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Financial Reporting Considerations Related to Pension and Other Postretirement Benefits

Introduction

This publication highlights some of the important accounting considerations related to the calculations and disclosures entities provide under U.S. GAAP[1] in connection with their defined benefit pension and other postretirement benefit plans. Many of these considerations have been included in prior *Financial Reporting Alert* newsletters and are summarized below. In the current year, relevant issues and disclosure items include (1) the ongoing effects of COVID-19 and (2) private entities' adoption of ASU 2018-14,[2] which addresses changes to disclosure requirements related to defined benefit plans.

Background

COVID-19

The COVID-19 pandemic continues to affect major economic and financial markets, and entities are facing challenges associated with the economic disruptions of adjusting to what appears to be an uncertain "new normal." Because of the potential long-term economic effects associated with the COVID-19 pandemic, entities should consider (1) the impact of their own actions on defined benefit plans (e.g., plan amendments) and (2) the potential impact of COVID-19 on certain significant actuarial assumptions that affect the measurement of defined benefit obligations.

[1] The views presented in this publication are specific to U.S. GAAP. For entities that use another reporting framework, such as IFRS® Standards, preparers are encouraged to discuss the accounting implications with their advisers as appropriate.

[2] FASB Accounting Standards Update (ASU) No. 2018-14, *Disclosure Framework — Changes to the Disclosure Requirements for Defined Benefit Plans*.

Further, entities may hold significant amounts of assets that do not have an active market, such as investments in hedge funds, structured products, and real estate assets that may have become more illiquid, making their valuation more complex. Appropriately determining the fair value of such assets is important in the determination of the funded status of a defined plan.

Connecting the Dots

ASC 715-20-50-1[3] requires extensive disclosures about (1) the funded status of defined benefit plans and (2) the key considerations of events during the annual period that affect plan assets (particularly when Level 3 investments are held by the plans).

The CARES Act further provided entities with the ability to delay making contributions to their defined benefit plans. Therefore, entities that had material required contributions and availed themselves of the 2020 deferral in contributions should disclose that fact to comply with ASC 715-20 requirements to disclose the nature and effect of the significant changes during the period that affect comparability.

The long-term effects of COVID-19 are still largely unknown and can vary depending on a reporting entity's particular facts and circumstances, thereby introducing additional uncertainty to estimates related to pension and other postretirement benefits. However, the requirement in ASC 715 that entities use the "best estimate" for each assumption as of the current measurement date remains unchanged. Therefore, entities should consider whether COVID-19 may have an impact on actuarial assumptions and document what factors they considered (including any recommendation by their actuaries) in selecting this year's assumptions for their pension and other postretirement benefits, as applicable.

Many entities use census data prepared before their fiscal year-end and project forward any changes for purposes of measuring their benefit obligation, as allowable under ASC 715. Entities that elect to do so should use judgment in determining whether any experience adjustments related to COVID-19 are necessary when rolling forward their benefit obligation and should document the judgments they made, as applicable.

Effective Dates for ASU 2018-14

ASU 2018-14 amends ASC 715 to add, remove, and clarify disclosure requirements related to defined benefit pension and other postretirement plans. The ASU's amendments are effective for public business entities for fiscal years ending after December 15, 2020. For all other entities, the ASU is effective for fiscal years ending after December 15, 2021. Especially for the benefit of calendar-year-end nonpublic entities that will be adopting the ASU shortly, the ASU's provisions are further discussed in the Presentation and Disclosure section.

Discount Rate

Over the past few years, we have provided insights into approaches used to support discount rates for defined benefit plans (e.g., hypothetical bond portfolio, yield curve, index-based discount rate), considerations related to the application of discount rates when an entity measures its benefit obligation, and considerations related to the use of a more granular approach to measure components of benefit cost. Entities should discuss with their employee benefits specialists whether certain refinements to hypothetical bond portfolio and yield curve construction methods occurred in the current period. Considerations related to an entity's discount rate selection method, its use of a hypothetical bond portfolio, its use of a yield curve, and its measurement of components of benefit cost are addressed below.

