# Employee benefits

## Handbook

US GAAP

September 2023

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# Contents




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# A significant and changing expense

Wages and salaries are typically the largest component of employee benefits, but they are not the only component. There are myriad other types of benefits – from compensated absences such as vacation days to retirement plans that cover large groups of employees – and the accounting can be complex.

The approach to compensation packages can change rapidly to match movements in the marketplace. The prevailing trend when we first published this Handbook in 2021 emphasized offering incentives to retain and attract employees. In only a few years, economic and social factors, including low attrition, have moved the focus to termination benefit packages as companies downsize and restructure.

And then there are the fluctuations in financial markets that can make it more difficult to project the cost of benefits promised to employees in the future. This too can lead companies to consider changing benefit plans to lessen earnings volatility. More and more companies are moving to a defined contribution retirement plan model, such as a 401(k), to reduce the exposure and uncertainty around funding defined benefit plans.

Amidst this changing landscape of employee benefits, we hope you use this Handbook as a reference. We've organized it in a Q&A format that makes it easy to identify the answers to both the common and the more uncommon questions.

**Michael Kraehnke**

Department of Professional Practice, KPMG LLP

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# About this publication

The purpose of this Handbook is to assist you in understanding the accounting for employee benefits under the following:

— Topic 420, exit or disposal cost obligations
— Topic 710, general compensation
— Topic 712, nonretirement postemployment benefits
— Topic 715, retirement benefits
— Subtopic 718-40, employee stock ownership plans

## Organization of the text

Each chapter of this Handbook includes excerpts from FASB's Accounting Standards Codification® and overviews of the relevant requirements. Our in-depth guidance is explained through Q&As that reflect the questions we are encountering in practice. We include observations and examples to explain key concepts.

Our commentary is referenced to the Codification, SEC Regulations and to other literature, where applicable. The following are examples.

— 715-30-50-1 is paragraph 50-1 of ASC Subtopic 715-30

— FAS 106.BC290 is paragraph 290 of the basis for conclusions to FASB Statement No. 106 (superseded)

— CON 8.E37 is paragraph E37 of FASB Concepts Statement No. 8, Conceptual Framework for Financial Reporting, chapter 4, Elements of Financial Statements

— S-X Rule 4-08(k) is Rule 4-08(k) of SEC Regulation S-X

— SEC Rel 33-8056 is SEC Release 33-8056

— FR501.06a is paragraph 06a of section 501 of the codified SEC Financial Reporting Releases

— CA&D.II(J)(1) is paragraph J1 in section II of the SEC's Current Accounting and Disclosure Issues in the Division of Corporation Finance

— 2011 AICPA Conf is the 2011 AICPA National Conference on Current SEC and PCAOB Developments. Where possible, these references are hyperlinked to the source material on the SEC's website

— TQA 2250.06 is paragraph 6 of AICPA Technical Question & Answer Section 2250

— AAG-STK is the AICPA Accounting and Valuation Guide 'Valuation of Privately-Held Company Equity Securities Issued as Compensation'

— ASOP 27 is Actuarial Standards of Practice No. 27

— IRC §411(d)(3) is section 411(d)(3) of the Internal Revenue Code of 1986

— Treas Reg §1.430(d) is section 1.430(d) of the US Treasury regulations

— US MTG is the US Master Tax Guide

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## September 2023 edition

This version of our Handbook includes guidance on accounting for buy-in and buy-out contracts. Also, guidance about the expected return on plan assets was moved to our discussion about the components of net periodic benefit cost in chapter 7.

The following symbols are used throughout this Handbook to indicate the types of revisions made in this edition for sections, Questions, Examples and other items. A summary is included in the Index of changes.

| | |
|---|---|
| ** | new item |
| # | significant updates or revisions to the item |
| ● | item moved |

Questions and Examples included in previous editions (regardless of when added or updated) that have not been significantly updated or relocated in this edition are not marked.

## Abbreviations

We use the following abbreviations in this Handbook.

| | |
|---|---|
| AOCI | Accumulated other comprehensive income |
| APBO | Accumulated postretirement benefit obligation |
| CD&A | Compensation Discussion and Analysis |
| CSV | Cash surrender value |
| DB | Defined benefit |
| DC | Defined contribution |
| ERISA | Employee Retirement Income Security Act of 1974 |
| EROA | Expected return on [plan] assets |
| ESOP | Employee Stock Ownership Plan |
| IRC | Internal Revenue Code |
| IRS | Internal Revenue Service |
| MD&A | Management's Discussion and Analysis |
| MMA | Medicare Prescription Drug, Improvement and Modernization Act |
| MRV | Market-related value |
| OCI | Other comprehensive income |
| OPEB | Other postretirement benefits |
| PBO | Projected benefit obligation |
| PTO | Personal time off |
| R&D | Research and development |
| SERP | Supplemental Executive Retirement Plan |
| VEBA | Voluntary Employees' Beneficiary Association |
| VSP | Voluntary severance plan |

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# 1. Executive summary

Several Topics in the FASB Codification address the accounting for various forms of employee benefits – from compensated absences (e.g. vacation pay), to deferred compensation arrangements with individual employees, to pension and other postretirement benefits available to large groups of employees.

More than half of this Handbook is devoted to pension and other postretirement plans. Several chapters discuss defined benefit (DB) plans (both pension and postretirement) because the accounting is complex and involves actuarial assumptions. Much less complicated is the accounting for other plans, such as defined contribution (DC) plans.

## Scope

**Because employee benefits come in so many forms, there are several Codification Topics that address these benefits.**

Compensation-related costs may be paid directly or through benefit plans. The first step in accounting for these costs is navigating which Codification Topic applies.

Read more: Chapter 2

## Compensation: General

**Despite its name, Topic 710 (compensation, general) is a narrow Topic.**

Topic 710 addresses how to account for four types of employee benefits:

— compensated absences – e.g. vacation pay, holiday pay, sick pay, sabbatical leave;
— lump-sum payments under union contracts;
— deferred compensation arrangements; and
— deferred compensation arrangements using rabbi trusts.

Read more: Chapter 3

## Termination benefits and other nonretirement postemployment benefits

**Nonretirement benefits provided to employees is the subject of Topic 712 (nonretirement postemployment benefits).**

Common postemployment benefits are termination benefits – either voluntary (employees volunteer to resign in return for benefits) or involuntary. These benefits include not only cash payments, but also benefits like disability and healthcare coverage.

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Topic 712 has different accounting requirements for postemployment benefits, depending on factors such as whether the benefits were:

- voluntary or involuntary; and
- paid pursuant to a contract with employees, as part of an ongoing plan or on an ad hoc basis.

However, involuntary termination benefits paid under a one-time termination benefit plan may fall in the scope of Topic 420 (exit and disposal costs), which has its own accounting requirements.

Determining which requirements apply to postemployment benefits can be very complex. This Handbook uses decision trees that guide readers through the evaluation process.

Read more: Chapter 4

## Retirement plans: General and DC plans

**A DC plan provides an individual account for each participant and benefits are based on the account balance.**

Accounting for DC plans is straightforward. However, what can be complex is determining whether a plan is a DC or a DB plan. This complexity arises when a plan has features of both of these types of benefit plans.

Cash balance plans are another type of benefit plan. They are often referred to as hybrid plans because they have features of both DC and DB plans. Like DC plans, they are account-based, although they are typically accounted for as DB plans.

Read more: Chapter 5

## DB pension and OPEB plans: Plan assets and obligations

**DB plans fall into one of two categories: pension plans in the scope of Subtopic 715-30 and other postretirement benefit (OPEB) plans in the scope of Subtopic 715-60.**

The plan assets and benefit obligations of DB plans together indicate whether a DB plan is over- or under-funded by reflecting the extent to which plan assets are available to fund future benefit payments the entity is obligated to pay.

In addition, calculation of the benefit obligation can be complex and include actuarial involvement.

Read more: Chapter 6

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## DB pension and OPEB plans: Costs

**Even though benefits under a DB plan may not be paid out until future periods, the costs related to providing those future benefits are recognized as plan participants earn the benefits by providing services to the entity.**

Some costs of DB plans may be recognized immediately in net income, while others are deferred in AOCI and amortized into net income.

The costs that a DB plan typically generate (collectively, the net periodic benefit cost) are:

- service costs;
- interest costs;
- expected return on plan assets;
- prior service cost; and
- gains and losses.

Read more: Chapter 7

## DB pension and OPEB plans: Assumptions and attribution

**Because benefits in DB plans are to be paid in future years, accounting for DB plans requires numerous actuarial assumptions.**

DB plans require paying benefits in the future based on a benefit formula. The actuarial present value of these future benefits needs to be estimated to determine an entity's benefit obligation.

Determining the actuarial present value of future benefits requires making many assumptions about the appropriate discount rate, the probability of future payments and the amount of those payments.

