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Audit and Enterprise Risk Services

Financial Reporting Considerations Related to Pension and Other Postretirement Benefits

Financial Reporting Alert 12-6
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This publication, which updates Financial Reporting Alert 11-6, highlights accounting considerations related to the calculations and disclosures entities provide under U.S. GAAP in connection with their defined benefit pension and other postretirement benefit plans. New topics addressed in this update are (1) new disclosure requirements for multiemployer plans, (2) financial reporting considerations resulting from health care legislation, and (3) the relationship between the discount rate and medical trend rate for other postretirement benefit plans.

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Accounting Standards Update

New Disclosures About an Employer's Participation in a Multiemployer Plan

In September 2011, the FASB issued **ASU 2011-09**,[1] which amends ASC 715-80[2] by increasing the quantitative and qualitative disclosures an employer is required to provide about its participation in significant multiemployer plans that offer pension or other postretirement benefits. The ASU's objective is to enhance disclosures about (1) the "significant multiemployer plans in which an employer participates," (2) the "level of an employer's participation in [those] plans," (3) the "financial health of the . . . plans," and (4) the "nature of the employer commitments to the plan." The disclosure requirements do not apply to an employer's participation in multiple-employer plans (i.e., single-employer plans aggregated to pool plan assets for investment purposes or to reduce the costs of plan administration).

The ASU only affects disclosure; it does not change the accounting for an employer's participation in a multiemployer plan. Employers should continue to recognize the required contribution to the plan for the period as pension or postretirement benefit cost. Any contributions due as of the reporting date should be recognized as a liability. In addition, ASC 450's provisions on accounting for and disclosing contingencies continue to apply "if an obligation due to withdrawal from a multiemployer plan is either probable . . . or reasonably possible."

For public entities, the new disclosure requirements became effective for fiscal years ending after December 15, 2011. However, for nonpublic entities, the effective date was deferred by one year, to fiscal years ending after December 15, 2012. The amendments in the ASU should be applied retrospectively for all periods presented. For more information on ASU 2011-09, see Deloitte's September 23, 2011, ***Heads Up***.

Health Care Legislation

Affordable Care Act and Health Care and Education Reconciliation Act of 2010

Entities need to continue to consider the impact on postretirement benefits of the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010 (collectively, the "Act"). The passage of the Act has resulted in comprehensive health care reform since its March 2010 enactment, with this reform continuing over the next several years. The Act, among other things, eliminated the annual and lifetime benefit caps on essential health benefits and imposed an excise tax on high-cost employer health plans. Another notable provision of the Act eliminates, beginning in 2013, the tax deduction for the portion of the prescription drug costs for which the employer receives a Medicare Part D subsidy. An entity should account for the impacts

of the Act, such as the excise tax on high-cost plans, on the basis of the provisions of its current substantive benefit plans, even if the entity is considering amending its plans before the related provision of the Act becomes effective.

Employee Group Waiver Plans

Before the Act, employers offering retiree prescription drug coverage that was at least as valuable as Medicare Part D coverage were entitled to a tax-free 28 percent federal retiree drug subsidy (RDS). Employers could claim a deduction for the entire cost of providing the prescription drug coverage even though a portion of the cost is offset by the subsidy they receive. The Act repealed the rule permitting deduction of the portion of the drug coverage expense that is offset by the Medicare Part D subsidy, beginning in 2013. However, the Act made certain enhancements to Medicare Part D prescription drug coverage and introduced other provisions to address Medicare Part D coverage gaps, including a pharmaceutical manufacturers' 50 percent discount on brand-name drugs beginning in 2011, increasing to a 75 percent discount on brand-name drugs and expanding to include discounted generic drugs by 2020.

Employers either can continue to apply for federal RDS payments that are received by the employer directly or they can sponsor a Medicare Part D plan through an employee group waiver plan[3] (EGWP) to take advantage of the enhancements under the Act (via cost savings passed along from the health care plan administrator). An EGWP is designed to provide benefits that are actuarially equivalent to Medicare Part D and must be run by the health care plan administrator.