[3] For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."

Discount Rate Selection Method

ASC 715-30-35-43 requires the discount rate to reflect rates at which the defined benefit obligation could be effectively settled. In the estimation of those rates, it would be appropriate for an entity to use information about rates implicit in current prices of annuity contracts that could be used to settle the obligation. Alternatively, employers may look to rates of return on high-quality fixed-income investments that are currently available and expected to be available during the benefits' period to maturity.

One acceptable method of deriving the discount rate would be to use a model that reflects rates of zero-coupon, high-quality corporate bonds with maturity dates and amounts that match the timing and amount of the expected future benefit payments. Since there are a limited number of zero-coupon corporate bonds in the market, models are constructed with coupon-paying bonds whose yields are adjusted to approximate results that would have been obtained through the use of the zero-coupon bonds. Constructing a hypothetical portfolio of high-quality instruments with maturities that mirror the benefit obligation (also referred to as bond matching) is one method that can be used to achieve this objective.

Other methods that can be expected to produce results that are not materially different would also be acceptable — for example, use of a yield curve constructed by a third party such as an actuarial firm. The use of indexes may be acceptable as well.

Connecting the Dots

In determining the appropriate discount rate, entities should consider the following SEC staff guidance (codified in ASC 715-20-S99-1):

> At each measurement date, the SEC staff expects registrants to use discount rates to measure obligations for pension benefits and postretirement benefits other than pensions that reflect the then current level of interest rates. The staff suggests that fixed-income debt securities that receive one of the two highest ratings given by a recognized ratings agency be considered high quality (for example, a fixed-income security that receives a rating of Aa or higher from Moody's Investors Service, Inc.).

Entity's Use of a Hypothetical Bond Portfolio

To support its discount rate, an entity may elect to use a hypothetical bond portfolio developed with the assistance of an actuarial firm or other third party. Many hypothetical bond portfolios developed by actuarial firms or other third parties are supported by a white paper or other documentation that discusses how the hypothetical bond portfolios are constructed. It is advisable for management to understand how the hypothetical bond portfolio it has used to develop its discount rate was constructed, including the universe of bonds used in the analysis. In particular, management should consider evaluating how bonds included in the bond universe are assessed for reliability and quality of pricing and the criteria used to evaluate and eliminate outliers.

We have been advised by some third parties, particularly those involved in developing hypothetical bond portfolios in the U.S. markets, of refinements to the bond-matching method resulting from advances in technology and modeling techniques. Such refinements may require management to exercise additional judgment when evaluating the reliability and quality of pricing of bonds selected from the revised bond universe for inclusion in the hypothetical bond portfolio. If applicable, management should consider the reasonableness of adjustments or changes to the bond universe that is used to develop the hypothetical bond portfolio and evaluate whether the changes made are appropriate for the plan.

Connecting the Dots

Refinements in discount rate models occur from time to time and may be driven by (1) the availability of new technology or modeling techniques or (2) changes in available market information. Entities and their auditors, with the assistance of

employee benefits specialists, should understand the nature of, the reason for, and the appropriateness of the change(s). Entities should also consider the requirement to use the best estimate when determining their discount rate selection method. ASC 715-30-55-26 through 55-28 state that an entity may change its method of selecting discount rates provided that the method results in "the best estimate of the effective settlement rates" as of the current measurement date. Changes in the method used to determine that best estimate should be made when facts or circumstances change. If the facts or circumstances do not change from year to year, it would generally be inappropriate for an entity to change the basis of selection. Changes to an entity's choice of discount rate selection method, as well as refinements to a given discount rate selection method, are viewed as changes in estimate, and the effect would be included in actuarial gains and losses and accounted for in accordance with ASC 715-30-35-18 through 35-21.