The 'attribution period' begins when a plan participant provides services that entitle them to potential benefits and ends when the participant is fully eligible to receive the benefits. An entity must determine both the attribution period and the appropriate method for attributing the benefit obligation to each year in the attribution period.

Read more: Chapter 8

## DB pension and OPEB plans: Settlements, curtailments and certain termination benefits

**DB plans are not often static. An entity may amend its plan, curtail its obligation, or even settle its obligation by transferring its**

A settlement occurs when an entity transfers all or part of its obligation under a DB plan to a third party. An entity typically settles its obligation to eliminate significant risks related to the benefit obligation and the plan assets. Topic 715 contains requirements for when and how settlements are recognized.

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**obligation to a third party.**

A curtailment occurs when an entity takes an action to either:

- significantly reduce plan participants' expected years of future service; or
- eliminate some or all of plan participants' benefits for future service.

Topic 715 contains requirements for when and how curtailments are recognized.

Read more: Chapter 9

## Retirement plans: Special topics, including multiemployer plans

**Topic 715 addresses several special issues, such as combining or dividing DB plans.**

Specific recognition and measurement requirements apply when an entity purchases annuity or insurance contracts to pay for benefits under a DB plan.

Corporate restructurings and business disposals can lead to an entity combining two or more DB plans into a single plan, or dividing a single DB plan into two or more separate plans. There are specific recognition and measurement requirements for combining or dividing plans.

An entity might participate in a multiple-employer DB plan or multiemployer DB plan (typically under a collective-bargaining arrangement). Specific recognition and measurement requirements apply to such plans.

Read more: Chapter 10

## Retirement plans: Disclosure

**The FASB requires extensive disclosures of compensation-related costs associated with retirement plans.**

There are prescriptive disclosure requirements for single-employer pension and OPEB plans, DC plans, and multiemployer plans.

Read more: Chapter 11

## Employee Stock Ownership Plans (ESOPs)

**Subtopic 718-40 contains the measurement, recognition,**

Subtopic 718-40's requirements apply to the entity (i.e. the employer sponsoring the ESOP) and not to the ESOP itself.

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**presentation and disclosure requirements for ESOPs.**

Accounting for nonleveraged ESOPs is typically straightforward. In contrast, accounting for leveraged ESOPs can be more complex because they are funded by loans from the entity or outside lender.

There are also several accounting issues that apply to both types of ESOPs, such as accounting for participant redemptions and forfeitures.

Read more: Chapter 12

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# 2. Scope

## Detailed contents



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## 2.1 How the standard works

Employee benefits comprise any type of compensation provided to employees during their employment – whether it be in the form of cash compensation (e.g. wages) or benefits (e.g. paid vacation days). They also comprise benefits provided to employees after their employment ends, whether they move on to other opportunities, are terminated or retire.

Most employee benefits are accounted for under the 700 Codification Topics related to compensation, specifically Topics 710, 712, 715 and 718. However, Topic 420 also comes into play when employee benefits relate to an exit or disposal cost activity, such as a plant closing.

| | Relevant Topics | Examples of benefits | Reference |
|---|---|---|---|
| **General compensation** | **Topic 710** | – Compensated absences<br>– Lump-sum payments under union contracts<br>– Deferred compensation arrangements (including those using Rabbi trusts) | Chapter 3 |
| **Nonretirement post-employment benefits** | **Topics 420, 712, 715** | – One-time direct termination payments (Topic 420)<br>– Direct payments through an established termination plan (Topic 712)<br>– Termination payments through a retirement plan (Topic 715) | Chapter 4 |
| **Retirement benefits** | **Topic 715** | – Defined contribution plans<br>– Defined benefit pension plans<br>– Defined benefit OPEB plans<br>– Multiemployer plans | Chapters 5 to 11 |
| **Retirement benefits** | **Topic 718** | All share-based payments to employees (e.g. stock options, stock appreciation rights), except payments to ESOPs. Not covered in this Handbook. | KPMG Handbook, Share-based payment (except for 718-40) |
| **ESOPs** | **Subtopic 718-40** | Transactions with employee stock ownership plans (ESOPs) | Chapter 12 |

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# 2.2 Scope of compensation Topics

## 2.2.10 Overall

### Excerpt from ASC 710-10

**05 Overview and Background**

**05-1** The Codification contains several Topics for compensation-related costs. The Topics include:

a. Compensation—General
b. Compensation—Nonretirement Postemployment Benefits
c. Compensation—Retirement Benefits
d. Compensation—Stock Compensation.

This Handbook discusses how entities account for employee benefits, also known as compensation-related costs. To the extent those benefits are payable through retirement plans (e.g. a pension plan), this Handbook applies to how the entity (plan sponsor) accounts for its liability to fund those plans.

### Question 2.2.10

**What Codification Topics govern employee benefit plan accounting?**

**Interpretive response:** This Handbook provides guidance on an entity's accounting for employee benefits. Employee benefit *plans* apply the guidance in the following Topics, which are outside the scope of this Handbook.

— DB pension plans: Topic 960
— DC pension plans – Topic 962
— Health and welfare benefit plans – Topic 965.

### Question 2.2.20

**Do the Topics on compensation-related costs apply to not-for-profit entities?**

**Interpretive response:** Yes. The Topics covered in this Handbook apply to all entities, including not-for-profit entities. However, not-for-profit entities refer to Subtopic 958-715 when applying Topic 715 to retirement benefits. [420-10-15-2, 710-10-15-2, 712-10-15-2, 715-10-15-2]

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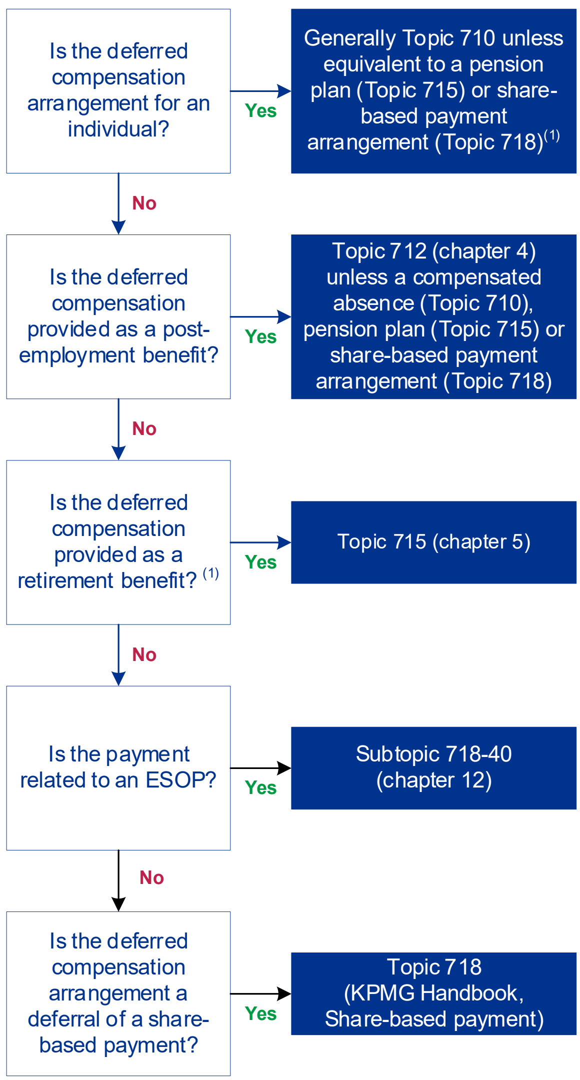
## 2.2.20 Deferred compensation – applicable Topics

A deferred compensation arrangement can be in the scope of one of four Codification Topics. Such an arrangement exists when an employee defers receipt of current remuneration to a future date. The payment may be received during or after employment, and the specific features of the arrangement will determine which Topic applies to the arrangement.

### Question 2.2.30
**How does an entity determine what Topic applies to a deferred compensation arrangement?**

**Interpretive response:** The following decision tree describes the types of deferred compensation arrangements and which Topic generally applies.

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Note:

1. See Question 2.2.40 on determining whether the deferred compensation arrangement is a retirement benefit.

Using this decision tree involves significant judgment and the specific features of the arrangement need to be analyzed. In addition, the facts and circumstances around other or future deferred compensation arrangements may require the accounting conclusions to be reassessed (see Question 2.2.50).

## Question 2.2.40

### When is a deferred compensation arrangement in the scope of Topic 710 vs Topic 715?

**Interpretive response:** We believe that a number of qualitative factors should be considered in determining whether a deferred compensation arrangement is in the scope of Topic 710 or Topic 715. The determination of which Topic to apply may require judgment based on the weight of each of the considerations.