It is generally expected that retiree plan participants will receive essentially the same prescription drug benefits under an EGWP as they would under an RDS approach. However, the cost of providing the benefit will generally be less. Depending on the specific plan design for cost sharing between the employer and the retiree, the cost savings may be realized by either party or both parties. If the benefits provided by the plan to the participants do not change as a result of the change from the RDS to an EGWP, only the assumption regarding plan costs has changed and the employer will record an actuarial gain. Generally, if a change from an RDS to an EGWP represents a "substantive" change to the plan, the change should be accounted for as a plan amendment due to a change in benefits provided to participants by the plan. For example, if the cost savings of the EGWP are shared between the plan sponsor and the retirees, a change to the benefits the plan provides would generally result and the employer should recognize a plan amendment under ASC 715-60-35. Furthermore, the timing of accounting for the plan amendment may need to be considered, depending on (1) whether the employer has the unilateral ability to make the change and (2) how changes to the substantive plan are communicated to participants and the detail and timing of this communication. Entities need to consider the potential effects of any such plan amendments that are made concurrently with their open-enrollment period for 2013, which will typically take place in late 2012, and recognize the accounting effects of any significant changes in the period of the change (e.g., the fourth quarter of 2012).

Moving Ahead for Progress in the 21st Century Act

In the latest effort to address pension funding concerns for ERISA-qualified pension plans, the Moving Ahead for Progress in the 21st Century Act (MAP-21), a federal highway funding bill enacted on July 6, 2012, included amendments to the pension minimum funding requirements of the Pension Protection Act of 2006 (PPA). The new legislation provides for a floor and ceiling on interest rates used for discounting pension obligations to determine the funding requirements of a plan. The introduction of the floor, which is initially set at 90 percent of the 25-year average of corporate bond rates, will raise the interest rate that entities use in measuring the pension

obligation when determining the required minimum contribution, thereby reducing the required future plan contributions. These provisions are generally effective for plan years beginning on or after January 1, 2012.

Like the PPA, MAP-21 requires entities to use a discount rate based on the average yield over the past 24 months on corporate bonds carrying one of the top three ratings. This requirement includes single-A-rated bonds, whose bond yields are not considered to be "high quality" by the SEC.[4] In addition, in contrast to the spot rate that entities are required to use as of the plan's measurement date in accordance with ASC 715, the interest rates represent an average yield over 24 months. Accordingly, it would be unusual for entities to be able to support their selection of the discount rate for financial reporting purposes by reference to the interest rates used for minimum funding purposes. For more information, see the "**Discount Rate**" section below.

The pension funding relief provisions of MAP-21 may allow entities to significantly reduce their planned contributions to qualified pension plans. If this change significantly affects a public entity's liquidity and capital resources, it should consider whether it needs to discuss this impact in Management's Discussion and Analysis.

In addition, ASC 715 requires entities to disclose, in their annual financial statements, an estimate of contributions expected to be made to their defined benefit plans during the next year. In interim financial statements, entities need to disclose an updated estimate of their current-year contributions if the estimate has changed significantly from the amount disclosed in the previous year-end financial statements.

Underlying Assumptions

In measuring each plan's defined benefit obligation and recording the net periodic benefit cost, financial statement preparers should understand, evaluate, and reach 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."

Editor's Note: The SEC staff continues to comment on registrants' disclosures about key assumptions that represent critical inputs for calculating benefit obligations and net periodic benefit cost. Given the volatility in the financial markets, comments have centered on (1) how registrants considered recent market performance in determining their key assumptions, such as those about long-term rates of return; (2) the impact of recent market performance on net periodic benefit cost and an entity's financial position; and (3) the impact of funding requirements on an entity's liquidity. In addition, the SEC staff has been requesting sensitivity analyses for critical accounting estimates associated with an entity's pension and other postretirement obligations. These disclosures should focus on changes in key assumptions that are reasonably likely to occur and that could be material to an entity (e.g., changes in the discount rate used to calculate an entity's benefit obligation).