It is important for entities that make refinements to the discount rate selection method to consider the impact of the change in estimate on disclosures. Specifically, entities should consider the disclosure requirements in ASC 250-10-50-4, under which an entity must disclose the material effect of changes in accounting estimates on income statement and earnings-per-share measures, and ASC 715-20-50-1(k) and (r), under which an entity must disclose (1) the discount rate used to determine the benefit obligation and net periodic benefit cost as well as (2) an explanation for any significant change in the benefit plan obligation not otherwise apparent in the other required disclosures of ASC 715.

Entity's Use of a Yield Curve

To support its discount rate, an entity may elect to use a yield curve constructed by an actuarial firm or other third party. Many such yield curves are supported by a white paper or other documentation that discusses how the yield curves are constructed.

Management should understand how the yield curve it has used to develop its discount rate was constructed as well as the universe of bonds included in the analysis. If applicable, management should also consider evaluating and reaching conclusions about the reasonableness of the approach the third party applied to adjust the bond universe used to develop the yield curve.

We have been advised by some third parties, particularly those constructing yield curves for non-U.S. markets (e.g., the eurozone and Canada), that because of a lack of sufficient high-quality instruments with longer maturities, they have employed a method in which they adjust yields of bonds that are not rated AA by an estimated credit spread to derive a yield representative of an AA-quality bond. This bond, as adjusted, is included in the bond universe when the third party constructs its yield curve. Management should understand the adjustments made to such bond yields in the construction of those yield curves and why those adjustments are appropriate.

In recent years, we have held discussions with actuarial firms regarding the incorporation of longer-duration bonds (bonds with stated maturities in the range of up to 80–100 years) in the development of the yield curve. There is significant judgment involved in the development of yield curves, particularly when longer-duration bonds are used, since there often are no observable market rates across the full spectrum of maturities. Management should understand and consider evaluating the reasonableness of how the additional bonds included in the bond universe are evaluated for reliability of pricing by considering parameters such as screening for potential outliers. In a manner similar to the discussion of hypothetical bond portfolios above, management should consider the reasonableness of any revisions to the yield curve construction method in such circumstances and decide whether the changes made are appropriate for the plan.

Measurement of Benefit Cost Components

Since 2015, a frequently discussed topic has been the alternatives for applying discount rates to measure the components of net periodic benefit cost for a defined benefit retirement plan obligation under ASC 715. That year, the SEC staff did not object to the use of a spot rate approach for measuring the service cost and interest cost components of net periodic benefit cost by entities that develop their discount rate assumption by using a yield curve approach (referred to as the granular approach). However, in 2016, the staff stated that it objected to the use of a similar granular approach for SEC registrants that use a bond-matching approach to support the discount rate.

Entities that use a bond-matching approach to the selection of discount rates and are considering changing to a yield curve approach should consider the views expressed at the 2015 AICPA Conference on Current SEC and PCAOB Developments. At the conference, the SEC staff made some observations about an entity's change from a bond-matching approach to a yield curve approach and simultaneously adopting the spot rate approach to measure interest cost. While the staff does not have a formal view on such changes, we understand that it would consider their acceptability on the basis of an individual registrant's specific facts and circumstances. The staff provided the following considerations for registrants contemplating a change from a bond-matching approach to a yield curve approach:

- Although the use of discount rates to measure the present value of the benefit obligation and the determination of interest cost are integrated concepts under ASC 715, the measurement of the benefit obligation is the starting point for application of the pension accounting model.
- An entity should evaluate its current approach to selecting discount rates for measuring the benefit obligation and should change its method only if (1) its facts and circumstances have changed and (2) another approach would result in better measurement information. The decision to select or change an approach to selecting discount rates should be consistent with the objective described in ASC 715 of making a best estimate of the rate at which the benefit obligation could be effectively settled.
- The rationale for a change in the approach to selecting discount rates should not be based on materiality.
- An entity should consider its prior rationale for choosing or changing to a bond-matching approach and why that was deemed a best estimate.
- A change in the approach to selecting discount rates for measuring interest cost (i.e., from the single weighted-average approach to the spot rate approach) would not be considered a sufficient change in facts and circumstances on its own to justify a switch in approach to selecting discount rates for measuring the benefit obligation.