However, in general, if the deferred compensation arrangement is for an individual (e.g. CEO), the arrangement is most likely in the scope of Topic 710. In determining whether Topic 715 applies instead, the following are some factors to consider (not exhaustive).

| Factor | Topic 715 indicator |
|---|---|
| Does the deferred compensation arrangement exist in writing and has it been formally approved by the entity's board of directors? | A written, formally approved arrangement is an indicator of a more widely applied deferred compensation arrangement that is not just applicable to an individual. |
| How many participants are included in the deferred compensation arrangement? | Several participants to an arrangement that provides an identical formula by employee class. |
| Is the benefit provided to each participant under the deferred compensation arrangement the same? | Individual employment arrangements that provide participants with the same retirement benefits. |
| Is eligibility to participate in the deferred compensation arrangement discretionary or nondiscretionary? | Nondiscretionary eligibility to participate. |
| Will other employees from the same personnel class be provided with the same or similar arrangements in the future? | Employees being provided the same or similar arrangements.<br>In contrast, uncertainty as to whether future participants from the same personnel class will be provided similar benefits is an indicator that the arrangement is in the scope of Topic 710. |

See an illustration of how these factors are applied in Example 2.2.10.

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## Example 2.2.10

### Determining whether Topic 710 or Topic 715 applies to a deferred compensation arrangement

ABC Corp. establishes a new nondiscretionary deferred compensation plan for 12 executive employees who are all in the same employee class. A formal plan document exists, which was approved by ABC's board of directors.

Benefits under the plan are calculated based on a formula of prior-year compensation in excess of the Section 415 compensation limit in the IRC, multiplied by ABC's matching contribution percentage. The plan is unfunded, and plan participants have a notional account that is credited with a pay credit and an interest credit annually.

To determine whether Topic 710 or Topic 715 applies, ABC evaluates the individual facts and circumstances associated with the arrangement and considers the following factors.

| Factor | Discussion | Indication based on specific features |
|---|---|---|
| Does the deferred compensation arrangement exist in writing and has it been formally approved by the entity's board of directors? | A formal plan document exists that has been formally approved by ABC's board of directors. | Topic 715 |
| How many participants are included in the deferred compensation arrangement? | There are 12 participants who are all executives in the same employee class. | Topic 715 |
| Is the benefit provided to each participant under the deferred compensation arrangement the same? | The benefits are calculated on a consistent basis for all participants. | Topic 715 |
| Is eligibility to participate in the deferred compensation arrangement discretionary or nondiscretionary? | Eligibility to participate is nondiscretionary. | Topic 715 |
| Will other employees from the same personnel class be provided with the same or similar arrangements in the future? | Because it is not explicitly stated, there is some uncertainty as to whether future participants from the same personnel class would be provided similar benefits. | Topic 710 |

After considering the above factors, ABC determines that the arrangement is in the scope of Topic 715.

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## Question 2.2.50

### Is the classification of a deferred compensation arrangement ever reassessed?

**Interpretive response:** Yes. The evaluation of whether a deferred compensation arrangement is in the scope of Topic 710 or Topic 715 may require reassessment.

For example, an entity enters into an individual deferred compensation arrangement with its CEO, which was approved by the board of directors, and at the time of the arrangement it was not probable that future executives would be provided with similar arrangements. The entity accounted for the deferred compensation arrangement under Topic 710.

After a period of time, identical deferred compensation arrangements, also approved by the board of directors, were granted to the entity's executive vice presidents and senior vice presidents, and it was probable that future executives would be provided with the same arrangement. As a result of additional executives being granted identical deferred compensation arrangements, the entity reassessed the accounting model used to account for its deferred compensation arrangements and began to apply Topic 715.

Topic 715 is further discussed in chapter 5.

## Question 2.2.60

### Which Topic applies to deferred compensation arrangements outside the US?

**Interpretive response:** Generally, there are no special provisions in US GAAP that apply to employee benefit plans outside the US. If the plans outside the US are in substance similar to those in the US, they are accounted for based on guidance that applies to the counterpart arrangement in the US (i.e. Topic 710 or Topic 715).

For example, there is a common type of deferred compensation arrangement in certain countries of the EU (sometimes referred to as flexible-lifetime-workload account plans) in which an employee can choose to contribute a portion of their earned compensation to a trust that invests in mutual funds or other marketable equity and debt securities based on their investment decisions. These plans are not subject to income tax withholding.

Local laws require that assets in the trust must not be available to the entity or to its creditors in case of bankruptcy. The employee receives information on the performance of the assets in the trust and retains all risks and rewards associated with them. Hardship withdrawals based on defined situations may be permitted. The employee may also use the account balance to retire early, seek part-time work in a period before retirement or take a sabbatical.

The entity accounts for the plan as a DC plan when the plan provides benefits in return for service rendered, provides an individual account for each participating

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employee, and specifies how contributions are determined instead of the amount of benefits received. For flexible-lifetime-workload account plans, the employee chooses to make contributions and receives periodic individual account statements detailing investments and performance (payout depends on contributed amounts and investment performance), and the entity is not obligated to provide defined benefits.

In substance, this deferred compensation type arrangement is like a 401(k) plan in the US, which is accounted for as a DC plan under Topic 715, not as a deferred compensation arrangement. If the assets in the trust are not bankruptcy proof, the guidance in Topic 710 for deferred compensation arrangements using rabbi trusts applies (see section 3.5).

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# 3. Compensation: General

## Detailed contents

**Item significantly updated in this edition #**



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## 3.4 Deferred compensation arrangements

### Questions



### Example



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## 3.5 Deferred compensation arrangements using rabbi trusts

### Questions



## 3.6 Presentation and disclosure

### Questions



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## 3.1 How the standard works

Topic 710 is a narrow topic that outlines specific guidance on the measurement, recognition, presentation and disclosure requirements for the following items.

| | |
|---|---|
| **Compensated absences – e.g. vacation pay, holiday pay, sick pay, sabbatical leave** | Section 3.2 |
| **Lump-sum payments under union contracts** | Section 3.3 |
| **Deferred compensation arrangements** | Section 3.4 |
| **Deferred compensation arrangements using rabbi trusts** | Section 3.5 |

All other compensation-related matters are addressed through other Codification Topics, or by applying FASB Concepts Statement 5. Many of the other compensation-related matters are discussed in subsequent chapters in this Handbook.

The accounting for each of the arrangements included in Topic 710 is predicated on whether the employee earns the compensation through current or future service. Understanding the specific facts and circumstances of each compensation arrangement is key to driving the appropriate accounting conclusions.

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# 3.2 Compensated absences

## 3.2.10 Overview

### Excerpt from ASC 710-10

**20 Glossary**

**Compensated Absences –** Employee absences, such as vacation, illness, and holidays, for which it is expected that employees will be paid.

**15 Scope and Scope Exceptions**

**> Transactions**

**15-3** The guidance in the Compensation—General Topic applies to the following compensation or employee benefit arrangements:

a. Compensation for future absences where employees have rights to receive compensation for future absences (referred to as **compensated absences**)

…

**> Other Considerations**

**15-6** The guidance in the Compensation—General Topic does not address the allocation of costs of compensated absences to interim periods.

**25 Recognition**

**> Compensated Absences**

**25-1** An employer shall accrue a liability for employees' compensation for future absences if all of the following conditions are met:

a. The employer's obligation relating to employees' rights to receive compensation for future absences is attributable to employees' services already rendered.
b. The obligation relates to rights that vest or accumulate. Vested rights are those for which the employer has an obligation to make payment even if an employee terminates; thus, they are not contingent on an employee's future service. Accumulate means that earned but unused rights to **compensated absences** may be carried forward to one or more periods subsequent to that in which they are earned, even though there may be a limit to the amount that can be carried forward.
c. Payment of the compensation is probable.
d. The amount can be reasonably estimated.

**25-2** A liability for amounts to be paid as a result of employees' rights to compensated absences shall be accrued, considering anticipated forfeitures, in the year in which earned. For example, if new employees receive vested rights to two-weeks' paid vacation at the beginning of their second year of employment with no pro rata payment in the event of termination during the first year, the two-weeks' vacation shall be considered to be earned by work performed in the first year and an accrual for vacation pay shall be required for new employees during their first year of service, allowing for estimated

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forfeitures due to turnover. Furthermore, the definition of a liability does not limit an employer's liability for compensated absences solely to rights to compensation for those absences that eventually vest. The definition also encompasses a constructive obligation for reasonably estimable compensation for past services that, based on the employer's past practices, probably shall be paid and can be reasonably estimated.

**25-3** Individual facts and circumstances must be considered in determining when nonvesting rights to compensated absences are earned by services rendered. The requirement to accrue a liability for nonvesting rights to compensated absences depends on whether the unused rights expire at the end of the year in which earned or accumulate and are carried forward to succeeding years, thereby increasing the benefits that would otherwise be available in those later years. If the rights expire, a liability for future absences shall not be accrued at year-end because the benefits to be paid in subsequent years would not be attributable to employee services rendered in prior years. (Jury duty and military leave benefits generally do not accumulate if unused and, unless they accumulate, a liability for those benefits shall not be accrued at year-end.) On the other hand, if unused rights do accumulate and increase the benefits otherwise available in subsequent years, a liability shall be accrued at year-end to the extent that it is probable that employees will be paid in subsequent years for the increased benefits attributable to the accumulated rights and the amount can be reasonably estimated.

