortization period determined at that date? [77]

A—Yes. The employer should continue to amortize any remaining portion of the unrecognized net asset or net obligation 17(46) existing at the date of initial application of Statement 87 using the same amortization period determined at that date.
1 (Popup - Footnote *)
Q&A 87 Footnote *—At the date of issuance of this implementation guide, Joan Lordi Amble was a project manager at the FASB and Jules M. Cassel was a senior technical advisor at the FASB. The positions and opinions expressed in this implementation guide were theirs. Revisions to this implementation guide have been made by current members of the FASB staff. Official positions of the FASB are determined only after extensive due process and deliberations.

2 (Popup - Footnote 1)
Q&A 87 Footnote 1—Numbers in brackets refer to the paragraphs in Statement 87 to which the question and answer relate.

3 (Popup - Footnote 3)
Q&A 87 Footnote 3—APB Opinion No. 12, Omnibus Opinion—1967.

4 (Popup - Footnote 4)
Q&A 87 Footnote 4—APB Opinion No. 8, Accounting for the Cost of Pension Plans.

5 (Popup - Footnote 5)
Q&A 87 Footnote 5—FASB Statement No. 109, Accounting for Income Taxes.

6 (Popup - Footnote 6)
Q&A 87 Footnote 6—FASB Technical Bulletin No. 85-4, Accounting for Purchases of Life Insurance.

7 (Popup - Footnote 8)
Q&A 87 Footnote 8—Paragraph 27 of Statement 87 states:

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 granting retroactive benefits is shorter than the entire remaining service period of the active employees. Identification of such situations requires an assessment of the individual circumstances and the substance of the particular plan situation. 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.

8 (Popup - Footnote 9)

Q&A 87 Footnote 9—Paragraph 25 of Statement 87 states:

Except as specified in paragraphs 26 and 27, that prior service cost shall be amortized by assigning an equal amount to each future period of service of each employee active at the date of the amendment who is expected to receive benefits under the plan. If all or almost all of a plan's participants are inactive, the cost of retroactive plan amendments affecting benefits of inactive participants shall be amortized based on the remaining life expectancy of those participants instead of based on the remaining service period.

9 (Popup - Footnote *)
Q&A 87, # 25, Illustration 2, Footnote *—In the year of initial application of Statement 87, the beginning balance of unrecognized net gain or loss is zero by definition.

10 (Popup - Footnote 10)
Q&A 87 Footnote 10—FASB Statement No. 36, Disclosure of Pension Information.

11 (Popup - Footnote 11)
Q&A 87 Footnote 11—FASB Statement No. 35, Accounting and Reporting by Defined Benefit Pension Plans.

12 (Popup - Footnote a)
Q&A 87, # 38, Illustration 3, Footnote a—Because the December 31, 1985 prepaid pension cost recognized in the statement of financial position (which is subtracted from plan assets in excess of the projected benefit obligation at September 30 in determining the unrecognized net asset or net obligation existing at the date of initial application of Statement 87) includes amounts paid to the pension plan during the fourth quarter, the fourth quarter contribution should be added to the measurement of plan assets at September 30, 1985.

13 (Popup - Footnote a)

Q&A 87, # 38, Illustration 3, Footnote a—Because the December 31, 1985 prepaid pension cost recognized in the statement of financial position (which is subtracted from plan assets in excess of the projected benefit obligation at September 30 in determining the unrecognized net asset or net obligation existing at the date of initial application of Statement 87) includes amounts paid to the pension plan during the fourth quarter, the fourth quarter contribution should be added to the measurement of plan assets at September 30, 1985.

14 (Popup - Footnote *)

Q&A 87, # 43, Illustration 4, Footnote *—Denotes a change from Case 2 as originally printed in Statement 87.

15 (Popup - Footnote *)

Q&A 87, # 43, Illustration 4, Footnote *—Denotes a change from Case 2 as originally printed in Statement 87.

16 (Popup - Footnote *)

Q&A 87, # 43, Illustration 4, Footnote *—Denotes a change from Case 2 as originally printed in Statement 87.

17 (Popup - Footnote *)

Q&A 87, # 43, Illustration 4, Footnote *—Denotes a change from Case 2 as originally printed in Statement 87.

18 (Popup - Footnote *)

Q&A 87, # 43, Illustration 4, Footnote *—Denotes a change from Case 2 as originally printed in Statement 87.

19 (Popup - Footnote a)

Q&A 87, # 43, Illustration 4, Footnote a—This amount is equal to unfunded accumulated benefits, plus prepaid (or minus accrued) pension cost, minus the previous balance. For financial statement presentation, the additional liability is combined with the (accrued)/prepaid pension cost.

20 (Popup - Footnote a)

Q&A 87, par. # 80, Footnote a—The weighted-average assumed discount rate reflects the rates at which the combined pension benefits could be effectively settled. (For purposes of this illustration, 9.6 percent is presumed to be the appropriate rate. It was not actually calculated using any of the data for the previously separate plans.)

21 (Popup - Footnote b)

Q&A 87, # 80, Footnote b—The expected long-term rate of return on plan assets does not change because both pension plans used the same rate.

22 (Popup - Footnote c)

Q&A 87, # 80, Footnote c—The average remaining service period of employees expected to receive benefits under the pension plan is weighted by the number of covered employees from each group as follows: (17 years x 300/720) + (15 years x 420/720) = 15.8 years (rounded). That should be the same period that would be determined by a new calculation for the combined group.