In light of the above considerations and in the absence of other entity-specific changes in facts and circumstances, we believe that it could be challenging to justify or support a change from the bond-matching approach to the yield curve approach. We also believe that the above considerations would apply to a nonpublic entity. Historically, entities have generally made the switch only from a yield curve approach to a bond-matching approach, which suggests that of the two methods, the bond-matching approach results in a better estimate. This historical practice, along with the SEC staff's informal views that the acceptability of the spot rate approach would not by itself be a change in facts and circumstances that justifies a change in approach to selecting discount rates, reduces the likelihood that switching from a bond-matching approach to a yield curve approach would be considered a better estimate in accordance with the best-estimate objective of ASC 715. However, if an SEC registrant believes that its facts and circumstances would support a switch from the bond-matching approach to the yield curve approach, it should consider submitting a preclearance request to the SEC staff to confirm that the staff will not object.

Mortality Assumption

Many entities rely on their actuarial firms for advice or recommendations related to demographic assumptions, such as the mortality assumption. Frequently, actuaries recommend published tables that reflect broad-based studies of mortality. Under ASC 715-30 and ASC 715-60, each assumption should represent the "best estimate" for that assumption as of the current measurement date. Entities should consider whether the mortality tables used and adjustments made (e.g., for longevity improvements) are appropriate for the employee base covered under the plan.

In 2014, the Retirement Plans Experience Committee of the Society of Actuaries (SOA)[4] released a new set of mortality base tables (RP-2014) and a new companion mortality improvement scale (Scale MP-2014). Every year since 2014, the SOA has released an updated mortality improvement scale — most recently, Scale MP-2021, which reflects historical U.S. population mortality experience through 2019. Therefore, MP-2021 does not reflect any historical or potential future effects of COVID-19. It should be noted that while Scale MP-2021 does not reflect any adjustments for the effects of COVID-19 on mortality patterns, the SOA's October 2021 report *Mortality Improvement Scale MP-2021* does discuss potential adjustments related to COVID-19 that may be considered. There is still significant uncertainty related to the long-term impacts of COVID-19 based on the potential for future variants, long-term side effects, and incomplete inoculation rates. Accordingly, assessing the impacts of COVID-19 on a particular pension population is best done on the basis of an entity's specific facts and circumstances.

In addition, in 2019, the SOA released a new set of mortality base tables (Pri-2012) that include more current data than the RP-2014 tables. Generally, we would expect an entity to use the Pri-2012 mortality tables because they are based on experience more current than that reflected in the RP-2014 tables. However, the selection of mortality base tables and improvement scales requires judgment and should take into account an entity's specific facts and circumstances. It is advisable for entities, with the help of their actuaries, to (1) continue monitoring the availability of updates to mortality tables, longevity improvement scales, and related experience studies and (2) consider reflecting these updates in the current-year mortality assumption, including whether the COVID-19 pandemic may affect the potential mortality trends. Entities should consider documenting the factors used (including any recommendation by their actuaries) in selecting this year's mortality assumption for their defined benefit plan, including how they evaluated the new base tables and mortality improvement scales.

Expected Long-Term Rate of Return

The expected long-term rate of return on plan assets[5] is a component of an entity's net periodic benefit cost and should represent the average rate of earnings expected over the long term on the funds invested to provide future benefits (existing plan assets and contributions expected during the current year). The long-term rate of return is set as of the beginning of an entity's fiscal year (e.g., January 1, 2021, for a calendar-year-end entity). If the target allocation of plan assets to different investment categories has changed from the prior year or is expected to change during the coming year, an entity should consider discussing with its actuaries and independent auditors whether an adjustment to its assumption about the long-term rate of return is warranted.