A compensated absence is a period of time when an employee is not actively providing services but will be paid. Common examples include vacations, holidays, personal time off (PTO), sick leave and sabbaticals. [710-10 Glossary]

## Question 3.2.10

### How are compensated absences accounted for?

**Interpretive response:** A liability for future compensated absences is recognized when the employee has earned the right to be compensated for those absences, and the liability is probable and estimable. The individual facts and circumstances for each compensated absence benefit need to be carefully analyzed to ensure that the liability is recognized at the appropriate time. [710-10-25-1 – 25-2]

The following decision tree indicates whether and when compensated absences are recognized.

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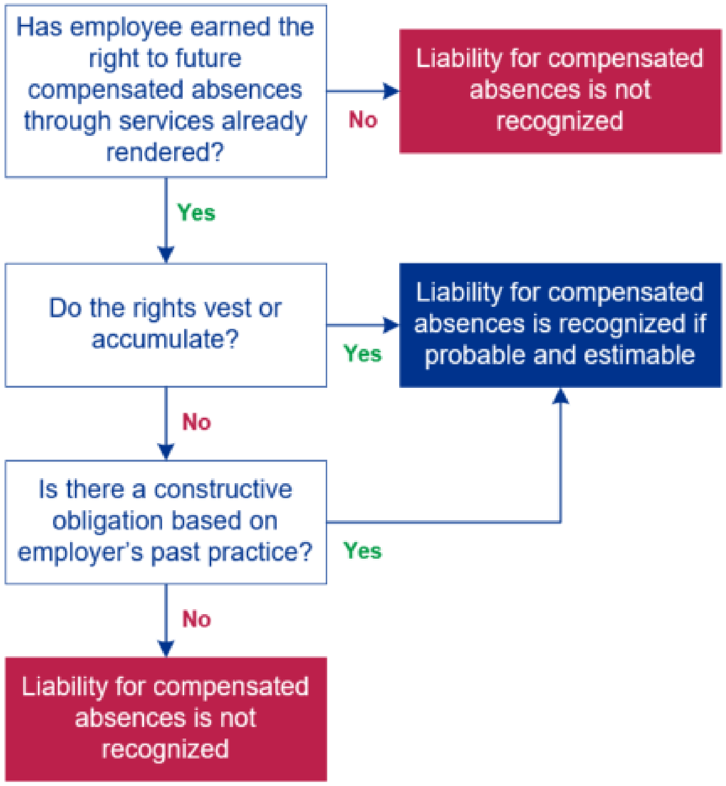


## Question 3.2.20

### What is a right that vests vs a right that accumulates?

**Interpretive response:** Rights that vest are those that, when fully vested, obligate the entity to make payment even if an employee terminates. They are not contingent on an employee's future service. [710-10-25-1(b)]

To illustrate this concept, Topic 710 includes an example of a new employee who receives vested rights to two weeks of paid vacation at the beginning of their second year of employment with no pro rata payment in the event of termination in Year 1. In this example, the entity believes the employee earns the two weeks' vacation for work performed in the first year and it is therefore accrued in that year. See also Question 3.2.30. [710-10-25-2]

Rights that accumulate are those that permit an employee to carry forward unused benefits to future periods, even if the amount to be carried forward is limited. Once accumulated, probability needs to be assessed as to whether the benefits would be paid to the employee, and therefore obligate the entity to make payment, if the employee terminates employment. A common example is unused vacation days that can be carried forward to the next fiscal year. The carry forward amount is sometimes capped. [710-10-25-1(b)]

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## Question 3.2.30

**Must the rights have already vested or accumulated to accrue a liability?**

**Interpretive response:** No. Although the obligation relates to rights that vest or accumulate, we believe there is no requirement for the rights to have already vested or accumulated to accrue the liability. The estimated cost of compensated absences is accrued when they are earned, which may be in advance of the date of vesting or accumulation.

## Question 3.2.40

**When is a liability recognized for rights that do not vest?**

**Interpretive response:** The definition of a liability also relates to compensated absences that do not vest.

The key factor to consider is whether the nonvesting rights to compensated absences have been earned by services already rendered. If the rights are both nonvesting and nonaccumulating because they expire at year-end, any benefits paid in the future are generally not earned by services already rendered, and a liability is not recognized. This applies to benefits such as jury duty and military rights. However, an entity must also consider whether a constructive obligation based on past practice exists, in which case a liability may be recognized (see Question 3.2.60). [710-10-25-2]

If the rights accumulate and carry forward to future periods, any benefits paid in the future are earned by services already rendered. Therefore, a liability is recognized to the extent it is probable and reasonably estimable.

## Question 3.2.50

**What is a right that expires?**

**Interpretive response:** A common example of a right that expires is a 'use it or lose it' vacation policy where an entity does not permit earned vacation days to be carried forward to future periods and does not pay out on termination. This type of arrangement is neither a vesting nor accumulating compensated absence benefit.

If the entity's fiscal year and the employee's vacation benefit year (e.g. based on hire date) coincide, a liability is not recognized for such compensated absences at period-end unless a constructive obligation based on past practice exists (see Question 3.2.60). [710-10-25-2]

However, if the entity's fiscal year (e.g. December 31) differs from the employee's vacation benefit year (e.g. March 31), the entity must determine if a

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liability exists at its fiscal year-end for unused vacation that has been earned at that date that is probable to be taken before expiring.

## Question 3.2.60

### What is a constructive obligation?

**Interpretive response:** For purposes of applying Topic 710, the definition of a liability also encompasses a constructive obligation for reasonably estimable compensation for past services that, based on the entity's past practices, probably will be paid and can be reasonably estimated. [710-10-25-2]

We believe an entity should carefully consider whether a constructive obligation exists if a vesting or accumulating right does not exist but there has been a historical practice of compensating employees for future absences (see Example 3.2.10 Scenario 2). If such a constructive obligation is probable and estimable, a liability is recognized.

## Example 3.2.10

### Accounting for compensated absences

Topic 710 outlines the conditions that need to be met to recognize a liability for compensated absences. An entity must carefully consider the terms of its compensated absence benefits to ensure the appropriate accounting treatment is applied. The accounting is explained below under four common vacation benefit scenarios that apply the decision tree in Question 3.2.10.

#### Scenario 1: Rights that vest but do not accumulate

ABC Corp. has a calendar year-end. Under ABC's vacation policy, employees fully vest in Year 2's vacation days on January 1, Year 2, provided they were employed in the prior year (Year 1). If an employee leaves ABC during Year 2, any earned but unused vacation is paid out. Any earned but unused vacation at the end of Year 2 cannot be carried forward under ABC's 'use it or lose it' policy.

As of December 31, Year 1, ABC's obligation relates to rights that will vest but do not accumulate – i.e. the rights will be fully vested one day later on January 1, Year 2. Further, the obligation relates to employees' rights to receive compensation for future absences that are attributable to employees' services already rendered in Year 1. Therefore, ABC recognizes a liability for Year 2's vacation days as of December 31 of Year 1, assuming the obligation is probable and estimable.

#### Scenario 2: Rights that do not vest or accumulate

Assume the fact pattern in Scenario 1, but if the employee leaves ABC during Year 2, any earned but unused vacation is not paid out at any time in Year 2.

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As of December 31, Year 1, ABC does not have an obligation relating to rights that vest or accumulate and therefore does not recognize a liability unless it has a constructive obligation. If ABC has a history of paying for unused vacation upon termination despite its stated policy, it considers whether it has a constructive obligation for reasonably estimable compensation for past services that, based on its past practices, is probable and estimable.

**Scenario 3: Rights that accumulate but do not vest**

Assume the fact pattern in Scenario 2, but ABC's policy does not include a vesting provision; instead, it allows employees to carry forward any earned but unused vacation days to future periods.

As of December 31, Year 1, ABC does not have an obligation relating to rights that vest but does have an obligation relating to rights that accumulate. Therefore, it recognizes a liability as of December 31, Year 1, provided that the obligation is probable and estimable.

**Scenario 4: Rights that vest and accumulate**

Assume the fact pattern in Scenario 3, but ABC also has a vesting provision where it pays out any earned but unused vacation to its employees on departure from the company.

As of December 31, Year 1, ABC has an obligation relating to rights that both vest and accumulate. Therefore, it recognizes a liability as of December 31, Year 1, provided that the obligation is probable and estimable.

## Question 3.2.70

**What considerations apply when measuring a compensated absence liability?**

**Interpretive response:** Topic 710 does not address:

- whether the liability is based on current or future rates of pay;
- whether the liability is discounted;
- when the entity accrues the effect of scheduled increases; or
- whether the entity accrues for associated fringe benefits (see Question 3.2.80).