23 (Popup - Footnote c)

Q&A 87, # 80, Footnote c—The average remaining service period of employees expected to receive benefits under the pension plan is weighted by the number of covered employees from each group as
follows: \((17 \text{ years} \times 300/720) + (15 \text{ years} \times 420/720) = 15.8 \text{ years} \) (rounded). That should be the same period that would be determined by a new calculation for the combined group.

24 (Popup - Footnote 12)

Q&A 87 Footnote 12—Statement 88 states that the pro rata amount of the maximum gain or loss to be recognized in earnings when a pension obligation is settled is equal to the percentage reduction in the projected benefit obligation. Paragraph 31 of Statement 88 indicates that determination could have been based on the reduction of assets since a decrease in the amount of plan assets also affects 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. [Revised 5/03.]

25 (Popup - Footnote a)

Q&A 87, # 81, Illustration 8, Footnote a—Allocation based on individual employees covered by each plan.

26 (Popup - Footnote a)

Q&A 87, # 81, Illustration 8, Footnote a—Allocation based on individual employees covered by each plan.

27 (Popup - Footnote a)

Q&A 87, # 81, Illustration 8, Footnote a—Allocation based on individual employees covered by each plan.

28 (Popup - Footnote b)

Q&A 87, # 81, Illustration 8, Footnote b—Allocation determined by employer. (Illustration presumes that no regulatory requirements apply.)

29 (Popup - Footnote b)

Q&A 87, # 81, Illustration 8, Footnote b—Allocation determined by employer. (Illustration presumes that no regulatory requirements apply.)

30 (Popup - Footnote b)

Q&A 87, # 81, Illustration 8, Footnote b—Allocation determined by employer. (Illustration presumes that no regulatory requirements apply.)

31 (Popup - Footnote c)

Q&A 87, # 81, Illustration 8, Footnote c—Allocation based on percent of total projected benefit obligation ($90,000) assumed by each pension plan. For Plans A, B, and C, that is 60 percent, 20 percent, and 20 percent, respectively.

32 (Popup - Footnote c)

Q&A 87, # 81, Illustration 8, Footnote c—Allocation based on percent of total projected benefit obligation ($90,000) assumed by each pension plan. For Plans A, B, and C, that is 60 percent, 20 percent, and 20 percent, respectively.

33 (Popup - Footnote c)

Q&A 87, # 81, Illustration 8, Footnote c—Allocation based on percent of total projected benefit obligation ($90,000) assumed by each pension plan. For Plans A, B, and C, that is 60 percent, 20 percent, and 20 percent, respectively.

34 (Popup - Footnote d)

Q&A 87, # 81, Illustration 8, Footnote d—Allocation based on applicable individual employees covered by each plan. (Illustration presumes prior service cost not allocable on the same percentage basis as projected benefit obligation assumed by each pension plan.)

35 (Popup - Footnote d)
Q&A 87, # 81, Illustration 8, Footnote d—Allocation based on applicable individual employees covered by each plan. (Illustration presumes prior service cost not allocable on the same percentage basis as projected benefit obligation assumed by each pension plan.)

36 (Popup - Footnote d)

Q&A 87, # 81, Illustration 8, Footnote d—Allocation based on applicable individual employees covered by each plan. (Illustration presumes prior service cost not allocable on the same percentage basis as projected benefit obligation assumed by each pension plan.)

37 (Popup - Footnote c)

Q&A 87, # 81, Illustration 8, Footnote c—Allocation based on percent of total projected benefit obligation ($90,000) assumed by each pension plan. For Plans A, B, and C, that is 60 percent, 20 percent, and 20 percent, respectively.

38 (Popup - Footnote c)

Q&A 87, # 81, Illustration 8, Footnote c—Allocation based on percent of total projected benefit obligation ($90,000) assumed by each pension plan. For Plans A, B, and C, that is 60 percent, 20 percent, and 20 percent, respectively.

39 (Popup - Footnote c)

Q&A 87, # 81, Illustration 8, Footnote c—Allocation based on percent of total projected benefit obligation ($90,000) assumed by each pension plan. For Plans A, B, and C, that is 60 percent, 20 percent, and 20 percent, respectively.

40 (Popup - Footnote *)

Q&A 87, # 81, Illustration 8, Footnote *—The accounting within the equity section is not addressed.

41 (Popup - Footnote *)

Q&A 87, # 81, Illustration 8, Footnote *—The accounting within the equity section is not addressed.

42 (Popup - Footnote 13)

Q&A 87 Footnote 13—Paragraph 60 of Statement 87 states that benefits covered by annuity contracts shall be excluded from the projected benefit obligation and the accumulated benefit obligation, and, except for participation rights, annuity contracts shall be excluded from plan assets.

43 (Popup - Footnote 14)
Q&A 87 Footnote 14—FASB Statement No. 57, Related Party Disclosures.

44 (Popup - Footnote 15)

Q&A 87 Footnote 15—FASB Technical Bulletin No. 79-4, Segment Reporting of Puerto Rican Operations.

45 (Popup - Footnote 16)

Q&A 87 Footnote 16—FASB Statement No. 74, Accounting for Special Termination Benefits Paid to Employees.

46 (Popup - Footnote 17)

Q&A 87 Footnote 17—The remaining portion of the unrecognized net asset or net obligation existing at the date of initial application of Statement 87 is the amount remaining after the employer accounts for the curtailment as required by paragraphs 12 and 13 of Statement 88.

Superseded by the FASB Accounting Standards Codification on July 1, 2009.