In August 2021, changes to ASOP 27[6] became effective. Management generally engages an actuarial specialist to assist in measuring pension obligations for financial reporting

[4] The SOA is a leading provider of actuarial research, and its mortality tables and mortality improvement scales are considered by many plan sponsors as a starting point for developing their mortality assumptions.

[5] As defined in ASC 715-30, the "expected return on plan assets is determined based on the expected long-term rate of return on plan assets and the market-related value of plan assets."

[6] Actuarial Standards Board Actuarial Standard of Practice (ASOP) No. 27, *Selection of Economic Assumptions for Measuring Pension Obligations*.

purposes. The assumptions used to measure the pension obligation are the responsibility of management. Before the changes in ASOP 27, actuarial specialists often would specifically disclaim any assessment regarding the expected long-term rate of return assumption when management selected the assumption and the actuary was not directly involved in the analysis supporting the selection. Under the new revisions to ASOP 27, an actuary is required to assess the reasonableness of each economic assumption that was not selected by the actuary.[7] Accordingly, actuaries are now expected to assess the reasonableness of the long-term rate of return assumption, and actuarial reports in most cases may no longer disclaim an assessment of that assumption. An actuary's assessment of reasonableness of the long-term rate of return assumption does not change management's responsibility for the assumption or eliminate the requirement that the independent auditor assess and mitigate any applicable risk of material misstatement associated with the assumption.

Other Postretirement Benefit Plans — Health Care Cost Trend Rate and Discount Rate

ASC 715-60-20 defines "health care cost trend rate" as an "assumption about the annual rates of change in the cost of health care benefits currently provided by the postretirement benefit plan. . . . The health care cost trend rates implicitly consider estimates of health care inflation, changes in health care utilization or delivery patterns, technological advances, and changes in the health status of the plan participants." The health care cost trend rate is used to project the change in the cost of health care over the period for which the plan provides benefits to its participants. Many plans use trend rate assumptions that include (1) a rate for the year after the measurement date that reflects the recent trend of health care cost increases, (2) gradually decreasing trend rates for each of the next several years, and (3) an ultimate trend rate that is used for all remaining years. Entities should consider whether the COVID-19 pandemic may change the health care cost trend rate — specifically, by assessing whether changes in claims between periods correlate with changes in caseloads and corresponding restrictions, thereby altering the timing of employees' health care treatments.

Historically, the ultimate health care cost trend rate had been less than the discount rate. With the recent years of discount rates near record lows, the discount rate for some plans is below the ultimate health care cost trend rate. Some parties have raised concerns regarding this phenomenon since expectations of long-term inflation rates are assumed to be implicit in both the health care cost trend rate and the discount rate. In such situations, entities should consider all the facts and circumstances of their plan(s) to determine whether the assumptions used (e.g., ultimate health care cost trend rate of 5 percent and a discount rate below that) are reasonable. Entities should also remember that (1) the discount rate reflects spot rates observable in the market as of the plan's measurement date, since it represents the rates at which the defined benefit obligation could be effectively settled on that date (given the rates implicit in current prices of annuity contracts or the rates of return on high-quality fixed-income investments that are currently available and expected to be available during the benefits' period to maturity), and (2) the health care cost trend rate is used to project the change in health care costs over the long term (which, as discussed above, includes the effects of changes other than inflation).

Other Considerations Related to Assumptions

In measuring each plan's defined benefit obligation and recording the net periodic benefit cost, financial statement preparers should understand and consider evaluating and reaching conclusions about the reasonableness of the underlying assumptions, particularly those that could be affected by continuing financial market volatility. ASC 715-30-35-42 states that "each significant assumption used shall reflect the best estimate solely with respect to that individual assumption."