The SEC staff frequently comments on registrants' disclosures regarding the valuation techniques and inputs used to measure the fair value of plan assets and has also requested entities to disclose their accounting policy election for calculating the market-related value of plan assets.

For more information, see Deloitte's ***SEC Comment Letters — Including Industry Insights: Improving Transparency***.

Management should establish processes and internal controls to ensure that the entity appropriately determines 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 cost) and that the documentation maintained in the company'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 document the key 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 (1) the basis for each important assumption used and (2) how management determined which assumptions were important.

Discount Rate

Discount Rate Selection Method

ASC 715-30-35-44 requires that the discount rate reflect rates at which the defined benefit obligation could be effectively settled. In estimating 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 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 indices may also be acceptable.

Entities should focus on 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. When an entity's method of selecting a discount rate results in higher rates than those being used by similar entities or in rates that remain consistent from year to year despite a fluctuating market, questions may be raised about whether the method is producing a reasonable result.

Editor's Note: 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.).

Hypothetical Bond Portfolios — Bond Pricing

Entities that use hypothetical bond portfolios (HBPs) to support the discount rate used to measure their postretirement benefit obligations should evaluate the impact of current market conditions on both bond pricing

and bond selection. Credit market unrest may affect the level of trading activity for some bonds, resulting in large spreads between the bid and ask prices. Pricing should reflect the amount at which the postretirement benefit obligation could be settled. In the current market, bid price (which is often used because of the availability of data) may not necessarily represent the cost of acquiring a hypothetical portfolio. In evaluating the appropriateness of bond pricing used to develop their models, entities may find it helpful to consider the guidance in ASC 820-10-35-56 and 35-57, which state, in part:

> If an input used to measure fair value is based on bid and ask prices (for example, in a dealer market), the price within the bid-ask spread that is most representative of fair value in the circumstances shall be used to measure fair value, regardless of where in the fair value hierarchy the input falls (Level 1, 2, or 3). . . .
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> This Subtopic does not preclude the use of mid-market pricing or other pricing conventions as a practical expedient for fair value measurements within a bid-ask spread.

Hypothetical Bond Portfolios — Bond Selection

In developing an HBP, entities must exclude certain bonds, known as “outliers.” The discount rate may be affected by volatility in the financial markets and pending downgrades in the bond instruments that are used to develop the rate. Entities should exclude outliers from the HBP when developing discount rates for defined benefit plans; discount rates derived from HBPs, which generally include fewer bonds than third-party yield curves, are more significantly affected by inappropriately included outliers.

Outliers may include bonds that have high yields because:

- The issuer is on review for possible downgrade by one of the major rating agencies (only if the downgrade would cause the bond to no longer be considered high-quality).
- Recent events have caused significant price volatility, and the rating agencies have not yet reacted.
- The bond’s lack of liquidity has caused price quotes to vary significantly from broker to broker.

Management should understand and evaluate the bonds in its HBPs to ensure that all outliers have been identified and excluded. Rating agencies have downgraded a number of bonds during the past few years. Downgrades from high-quality to less than high-quality that occur shortly after the balance sheet date may indicate that a bond was an outlier on the balance sheet date, particularly if the bond was subject to a downgrade watch. Even after identifying and excluding outliers, entities should select a discount rate that is appropriate.

Entities must also consider whether a sufficient quantity of the selected bonds ("capacity") is currently available in the market to cover their postretirement benefit obligations. In other words, for a benefit obligation to be effectively settled, the value of the bonds in the hypothetical portfolio must be sufficient to match the timing and amount of expected benefit payments.