Although Topic 710 does not provide explicit guidance about the pay rates (current or future) used to measure the liability, in general, we believe an entity should use current information about the amount at which it will settle the liability, including scheduled salary increases in effect at that date. Usually an entity will settle a liability for accrued vacation pay at the pay rate for which the employee is eligible, on the date the vacation is taken, or the date of termination of employment. Because the liability would usually be settled within a short period, any impact of discounting would likely be immaterial.

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## Question 3.2.80
### Are fringe benefits included in measuring a liability for compensated absences?

**Interpretive response:** No. We do not believe an entity is required to include fringe benefits (e.g. health insurance) in the measurement of its liability for compensated absences.

Our understanding from discussions with the FASB staff is that it does not believe Topic 710 would require fringe benefits to be included in the measurement of a liability for compensated absences because fringe benefits do not meet the definition of a current obligation; instead, they are period costs of active employees. The guidance in Topic 718 supports this view by analogy, stating that a liability for employer payroll taxes on share-based payments is recognized on the date of the event triggering the measurement and payment of the tax to the taxing authority. [718-10-25-22]

However, we also believe that an entity is not precluded by Topic 710 from including fringe benefits in its estimate. We believe an entity should elect an accounting policy and apply it consistently.

## Question 3.2.90
### Are compensated absences accrued at an interim reporting date?

**Background:** Effective January 1, ABC Corp. implemented a new PTO policy. PTO is expected to be used by employees to compensate them for all absences including vacation, time off for personal matters and absences for medical reasons. The full allotment of PTO hours is granted on January 1 of each year instead of being earned and accrued throughout the year; new hires will receive PTO on a pro rata basis based on the quarter in which they are hired.

For example, if an individual was hired January 1 and was eligible for 24 days per year, on that day the employee would have a PTO balance of 24 days. If an individual was hired on July 1 and was eligible for 24 days per year, the employee would have a PTO balance of 12 days on the date of hire. PTO is subject to a 'use it or lose it' policy at the end of the calendar year and is not paid out upon employee termination unless otherwise required by state law.

**Interpretive response:** Not necessarily. In the fact pattern described in the background, because the full PTO hours are granted on January 1 instead of being earned throughout the year, and these hours are nonvesting and nonaccumulating, we believe an accrual for PTO at an interim date is not necessary. Instead, the PTO should be expensed as it is taken.

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## 3.2.20 Sabbatical leave benefits

### Excerpt from ASC 710-10

**20 Glossary**

**Sabbatical Leave –** A benefit in the form of a compensated absence whereby the employee is entitled to paid time off after working for an entity for a specified period of time. During the sabbatical, the individual continues to be a compensated employee and is not required to perform any duties for the entity.

**15 Scope and Scope Exceptions**

**> Transactions**

**15-3** The guidance in the Compensation—General Topic applies to the following compensation or employee benefit arrangements: …

b. **Sabbatical leave** or other similar benefit arrangement that is unrestricted (that is, the employee is not required to perform any direct or indirect services for or on behalf of the entity during the absence)

…

**25 Recognition**

**>> Sabbatical Leave Benefits**

**25-4** The appropriate accounting for a **sabbatical leave** depends on the purpose of the leave. If a sabbatical leave is granted only to perform research or public service to enhance the reputation of or otherwise benefit the employer, the compensation is not attributable to services already rendered (see paragraph 710-10-25-1(a)); a liability shall not be accrued in advance of the employee's services during such leave. If the leave is granted to provide compensated unrestricted time off for past service and the other conditions for accrual are met, a liability for sabbatical leave shall be accrued.

**25-5** An employee's right to a compensated absence under a sabbatical or other similar benefit arrangement that requires the completion of a minimum service period and in which the benefit does not increase with additional years of service accumulates pursuant to paragraph 710-10-25-1(b) for arrangements in which the individual continues to be a compensated employee and is not required to perform any direct or indirect services for or on behalf of the entity during the absence. Therefore, assuming all of the other conditions of paragraph 710-10-25-1 are met, the compensation cost associated with a sabbatical or other similar benefit arrangement shall be accrued over the requisite service period.

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## Question 3.2.100

**How is sabbatical leave accounted for?**

**Background:** ABC Corp. offers three months of sabbatical leave to its employees upon completion of a minimum of five years of service. Any years of service beyond the five-year minimum do not give rise to a higher sabbatical leave benefit. There are no restrictions on how the employees use their sabbatical leave.

**Interpretive response:** If the sabbatical is unrestricted and is an accumulating compensated benefit right as described in the background fact pattern, a liability for future sabbaticals is accrued over the minimum service period (five years in the fact pattern described in the background), provided the obligation is probable and estimable.

In contrast, if the sabbatical is to be used solely to benefit the entity's business (e.g. to perform research or public service to enhance the reputation of or otherwise benefit the entity), the employee is effectively not absent from the entity's active employment. Therefore, a liability for future sabbaticals is not accrued over the minimum service period. Instead, the compensation paid is recognized as a period cost during the sabbatical period. [710-10-25-4]

## 3.2.30 Sick pay benefits

### Excerpt from ASC 710-10

**25 Recognition**

**>> Sick Pay Benefits**

**25-6** The employer's actual administration of sick pay benefits shall determine the appropriate accounting. In accounting for compensated absences, the form of an employer's policy for compensated absences shall not prevail over actual practices. For example, if employees are customarily paid sick pay benefits even though their absences from work are not actually the result of illness or if employees are routinely allowed to take compensated terminal leave for accumulated unused sick pay benefits prior to retirement, such benefits shall not be considered sick pay benefits for purposes of applying the provisions of the following paragraph but rather shall be accounted for in accordance with paragraph 710-10-25-1.

**25-7** Notwithstanding the conditions specified in paragraph 710-10-25-1, an employer is not required to accrue a liability for nonvesting accumulating rights to receive sick pay benefits (that is, compensation for an employee's absence due to illness).

**25-8** This Subtopic does not prohibit an employer from accruing a liability for such nonvesting accumulating sick pay benefits, providing the criteria of paragraph 710-10-25-1 are met.

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## Question 3.2.110

**Is a liability for compensated absences due to sickness recognized?**

**Interpretive response:** Not necessarily. Topic 710 states that there is no requirement to recognize a liability for nonvesting accumulating rights to receive benefits for compensated absences due to sickness. However, it does not prohibit it, provided the four criteria highlighted in Question 3.2.10 are met. [710-10-25-8]

We believe that it may be difficult for an entity to reasonably estimate the number of sick days that an employee may take, which could preclude recognition of a liability. See also Question 3.2.120.

## Question 3.2.120

**How are unused sick days that can be used even if not sick accounted for?**

**Background:** ABC Corp.'s sick pay policy provides 10 sick days annually to any employee who has been employed for at least three months. ABC has a June 30 year-end; however, the sick pay policy is based on a calendar year. Specifically, an employee is entitled to the sick days as of January 1 and will be paid for unused sick days as of December 31.

**Interpretive response:** Unused sick days that can be used even if not sick are general compensated absences instead of pay for sick days under paragraph 710-10-25-6; this is because they are paid at year-end if not used for illness. ABC accrues for the obligation related to vested compensated absences in its June 30 financial statements, assuming it is probable and estimable. For example, if an employee uses three days through June 30, ABC accrues for the remaining seven days, which are fully vested.

In contrast, if the employee earns the sick days pro rata throughout the year, the employee has earned only five days through June 30. If an employee used three days through June 30, ABC would recognize a liability for the two remaining fully vested days in its June 30 financial statements.

## 3.2.40 Furlough arrangements

Furlough arrangements typically consist of employees taking mandatory time off with no or reduced pay and/or a continuation of fringe benefits. An entity accounts for furlough arrangements under Topic 710 or Topic 712 depending on the facts and circumstances. For further discussion, see section 4.6.80.

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## 3.3 Lump-sum payments under a union contract

### Excerpt from ASC 710-10

**15 Scope and Scope Exceptions**

**> Transactions**

**15-3** The guidance in the Compensation—General Topic applies to the following compensation or employee benefit arrangements: …

c. Lump-sum payments under union contracts (that is, not to individual employment contracts or any other situation involving compensation payments to individual employees).

**25 Recognition**

**> Lump-Sum Payments Under Union Contracts**

**25-12** In connection with the signing of new union contracts, union employees may agree to accept a lump-sum cash payment or payments in lieu of all or a portion of an increase in their base wage rate. Entities believe that in certain circumstances those lump-sum payments reduce or eliminate increases in base wage rates during the contract period that would otherwise be required. The specific terms of lump-sum payments vary, but ordinarily there is no requirement that the employee refund to the entity any portion of the payment if the employee terminates employment prior to the end of the contract period. Unlike an employment contract with an individual, the union contract applies to the work force, and there is a presumption that an employee who terminates generally will be replaced by another union member at the same base wage rate without an additional lump-sum payment.