[7] Other than prescribed assumptions or methods set by law, or assumptions disclosed in accordance with Section 4.2(b) of ASOP 27.

Entities should consider comprehensively assessing the relevancy and reasonableness of each significant assumption on an ongoing basis (e.g., by considering the impact of significant developments that have occurred in the entity's business as well as employees' long-term behavioral changes). Management should establish processes and internal controls to ensure that the entity appropriately selects each of the assumptions used in accounting for its defined benefit plans. The internal controls should be designed to ensure that the amounts reported in the financial statements properly reflect the underlying assumptions (e.g., discount rate, estimated long-term rate of return, mortality, turnover, health care costs) and that the documentation maintained in the entity's accounting records sufficiently demonstrates management's understanding of and reasons for using certain assumptions and methods (e.g., the method for determining the discount rate). Management should also consider documenting the significant assumptions used and the reasons why certain assumptions may have changed from the prior reporting period.

A leading practice is for management to prepare a memo supporting the following:

- The basis for each significant assumption used.
- How management determined which assumptions were significant from a range of potential assumptions, when applicable.
- The consistency of significant assumptions with relevant industry, regulatory, and other external factors, including (1) economic conditions; (2) the entity's objectives, strategies, and related business risks; (3) existing market information; (4) historical or recent experience; and (5) other significant assumptions used by the entity in other estimates.
- For issuers that identify pension and other postretirement benefit obligations as critical accounting estimates, how management analyzed the sensitivity of its significant assumptions to change.

U.K. Pension Benefits — High Court of Justice Rulings on Equalization

On October 26, 2018, the High Court of Justice in the United Kingdom (the "High Court") issued a ruling (the "initial High Court ruling") requiring Lloyds Bank plc to equalize benefits payable to men and women under its U.K. defined benefit pension plans by amending those plans to increase the pension benefits payable to participants that accrued such benefits during the period from 1990 to 1997. The inequalities arose from statutory differences in the retirement ages and rates of accrual of benefits for men and women related to Guaranteed Minimum Pension (GMP) benefits that are included in most U.K. defined benefit pension plans. In the initial High Court ruling and in a supplementary ruling issued on December 6, 2018, the High Court also provided details on acceptable alternative methods of amending plans to equalize the pension benefits. In a separate ruling issued on November 20, 2020, the High Court also mandated that pension schemes will need to revisit previous payments to employees who transferred out of a pension scheme to assess whether those employees are owed additional value under the equalization rules.

All entities in the United Kingdom that offered GMP benefits during this period will need to consider the applicability of these High Court rulings to their U.K. defined benefit pension plans. On January 23, 2019, the U.K. government published guidance on GMP conversion and equalization that is applicable to all entities. Although the potential impact of the rulings on any individual pension scheme will vary, current preliminary estimates of the potential increase in the projected benefit obligation of a pension plan are from 0 percent to 3 percent.

Accounting Implications

Initial Recognition and Remeasurement Considerations

Under U.S. GAAP, defined benefit pension plan changes (including changes attributable to legislation or court rulings) that result in a retroactive increase or decrease in benefit levels for plan participants are viewed as prior service cost under ASC 715. Since the initial High Court ruling requires retroactive changes in the level of benefits accrued during the period from 1990 to 1997 to equalize the level of pension benefits accrued for men and women participants, the equalization adjustment should be treated as a prior service cost.

Generally, plan amendments required by legislation or court rulings are accounted for upon enactment of the legislation or finalization of the court rulings. As noted above, the initial High Court ruling was issued on October 26, 2018, and the additional High Court ruling regarding those who had transferred out of a pension scheme was issued on November 20, 2020. An entity will need to determine with its legal advisers whether the rulings are applicable and require plan amendments to address benefit equalization and, if so, whether the entity intends to comply with the rulings and make the necessary plan amendments.

The resulting increase in the projected benefit obligation when the effect of the High Court rulings is included in the measurement of the projected benefit obligation should be treated as prior service cost.