Hypothetical Bond Portfolios — Use of Collateralized Bonds

Some actuarial firms include collateralized bonds in the construction of HBPs. The rating of the bond and the related cash flows may achieve a rating of high-quality partly as a result of the collateral feature. The yields on these collateralized bonds may be higher than those on other comparably rated securities with the same duration. In other words, the bond may not be rated high-quality in the absence of the collateral feature. Depending on the facts and circumstances related to the terms of the bond, the collateral, and the issuer, collateralized bonds may be considered outliers that need to be removed from the HBP to achieve the appropriate discount rate. Entities will need to use judgment in evaluating whether collateralized bonds could be included in an HBP or whether a yield adjustment would be required for any such bonds included in an HBP. If a yield adjustment is required,

entities should assess whether such an adjustment is objectively determinable.

Use of a Yield Curve Developed by a Third Party in Selecting a Discount Rate

As previously mentioned, an entity may elect to use a yield curve that was constructed by a third party to support its discount rate. Many yield curves constructed by third parties 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 evaluate and reach conclusions about the reasonableness of the approach the third party used to adjust the bond universe that was used to develop the yield curve.

In evaluating the inclusion of such bonds in a yield-curve analysis, entities should also consider the discussion above regarding inclusion of collateralized bonds in an HBP. Collateralized bonds may qualify for inclusion in a yield-curve bond universe if an entity can demonstrate that the collateralized bonds have been appropriately adjusted for, if necessary, or that the impact of the inclusion of the collateralized bonds does not significantly affect the discount rate derived from the yield curve.

We have been advised by some third parties, in particular those constructing yield curves for non-U.S. markets (e.g., 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.

Use of Indices in Selecting a Discount Rate

An entity may also select a discount rate by referring to index rates as long as the entity can demonstrate that the timing and amount of cash flows related to the bonds included in the index match its estimated defined benefit payments. In the current economic environment, an entity should consider whether the specific index reflects the market in a manner consistent with other similar indices and whether market conditions have affected the level of trading activity for bonds included in the index (as demonstrated by large spreads between the bid and ask prices). As noted above, pricing should reflect the amount at which the postretirement benefit obligation could be settled. The practice of using indices (with appropriate adjustments) is more prevalent for U.K. and other European plans because the high-quality bond universe in Europe is smaller than that in the United States; consequently, HBPs and yield curves are more difficult to construct for these plans.

> **Editor's Note:** For eurozone and U.K. plans, discount rates may be selected from several available indices. Sources of these indices include Bloomberg, Reuters, and International Index Company.
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> The International Index Company, which manages and administers the Markit iBoxx bond indices, states on its Web site that "[m]ost Markit iBoxx bond indices are rebalanced [only at the beginning of each month]. Three days before month end the new constituent list for the following month is determined according to the selection criteria for each index." For example, under this method, bonds that have been downgraded in late November and that are no longer considered high-quality by iBoxx may be included in the construction of the December indices (i.e., the indices may include bonds that are considered "outliers"). In addition, we have noted that a Markit iBoxx index may, on occasion, include a callable bond that could distort the index depending on the maturity assumed.

Entities that refer to indices when selecting their discount rate should determine whether it is appropriate to use

them or whether it is necessary to make adjustments to the indices in addition to those made to reflect differences in timing of cash flows (e.g., removal of outliers and adjustments for callable bonds). In addition, management must be able to conclude that the results of using a shortcut to calculate its discount rate, such as an index, are reasonably expected not to be materially different from the results of using a discount rate calculated from a hypothetical portfolio of high-quality bonds.

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

ASC 715-60-20 defines "health care cost trend rate" as "[a]n 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.

Historically, the ultimate health care cost trend rate has been less than the discount rate. In recent years, however, the discount rate has fallen to record lows, and for some plans it has fallen below the ultimate health care cost trend rate by almost two percentage points. Some concerns have been raised 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 discount rate of 4 percent) 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.

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, 2012, for a calendar-year-end entity). If the target allocation has changed from the prior year, an entity should consider whether adjusting its assumption about the long-term rate of return is warranted.