**25-13** All or a portion of a lump-sum payment may be deferred and appropriately amortized only when it is clear that the payment will benefit a future period in the form of a lower base wage rate than otherwise would have existed. The period of amortization shall not extend beyond the contract period. The terms and conditions of those payments may vary and the facts and circumstances surrounding the contract and the negotiations must be reviewed to determine how to account for the payment.

**25-14** This guidance relates solely to union contracts and not to individual employment contracts or any other situation involving compensation payments to individual employees.

Lump-sum payments under union contracts refer to lump-sum cash payments that union employees agree to accept in lieu of all or a portion of an increase in their base wage rate. [710-10-25-12]

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## Question 3.3.10

**When is a liability for lump-sum payments under union contracts recognized?**

**Interpretive response:** The accounting event that triggers liability recognition is the signing of the new union contract. No accrual is recognized in advance of this, even if the lump-sum payment is for past employee performance and is probable and reasonably estimable.

If the agreement is signed after the reporting date but before the financial statements are issued (or available to be issued), we believe a nonrecognized subsequent event has occurred. The nonrecognized subsequent event is not recognized in the current financial statements; however, the entity determines whether it is of such a nature that it must be disclosed to keep the financial statements from being misleading. [855-10-50-2]

## Question 3.3.20#

**How is the expense for a lump-sum payment liability recognized?**

**Interpretive response:** Lump-sum payments under union contracts are usually recognized as a one-time period cost, but may be recognized over time, depending on the specific facts and circumstances of the contractual arrangement.

We believe an entity should consult with legal counsel to determine whether the terms of the contractual arrangement will clearly benefit future periods in the form of a lower base wage rate than would otherwise be paid. If there is a clear legal and contractual benefit to future periods, an entity may defer the cost of such lump-sum payments and recognize the expense over the amortization period, which should not extend beyond the contractual period.

For example, assume each employee receives a $1,000 lump-sum payment in lieu of a 3% annual wage increase over the next three years. If an entity determines that this payment will clearly benefit it over the next three years, it defers the lump-sum payment and amortizes the amount over the three-year period.

In the absence of a clear legal and contractual benefit to future periods in the form of a lower base wage rate than would otherwise be paid, we believe the lump-sum payment should be expensed as a period cost.

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## 3.4 Deferred compensation arrangements

### Excerpt from ASC 710-10

**20 Glossary**

**Full Eligibility Date –** The date at which an employee has rendered all of the service necessary to have earned the right to receive all of the benefits expected to be received by that employee (including any beneficiaries and dependents expected to receive benefits). Determination of the full eligibility date is affected by plan terms that provide incremental benefits expected to be received by or on behalf of an employee for additional years of service, unless those incremental benefits are trivial. Determination of the full eligibility date is not affected by plan terms that define when benefit payments commence or by an employee's current marital or dependency status.

**15 Scope and Scope Exceptions**

**> Transactions**

**15-4** The guidance in this Topic applies to the following deferred compensation or employee benefit arrangements:

a. All forms of postemployment benefits, as defined in Subtopic 712-10, that meet the conditions in paragraph 710-10-25-1
b. Split-dollar life insurance arrangements if the arrangement is, in substance, an individual deferred compensation contract (see paragraphs 715-60-35-177 through 35-185.
c. Other deferred compensation contracts accounted for individually.

**15-5** The guidance in this Topic does not apply to the following deferred compensation or employee benefit arrangements:

a. Benefits paid to active employees other than compensated absences
b. Benefits paid at retirement or provided through a pension or postretirement benefit plan including special or contractual termination benefits payable upon termination from a pension or other postretirement plan are covered by Subtopics 715-30 and 715-60.
c. Individual deferred compensation contracts that are addressed by Subtopics 715-30 and 715-60, if those contracts, taken together, are equivalent to a defined benefit pension plan or a defined benefit other postretirement benefit plan, respectively.
d. Special or contractual termination benefits that are not payable from a pension or other postretirement plan are covered by Topic 712
e. Stock compensation plans that are addressed by Topic 718
f. Other postemployment benefits (see Topic 712) that do not meet the conditions in paragraph 710-10-25-1 and are accounted for in accordance with Topic 450.

**25 Recognition**

**> Deferred Compensation Arrangements**

**25-9** To the extent the terms of a contract attribute all or a portion of the expected future benefits to an individual year of the employee's service, the

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cost of those benefits shall be recognized in that year. To the extent the terms of the contract attribute all or a portion of the expected future benefits to a period of service greater than one year, the cost of those benefits shall be accrued over that period of the employee's service in a systematic and rational manner.

**25-10** If elements of both current and future services are present, only the portion applicable to the current services shall be accrued. Example 1 (see paragraph 710-10-55-1) illustrates this guidance.

This section discusses accounting for deferred compensation arrangements in the scope of Topic 710. To determine if an arrangement is in the scope of Topic 710 and not Topic 715, see section 2.2.20.

## Question 3.4.10

### What is a deferred compensation arrangement under Topic 710?

**Interpretive response:** A deferred compensation arrangement under Topic 710 includes the following:

— postemployment benefits that meet the criteria to be compensated absences (see section 3.2). Compensated absences are the only type of deferred compensation arrangement offered to active employees under Topic 710;
— contracts with individuals that do not apply to all employees or a class of employees;
— split-dollar life insurance arrangements if the arrangement is, in substance, an individual deferred compensation contract (see chapter 5);
— certain profits interests where the arrangement shares the characteristics of a profit-sharing or performance bonus (see KPMG Handbook, Share-based payment);
— cash compensation plans; stock compensation plans are covered by Topic 718; and
— plans that do not provide benefits paid through a pension or OPEB plan.

These arrangements are generally offered as a retention tool to incentivize certain key employees to remain with an entity. Common examples are bonus arrangements, commissions and longer-term compensation plans that are paid to individuals during or following their employment either for a fixed period or for life. Compensated absences described in section 3.2 are also a form of deferred compensation, but their accounting is addressed in that section.

An individual contract will generally contain a service component, which outlines the underlying service requirement for the employee to earn the future deferred compensation. The contract will also generally outline the associated vesting or accumulating features and the nature and amount of compensation that is being deferred. It may also contain a performance component, such as a requirement that the entity attain a certain level of profitability or some other performance target before the employee is entitled to the compensation.

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As the Questions and Examples below indicate, a key concept in accounting for these arrangements is the 'full eligibility date'. That date is the date at which an employee has rendered all of the services necessary to have earned the right to receive all of the benefits under the contract. [710-10 Glossary]

## Question 3.4.20

**How is a fully vested deferred compensation arrangement accounted for?**

**Interpretive response:** If an employee enters into a deferred compensation contract that is fully vested at the contract date, there is no further service requirement and the liability for the future deferred compensation benefit is recognized in full at that time. The full eligibility date is the same as the contract date in this case. [710-10-25-9, 710-10 Glossary]

## Question 3.4.30

**How is a deferred compensation arrangement with a current-period service requirement accounted for?**

**Interpretive response:** A deferred compensation arrangement that requires the employee to provide service in the current fiscal year but not in future periods will be fully vested at the end of the current fiscal year. The liability for the future deferred compensation benefit is recognized in full in the current year. The full eligibility date is the last day of the current fiscal year in this case. [710-10-25-9]

## Question 3.4.40

**How is a deferred compensation arrangement with a multiple-period service requirement accounted for?**

**Interpretive response:** If an employee is required to provide services over multiple periods to reach full eligibility for the deferred compensation benefit, the cost is recognized over the service period. The liability at the full eligibility date will be equal to the present value of the future benefits expected to be paid. [710-10-25-9]

Subtopic 710-10's Example 1 (reproduced directly below) illustrates this accounting by presenting two scenarios.

— Employee receives credit for services rendered prior to the date of the deferred compensation contract but none of the deferred compensation benefits vest until the end of a future service period: entity's entire obligation for the benefits is recognized in a systematic and rational manner over the required future service period; [710-10-55-2]

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— Employee's service rendered prior to the date of the deferred compensation contract results in partial vesting of the benefits: the entity's obligation for the partially vested obligation is accrued at the contract date and the remaining obligation is accrued in a systematic and rational manner over the future service period. [710-10-29-10, 55-3]

## Excerpt from ASC 710-10

**55 Implementation Guidance and Illustrations**

**> Illustrations**

**>> Example 1: Nonvesting Deferred Compensation Contract**

**55-1** This Example illustrates the guidance in paragraphs 710-10-25-9 and 710-10-30-1.

**55-2** An employer's deferred compensation contract does not provide a vested benefit for employees' prior service at the date the contract is entered into. Employees must render 30 years of service to receive benefits under a deferred compensation contract. An employee has rendered 16 years of service at the date of entering into the contract. Credit is granted for that prior service in determining eligibility for the benefit to be provided.

**55-3** In this Example, the employer should accrue the total obligation under the deferred compensation contract in a systematic and rational manner over the employee's future service period to the date full eligibility for the benefits is attained, that is, over the next 14 years. If the employee is eligible to receive a portion of the benefits without regard to future service, that is, the credit for prior service results in a vested benefit, the obligation for that benefit should be fully accrued at the time the contract is entered into.