Subsequent Recognition

ASC 715-30-35-11 provides that after the prior service cost is initially recognized, it "**shall be amortized as a component of net periodic pension cost**" (emphasis added). An entity should review the considerations in ASC 715-30-35-10 through 35-17 to determine the method and period of the amortization of the prior service cost from other comprehensive income to recognize as a component of net periodic pension cost.

Changes in Estimates in Future Periods

Given the difficulty of obtaining the information needed to measure the effect of the High Court rulings, combined with the ongoing complexity and uncertainty associated with implementing the several acceptable alternative methods of equalizing pension benefits, reporting entities most likely have made estimates and assumptions as part of the measurement and initial recognition of the effect of the High Court rulings that will be treated as prior service cost. Over time, improved availability of information supporting the estimates and measurement assumptions as well as further clarity regarding application of the equalization methods may give rise to actuarial gains or losses in future remeasurements of the pension obligation. Subsequent gains and losses in measurements of the projected benefit obligation (after initial recognition of the prior service cost related to the High Court rulings) that are related to equalization and that arise from experience different from that assumed or from a change in an actuarial assumption should generally be recorded as gains and losses in accordance with ASC 715-30-35-18 through 35-27. However, the guidance therein "**does not require recognition of gains and losses as components of net pension cost of the period in which they arise**"[8] (emphasis added).

Presentation and Disclosure

In August 2018, the FASB issued ASU 2018-14, which amends ASC 715 to add, remove, and clarify disclosure requirements related to defined benefit pension and other postretirement plans. The ASU's changes related to disclosures are part of the FASB's disclosure framework project, which the Board launched in 2014 to improve the effectiveness of disclosures in notes to financial statements.

[8] Quoted from ASC 715-30-35-19.

ASU 2018-14 adds requirements for an entity to disclose the following:

- The weighted-average interest crediting rates used in the entity's cash balance pension plans and other similar plans.
- A narrative description of the reasons for significant gains and losses affecting the benefit obligation for the period.
- An explanation of any other significant changes in the benefit obligation or plan assets that are not otherwise apparent in the other disclosures required by ASC 715.

Further, ASU 2018-14 removes guidance that currently requires the following disclosures:

- The amounts in accumulated other comprehensive income expected to be recognized as part of net periodic benefit cost over the next year.
- Information about plan assets to be returned to the entity, including amounts and expected timing.
- Transactions resulting from the June 2001 amendments to the Japanese Welfare Pension Insurance Law.
- Information about (1) benefits covered by related-party insurance and annuity contracts and (2) significant transactions between the plan and related parties. (Entities separately need to provide the related-party disclosures required under ASC 850.)
- For nonpublic entities with Level 3 plan assets in the fair value hierarchy measured on a recurring basis, a reconciliation of the opening balances to the closing balances. (However, those entities would still need to disclose transfers of plan assets into and out of Level 3 and any purchases of Level 3 assets by the plan.)
- For public entities, the effects of a one-percentage-point change on the assumed health care costs and the effect of this change in rates on service cost, interest cost, and the benefit obligation for postretirement health care benefits.

The ASU's amendments are effective for public business entities for fiscal years ending after December 15, 2020. For all other entities, the ASU is effective for fiscal years ending after December 15, 2021. Early adoption is permitted; however, all provisions of ASU 2018-14 should be adopted if early adoption is elected. A retrospective transition method is required.

Calendar-year-end public companies adopted the ASU last year. We have observed diversity in practice related to the format of, and detail provided in, the narrative description of the reasons for significant gains and losses and other significant changes. In terms of format, SEC registrants have (1) added footnotes to the rollforwards of pension obligations and assets, (2) added a separate discussion to narratively describe significant gains and losses, or (3) included discussions of the results. The detail provided has ranged from a short description attributing changes to updated discount rates to detailed discussions that attribute significant gains or losses to each relevant assumption (e.g., discount rate, mortality).