Some entities engage an external investment adviser to actively manage their portfolios of plan assets. In calculating the expected long-term rate of return, such entities will include an adjustment ("alpha" adjustment) to increase the rate of return to reflect their expectations that actively managed portfolios will generate higher returns than portfolios that are not actively managed. If an entity adjusts for "alpha," management should support its assumption that returns will exceed overall market performance plus management fees. Such support would most likely include a robust analysis of the historical performance of the plan assets.

As with the discount rate, an entity should understand, evaluate, and reach conclusions about the reasonableness of the expected long-term rate of return on plan assets. To determine the expected long-term

rate of return, management must make assumptions about the future performance of each class of plan assets on the basis of both historical results and current market information. Management's documentation supporting these assumptions should contain details about the expected return for each asset category, including (1) an analysis of how the expected return compares with historical returns and (2) the impact of current trends related to economic conditions, inflation, and market sentiment.

Mortality Assumption

Many entities rely on their actuarial firms for advice or recommendations concerning demographic assumptions, such as the mortality assumption. For most plans, actuaries use published mortality tables that are based on broad-based studies of mortality. In response to concerns about the impact of potential future improvements in longevity on benefit obligation measurements, the U.S. Actuarial Standards Board recently revised Actuarial Standard of Practice No. 35, *Selection of Demographic and Other Noneconomic Assumptions for Measuring Pension Obligations*. The revised standard (effective for actuarial valuations whose measurement date is on or after June 30, 2011) provides actuaries with guidance on considering longevity improvement both (1) from the effective date of the mortality table being used to the measurement date of the plan and (2) beyond the measurement date. As stated previously, under U.S. GAAP, each assumption should represent the "best estimate" for that assumption as of the current measurement date. The mortality tables used and adjustments made (e.g., for longevity improvements) should be appropriate for the employee base covered under the plan.

In March 2012, the Society of Actuaries (SOA) Retirement Plans Experience Committee released an exposure draft (ED) of an interim mortality table, *Mortality Improvement Scale BB*. Once approved, this table can be used in the interim period until a new set of retirement plan mortality tables (successors to the RP-2000 tables and Scale AA) is completed. Although the interim tables are in the ED phase and not final, entities may consider the data in the ED and the recently released SOA **report** on such tables when developing their mortality assumptions for the upcoming period.

Net Periodic Benefit Cost

Entities should consider the effect of the gain or loss amortization component of net periodic benefit cost. Many entities record the minimum amortization amount (the excess outside the "corridor").[6] In the current economic environment, many entities have experienced a decline in discount rates and actual asset returns that continue to be less than the long-term rate of return, resulting in an increase in accumulated losses. Accordingly, this component of net periodic benefit cost may be greater than previously estimated.

Changes to Accounting Policies for Gains and Losses and Market-Related Value of Plan Assets

An entity may consider moving to a "mark-to-market" approach in which it immediately recognizes actuarial gains and losses as a component of net periodic benefit cost. Any change in the amortization method selected for gains and losses is considered a change in accounting policy accounted for in accordance with ASC 250. Once an entity changes to an approach in which net gains and losses are more rapidly amortized, the preferability of a subsequent change to a method that results in slower amortization would be difficult to support.

As with all defined benefit retirement plans, plan sponsors' use of computational shortcuts and estimates is appropriate "provided the results are reasonably expected not to be materially different from the results of a detailed application."[7] Entities that use the mark-to-market approach should be vigilant when using shortcuts and approximations, since all changes in the measurement of the benefit obligation and plan assets immediately affect net periodic benefit cost.

The "market-related value of plan assets" is used to calculate the expected return on plan assets component of net periodic benefit cost. ASC 715-30-20 indicates that this value can be either "fair value or a calculated value that recognizes changes in fair value in a systematic and rational manner over not more than five years." The method used to calculate the market-related value must also be applied consistently from year to year for each asset class. If an entity changes from using a calculated value to using fair value in determining the expected return on plan assets, the changes in the expected return will more closely align with changes in the actual return on plan assets. These changes will be recognized in the net periodic benefit cost in the period of the change and could result in greater earnings volatility. Generally, a change from the use of a calculated value to fair value is a change to a preferable method because it accelerates the recognition in earnings of events that have already occurred.