## Question 3.4.50

### How is a deferred compensation arrangement with both performance and service conditions accounted for?

**Interpretive response:** When a deferred compensation arrangement has both a performance condition and a service condition, we believe the entity can apply Topic 718 (share-based payments) by analogy. This is because the deferred compensation is granted in the year it is awarded but is contingent on the employee's continued employment with the entity. Under this view, the deferred compensation award would be accrued ratably over the required service period (i.e. the vesting period) to the full eligibility date. We believe the award is not required to be discounted over the vesting period because the liability at the full eligibility date will equal the then present value of the benefit expected to be paid.

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There is some practice of attributing these arrangements to a single period if the amount of the bonus is determined based on an earnings measure during that period, even if the deferred compensation arrangement requires service beyond that performance measurement period. This is based on analogy to other compensation guidance that predates Topic 718, such as Topic 715. Even though this is not predominant practice, we believe it is acceptable to recognize the full liability in the year it is earned even if there is a future service requirement because there is no specific guidance that applies to a deferred compensation arrangement with these attributes.

Choosing one of these views is an accounting policy election to be applied consistently to all similar arrangements.

## Example 3.4.10

**Deferred compensation arrangements with performance and service conditions**

In Year 1, ABC Corp. enters into a deferred compensation arrangement with its CEO in the form of a deferred cash bonus. This bonus is calculated annually based on ABC's performance for that year. If ABC does not meet the performance targets defined in the plan in a particular year, there is no deferred cash bonus with respect to that year. In Year 1, ABC meets the performance targets.

### Scenario 1: Future performance does not impact vesting of the Year 1 bonus

As a service condition for receiving the cash bonus, the CEO must continue to be employed with ABC for three years after the year the award was granted (i.e. Year 4). The results of future fiscal years do not affect the eligibility or vesting for the award granted in Year 1, which is calculated solely on the operating results of that year.

If ABC elects to apply accounting that is analogous to Topic 718 (see Question 3.4.50), it would accrue the Year 1 bonus ratably over four years to the full eligibility date at the end of Year 4. The award is not required to be discounted over the four-year vesting period because the liability at the full eligibility date will equal the then-present value of the benefit expected to be paid to the CEO.

Alternatively, ABC could recognize the full liability in Year 1 under the alternative practice explained in Question 3.4.50. Whichever accounting it applies amounts to an accounting policy election that it must apply consistently.

### Scenario 2: Future performance impacts the vesting of the Year 1 bonus

Similar to Scenario 1, as a service condition for receiving the full cash bonus, the CEO must continue to be employed with ABC for three years after the year the award was granted (Year 4). However, the results of future fiscal years affect the eligibility or vesting for the award granted in Year 1 for a portion of the cash bonus because the cash bonus plan has both a current and a deferred component.

The current component of the cash bonus plan is earned and paid to the CEO in the year of grant (Year 1). The deferred component of the cash bonus plan is

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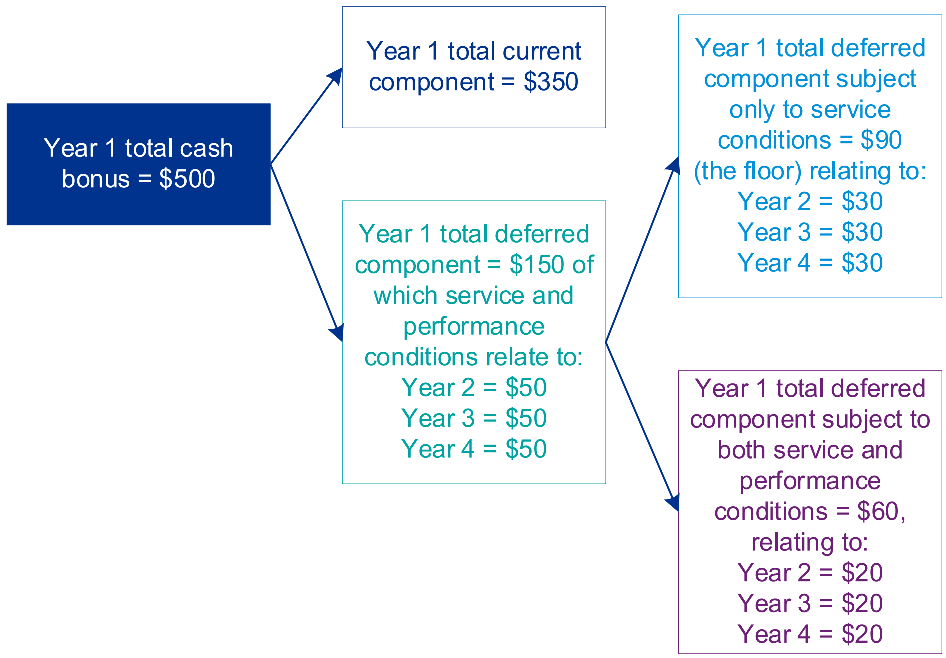
subject to the achievement of additional performance and service conditions known as of the grant date for each of the three years after the year the award was granted – i.e. one-third of the deferred component is earned and paid in each of Years 2, 3 and 4.

60% of the deferred component in each year vests only on the achievement of the CEO's service condition; this represents the floor. The remaining 40% of the deferred component in each year is subject to achieving performance conditions during each year of the three-year period.

The following diagram represents each component of the CEO's award.




Assuming that all service and performance conditions are met, ABC recognizes the following expenses in Years 1 to 4.

| | Year 1 | Year 2 | Year 3 | Year 4 | Total |
|---|---|---|---|---|---|
| Current component | $350.00[1] | $ – | $ – | $ – | **$350** |
| Deferred component – service conditions only[2]: | | | | | |
| Year 2 component | 15.00 | 15.00 | – | – | **30** |
| Year 3 component | 10.00 | 10.00 | 10.00 | – | **30** |
| Year 4 component | 7.50 | 7.50 | 7.50 | 7.50 | **30** |
| Deferred component – service and performance conditions: | | | | | |
| Year 2 component | – | 20.00 | – | – | **20** |
| Year 3 component | – | – | 20.00 | – | **20** |
| Year 4 component | – | – | – | 20.00 | **20** |
| **Total** | **$382.50** | **$52.50** | **$37.50** | **$27.50** | **$500** |

Notes:

1. The current component of the cash bonus plan vests in the year of grant and therefore is expensed in Year 1.

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2. The 60% portion of the deferred component of the cash bonus plan that is subject only to a service condition is accounted for the same as Scenario 1, by making an accounting policy election. ABC elects to apply Topic 718 by analogy and recognize the $90 deferred amount over the service period of each component.

   For the remaining 40% portion of the deferred component of the cash bonus plan, vesting is also based on the achievement of a performance condition. By analogy to Topic 718, ABC recognizes the liability in the year to which the performance condition relates. If the performance condition is probable of achievement, ABC recognizes the liability for Years 2, 3 and 4 in each respective year.

Alternatively, we believe the entire $90 deferred component with a service condition can be recognized only in Year 1 in accordance with the alternative practice discussed in Question 3.4.50.

This is because if ABC does not achieve the performance targets outlined in the CEO's bonus plan, the CEO will receive a lower bonus relative to the deferred component with both a service and performance condition. For example, if ABC achieves 50% of performance targets in Year 2, 75% in Year 3, and 25% in Year 4, $10 would be recognized in Year 2 ($20 at 50%), $15 in Year 3 ($20 at 75%) and $5 in Year 4 ($20 at 25%). This would reduce the CEO's total bonus payout from $500 to $470.

## Question 3.4.60

### Are deferred compensation arrangements indexed solely to a measure of income or operating cash flows accounted for under Topic 710?

**Interpretive response:** Yes, we believe that cash-settled compensation arrangements indexed solely to a measure of an entity's income or operating cash flows should be accounted for as compensation contracts under Topic 710. As such, the benefits under these arrangements should be accrued in a systematic and rational manner over the employee service period – e.g. based on intrinsic value and percentage of the elapsed service period at each reporting date.

An example of such an arrangement is when an employee is entitled to a fixed cash payout if EBITDA (earnings before interest taxes, depreciation and amortization) exceeds a predetermined level after one year. Another example is when an employee is entitled to exercise a right at any point during a specified term to receive a cash payout for the difference between a predetermined level of EBITDA (the strike price) and current trailing EBITDA multiplied by a specified percentage factor.

Both of these example arrangements are paid in cash, require the employee to provide service and maintain current employment to be eligible to receive the payout. Therefore, neither are in the scope of Topic 718.

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## Question 3.4.70

**Is a cash-settled compensation arrangement a derivative if it is indexed to entity-specific measures of income or operating cash flows?**

**Interpretive response:** Not necessarily. Cash-settled arrangements that are indexed to entity-specific measures of income or operating cash flows could appear to meet the requirements to be considered derivatives under Topic 815. However, we believe the arrangements are eligible for the scope exception under Topic 815 related to contracts indexed to specified sales volumes of one of the parties to the arrangement.