SEC Staff Views

The SEC staff has commented on disclosures related to how registrants account for pension and other postretirement benefit plans and how significant assumptions and investment strategies affect their financial statements. Further, registrants may be asked how they concluded that assumptions used for their pension and other postretirement benefit accounting are reasonable relative to (1) current market trends and (2) assumptions used by other registrants with similar characteristics.

Disclosures of Critical Accounting Policies and Estimates

The SEC staff has asked registrants how their disclosures in the critical accounting policies and estimates section of MD&A align with their accounting policy disclosures in the notes to the financial statements. The staff expects registrants to provide robust disclosures of their critical accounting policies and estimates in MD&A. Accordingly, a registrant's disclosures in MD&A of critical accounting policies and estimates should not merely duplicate documentation from the accounting policy disclosures in the financial statement footnotes.

In addition, the SEC staff has indicated that it may be appropriate for a registrant to disclose:

- Whether a corridor is used to amortize the actuarial gains and losses and, if so, how the corridor is determined and the period for amortization of the actuarial gains and losses in excess of the corridor.
- A sensitivity analysis estimating the effect of a change in assumption regarding the long-term rate of return. This estimate should be based on a reasonable range of likely outcomes.
- How the registrant calculates historical returns to develop its expected rate of return assumption. If use of the arithmetic mean to calculate the historical returns produces results that are materially different from the results produced when the geometric mean is used to perform this calculation, it may be appropriate for the registrant to disclose both calculations.
- The reasons why the expected return has changed or is expected to change in the future.
- The effect of plan asset contributions during the period on profit or loss, when this effect is significant. The SEC staff has indicated that additional plan asset contributions reduce net pension costs even if actual asset returns are negative because the amount included in profit or loss is determined through the use of expected, as opposed to actual, returns. Consequently, such information can provide an understanding of unusual or nonrecurring items or other significant fluctuations so that investors can ascertain the likelihood that past performance is indicative of future performance.

Connecting the Dots

When evaluating critical accounting estimates in accordance with PCAOB Auditing Standard 2501,[9] auditors are required to obtain an understanding of how management analyzed the sensitivity of its significant assumptions to change on the basis of other reasonably likely outcomes that would have a material effect on the registrant's financial condition or operating performance. Therefore, registrants should expect that auditors may continue to expand their audit procedures to better understand how management analyzes the significant assumptions that may affect the measurement of the defined benefit obligation and certain plan assets.

Non-GAAP Measures

In recent years, the SEC renewed its focus on non-GAAP measures resulting from concerns about the increased use and prominence of such measures, the nature of the adjustments, and the increasingly large difference between the amounts reported for GAAP and non-GAAP measures. In response to increasing concerns about the use of non-GAAP measures, the SEC's Division of Corporation Finance updated its Compliance and Disclosure Interpretations in May 2016, October 2017, and again in April 2018 to provide additional guidance on what it expects from registrants when they use these measures. Some registrants present non-GAAP measures that adjust for items related to defined benefit pension plans. For example, a registrant may adjust to remove (1) all non-service-related pension expense, (2) all pension

[9] PCAOB Auditing Standard No. 2501, *Auditing Accounting Estimates, Including Fair Value Measurements.*

expense in excess of cash contributions, or (3) the amortization of actuarial gains and losses. Some registrants that immediately recognize all actuarial gains and losses in earnings present non-GAAP measures that remove the actuarial gain or loss attributable to the change in the fair value of plan assets from a performance measure and include an expected return. The SEC staff has observed that these pension-related adjustments can be confusing without the appropriate context about the nature of the adjustment. The staff suggested that registrants clearly label such adjustments and avoid the use of confusing or unclear terms in their disclosures.

For more information, see Section 4.16 of Deloitte's Roadmap *Non-GAAP Financial Measures and Metrics*.

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