For more information, see Deloitte's **Financial Reporting Alert 11-2, *Pension Accounting Considerations Related to Changes in Amortization Policy for Gains and Losses and in the Market-Related Value of Plan Assets***.

Measurement Date for Plan Assets and Benefit Obligations

Measurement of Plan Assets

In accordance with ASC 715-30-35-63, preparers should ensure that they use actual market values as of the measurement date (e.g., their fiscal year-end) for assets with readily determinable fair values. Entities should value assets without readily determinable fair values (e.g., alternative investments) as of the measurement date by applying ASC 820's principles on estimating the fair value of financial assets in inactive markets. For example, ASC 820-10-15-4 provides guidance on using net asset value per share (provided by an investee) to estimate the fair value of an alternative investment.

Editor's Note: Management is responsible for measuring the benefit plan assets at fair value and for providing related disclosures in the financial statements. To fulfill this responsibility, management should develop a financial accounting and reporting process that includes (1) using appropriate valuation methods, (2) supporting significant assumptions used to determine fair value, (3) documenting the valuation of the plan assets, and (4) ensuring that such fair value measurements are accounted for and reported in accordance with the entity's accounting policies and U.S. GAAP. Management may seek input from outside investment managers on the mechanics of valuing certain plan assets but must have sufficient knowledge to evaluate and independently challenge such valuation.

Measurement of Benefit Obligations

An entity must measure benefit obligations on a plan-by-plan basis by using the discount rate as of the measurement date (e.g., the entity's fiscal year-end). Because of market volatility, it may be difficult for an entity to demonstrate that an adjusted discount rate based on a rollforward of a discount rate from an earlier date would meet the requirements of ASC 715. Under ASC 715-30-35-1 and ASC 715-60-35-1, an entity may employ computational shortcuts if the results are "reasonably expected not to be materially different from the results of a detailed application." Accordingly, preparers should maintain sufficient evidence that this requirement has been met. Such evidence should include a calculation of the benefit obligation, as of the measurement date, by using a discount rate that reflects inputs as of the measurement date. Any material difference that the entity does not record would be deemed an error.

Curtailments

Over the past few years, many entities have sought to reduce operating costs by amending their defined benefit plans to eliminate benefits for future service. This elimination of benefits could be classified as either of the following:

- *Hard freeze* — An amendment to a defined benefit plan that permanently eliminates future benefit accruals.
- *Soft freeze* — An amendment to a defined benefit plan that eliminates benefits for future service but takes into account salary increases in the determination of the benefit obligation for prior service.

The *FASB Accounting Standards Codification* defines a plan curtailment as "[a]n event that significantly reduces the [aggregate] expected years of future service of present employees or eliminates for a significant number of employees the accrual of defined benefits for some or all of their future services." Generally, a hard freeze that represents a permanent suspension of benefits is treated as a curtailment for accounting purposes. The guidance on accounting for soft freezes is unclear, and entities differ on whether to treat a soft freeze as a plan amendment or a curtailment. Those that treat the soft freeze as a curtailment note that the measurement of the projected benefit obligation takes into account salary increases. We believe that an entity may treat a soft freeze as either a plan amendment or a curtailment. An entity should choose one of these two alternatives as an accounting policy and consistently apply its accounting election.

Other events, such as corporate restructurings or plant shutdowns, could also trigger curtailment accounting. An entity should assess each of these events on the basis of its particular facts and circumstances. Curtailments generally trigger an interim remeasurement date in a manner similar to other significant events that occur during a fiscal year.

Settlements

In response to the current economic challenges, some entities may institute restructuring programs that include a reduction in workforce. Such entities may have pension plans that permit employees to elect to receive their pension benefit in a lump sum, which could result in multiple lump-sum payments over the course of the year. Accordingly, if the total of such lump-sum payments made during the year is significant, settlement accounting could be required under ASC 715.

Under ASC 715-30-35-82, if a settlement has occurred, any gain or loss from the settlement should be recognized in earnings "if the cost of all settlements during a year is greater than the sum of the service cost and interest cost components of net periodic pension cost for the pension plan for the year." Alternatively, if an entity adopts an accounting policy to apply settlement accounting to a settlement or settlements that are below the service-cost-plus-interest-cost threshold, the policy must be applied to all settlements.

Questions have arisen about how settlements that occur in an interim period should be accounted for when it is probable that the cumulative settlements for the year are expected to exceed the service-cost-plus-interest-cost threshold. On at least a quarterly basis, an entity should assess whether it is probable that the criteria for settlement accounting will be met (e.g., the total settlements will exceed the threshold). If the entity concludes that it is probable that the threshold will be exceeded during the year, the entity should apply settlement accounting on at least a quarterly basis rather than wait for the threshold to be exceeded on a year-to-date basis. Accordingly, as the settlements occur, and at least quarterly, the entity should complete a full remeasurement of its pension obligations and plan assets in accordance with ASC 715-30-35. Recognizing settlement accounting at quarter-end would be an acceptable practical accommodation unless, under the circumstances, the assumptions and

resulting calculations indicate that using the exact date within the quarter would result in a materially different outcome.

Plan Sponsor Disclosures

Fair Value Measurement Disclosures

Because a sponsor's fair value measurement disclosures related to defined benefit plans are outside the scope of ASC 820, the FASB's fair value measurement disclosures project addressed a sponsor's fair value disclosures that are specific to retirement plans. In accordance with ASC 715-20-50-5(c)(5)(iv), the sponsor must disclose information about the fair value measurements of plan assets separately for each annual period for each class of plan assets.

Implementation issues have arisen about these disclosures, primarily about the Level 3 reconciliation disclosure. The FASB's rationale for requiring this disclosure is identical to its rationale for requiring the Level 3 reconciliation under ASC 820, except that gains and losses reported in earnings during the period must be presented separately from those recognized in other comprehensive income. We understand that the FASB will accept presentation alternatives as long as the rollforward disclosure meets the objective under ASC 715-20-50-1(d)(4) of showing the "effect of fair value measurements using significant unobservable inputs (Level 3) on changes in plan assets **for the period**" (emphasis added).

Entities With Foreign Plans

The SEC staff sometimes requests registrants to support their basis for combining pension and other postretirement benefit plan disclosures for U.S. and non-U.S. plans. ASC 715-20-50-4 states that a "U.S. reporting entity may combine disclosures about pension plans or other postretirement benefit plans outside the United States with those for U.S. plans unless the benefit obligations of the plans outside the United States are significant relative to the total benefit obligation and those plans use significantly different assumptions."

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1 FASB Accounting Standards Update No. 2011-09, *Disclosures About an Employer's Participation in a Multiemployer Plan*.

2 For titles of *FASB Accounting Standards Codification* references, see Deloitte's "Titles of Topics and Subtopics in the ***FASB Accounting Standards Codification***."

3 An EGWP could be structured as either (1) a self-insured program in which employers and union plans contract directly with the Centers for Medicare and Medicaid Services for benefits or (2) an insured program in which plan sponsors contract with a third party to provide prescription drug coverage to retirees.

4 See ASC 715-20-S99-1.

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 ASC 715-30-35-24 provides guidance on net periodic pension benefit cost and defines the corridor as "10 percent of the greater of the projected benefit obligation or the market-related value of plan assets." Likewise, ASC 715-60-35-29 provides guidance on net periodic postretirement benefit cost and defines the corridor as "10 percent of the greater of the accumulated postretirement benefit obligation or the market-related value of plan assets."

7 Excerpted from ASC 715-30-35-1 and ASC 715-60-35-1.

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