Judgment should be applied when evaluating whether the Topic 815 scope exception applies, and the Topic 815 scope exception is discussed in-depth in section 2.7 of KPMG Handbook, Derivatives and hedging.

Further, individual employee compensation contracts similar to the example arrangements in Example 3.4.10 may qualify as any of the following depending on their indexation and settlement provisions:

— derivatives under Topic 815;
— share-based compensation awards under Topic 718; or
— deferred compensation arrangements under Topic 710.

For example, we believe that an award dual-indexed to issuer profitability and the price of gold would likely qualify as a Topic 815 derivative. An award indexed to the price of gold but settled in issuer common stock would generally be accounted for as a liability-classified share-based payment award under Topic 718. Small changes in contractual terms can dramatically affect the applicable authoritative literature and resulting accounting treatment.

## Question 3.4.80

**How is a deferred compensation arrangement accounted for if there is a lump-sum settlement provision in the case of death?**

### Excerpt from ASC 710-10

**25 Recognition**

**> Deferred Compensation Arrangements**

**25-11** Some deferred compensation contracts provide for periodic payments to employees or their surviving spouses for life with provisions for a minimum lump-sum settlement in the event of the early death of one or all of the beneficiaries. The estimated amount (see paragraph 710-10-30-1) of future payments to be made under such contracts shall be accrued over the period of

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active employment from the time the contract is entered into. Example 2 (see paragraph 710-10-55-4) illustrates this guidance.

**55 Implementation Guidance and Illustrations**

**>> Example 2: Attribution Period for a Deferred Compensation Contract**

**55-4** This Example illustrates the guidance in paragraph 710-10-25-11.

**55-5** An employee becomes fully eligible for benefits under a deferred compensation contract five years after entering into the contract. The contract states, however, that if the employee dies or becomes disabled, benefits will be payable immediately. The contract is not one of a group of contracts that possess the characteristics of a pension plan.

**55-6** In this Example, if the employee is expected to render service over the next five years, benefits should be attributed over that service period. If death or disability unexpectedly occurs during the five-year period, the benefit obligation should be remeasured and any previously unrecognized amount should be immediately recognized at the date of the event. If the employee is expected to terminate service within the next five years, an accrual is normally not required because the employee is not expected to receive benefits under the plan. However, in the rare situation that it is probable that death or disability will occur during the five-year period, the benefit should be accrued over the relevant service period.

**Interpretive response:** Topic 710's Example 2 illustrates a situation in which an employee becomes fully eligible for benefits under a deferred compensation contract five years after entering into the contract. The contract states that if the employee dies or becomes disabled, benefits will be payable immediately. The contract is not one of a group of contracts that possess the characteristics of a pension plan.

The deferred compensation is accounted for as follows. [710-10-25-11, 55-5 – 55-6]

— If the employee is expected to render service over the next five years, benefits are attributed over that service period.

— If death or disability unexpectedly occurs during the five-year period, the benefit obligation is remeasured and any previously unrecognized amount is immediately recognized at the date of the event.

— If the employee is expected to terminate service within the next five years, an accrual is normally not required because the employee is not expected to receive benefits under the plan. However, in the rare situation that it is probable that death or disability will occur during the five-year period, the benefit is accrued over the relevant service period.

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## Question 3.4.90

**How is a deferred compensation benefit that makes payments to an individual for life measured?**

### Excerpt from ASC 710-10

**30 Initial Measurement**

**> Deferred Compensation Arrangements**

**30-1** The amounts to be accrued periodically under paragraph 710-10-25-9 shall result in an accrued amount at the **full eligibility date** equal to the then present value of all of the future benefits expected to be paid. Such estimates shall be based on the life expectancy of each individual concerned (based on the most recent mortality tables available) or on the estimated cost of an annuity contract rather than on the minimum payable in the event of early death.

**30-2** At the end of that period the aggregate amount accrued shall equal the then present value of the benefits expected to be provided to the employee, any beneficiaries, and covered dependents in exchange for the employee's service to that date. Example 1 (see paragraph 710-10-55-1) and Example 3 (see paragraph 710-10-55-7) illustrate this guidance.

**Interpretive response:** The amount of the liability recognized must be equal to either: [710-10-30-1]

— the present value of all future benefits expected to be paid based on the life expectancy of the individual (based on the most recent mortality tables available); or
— the estimated cost of an annuity contract.

The liability recognized cannot be based on the minimum payable in case of early death, unless that amount is greater than the one determined based on the life expectancy of the individual entitled to benefits or the estimated cost of an annuity.

Subtopic 710-10's Example 3 (reproduced below) illustrates these measurement principles.

### Excerpt from ASC 710-10

**55 Implementation Guidance and Illustrations**

**>> Example 3: Individual Deferred Compensation Contracts**

**55-7** This Example illustrates the guidance in paragraph 710-10-30-1. An employer may provide postretirement benefits to selected employees under individual contracts with specific terms determined on an individual-by-

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individual basis. That paragraph attributes those benefits to the individual employee's years of service following the terms of the contract. The following Cases illustrate the application of that paragraph for individual deferred compensation contracts:

a. Contract provides only prospective benefits (Case A).
b. Contract provides retroactive benefits (Case B).

**>>> Case A: Contract Provides Only Prospective Benefits**

**55-8** An entity enters into a deferred compensation contract with an employee at the date of hire. The contract provides for a payment of $150,000 upon termination of employment following a minimum 3-year service period. The contract provides for a compensation adjustment for each year of service after the third year determined by multiplying $150,000 by the entity's return on equity for the year. Also, each year after the third year of service, interest at 10 percent per year is credited on the amount due under the contract at the beginning of that year. Accordingly, a liability of $150,000 is accrued in a systematic and rational manner over the employee's first 3 years of service. Following the third year of service, the accrued liability is adjusted annually for accrued interest and the increased or decreased compensation based on the entity's return on equity for that year. At the end of the third year and each subsequent year of the employee's service, the amount accrued equals the then present value of the benefit expected to be paid in exchange for the employee's service rendered to that date.

**>>> Case B: Contract Provides Retroactive Benefits**

**55-9** An entity enters into a contract with a 55-year-old employee who has worked 5 years for the entity. The contract states that in exchange for past and future services and for serving as a consultant for 2 years after the employee retires, the entity will pay an annual pension of $20,000 to the employee, commencing immediately upon the employee's retirement. It is expected that the future benefits to the employer from the consulting services will be minimal. Consequently, the actuarial present value of a lifetime annuity of $20,000 that begins at the employee's expected retirement date is accrued at the date the contract is entered into because the employee is fully eligible for the pension benefit at that date.

**55-10** If the terms of the contract described in the preceding paragraph had stated that the employee is entitled to the pension benefit only if the sum of the employee's age and years of service equal 70 or more at the date of retirement, the employee would be fully eligible for the pension benefit at age 60, after rendering 5 more years of service. The actuarial present value of a lifetime annuity of $20,000 that begins at the expected retirement date would be accrued in a systematic and rational manner over the 5-year period from the date the contract is entered into to the date the employee is fully eligible for the pension benefit.

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## Question 3.4.100

**How is deferred compensation payable to a surviving spouse treated?**

**Background:** ABC Corp. enters into an employment contract with its CEO. The contract stipulates that if the CEO dies while employed by ABC, it will pay $5,000 a month to the CEO's spouse for the rest of the spouse's life. ABC did not purchase an annuity contract to fund the obligation related to the employment contract. Shortly after the employment contract is signed, the CEO dies. The present value of the estimated future payments by ABC to the CEO's spouse is $1 million.

**Interpretive response:** The estimated amounts to be paid under a deferred compensation contract would normally be accrued over the period of active employment based on the most recent mortality tables available. The CEO's death accelerates recognition of the liability that was reasonably determinable from the actuarial tables. The present value of the estimated future payments not previously recognized is recognized as an expense at the date of the CEO's death. [710-10-30-1]

## Question 3.4.110

**What discount rate is used to calculate the present value of future deferred compensation benefits?**

**Interpretive response:** In determining the present value of all future benefits expected to be paid (including benefits to be paid to beneficiaries and covered dependents), we believe an entity should use a discount rate that reflects the rates at which the benefits could effectively be settled.

This can be done as follows.

— For arrangements that are long-term and provide benefits similar to those of a typical DB pension plan, we believe it is appropriate to use the guidance in Topic 715 to derive the appropriate rate. Topic 715 states that the discount rate may be derived from a hypothetical portfolio of high-quality debt instruments with maturities similar to the payments required under the arrangement.

— If there are highly variable cash flows in a longer-term arrangement, we believe that applying a discount rate that is consistent with the nature of the cash flows would be reasonable, as described in Topic 820 (fair value measurement). See Question F30 in KPMG Handbook, Fair value measurement, for guidance on valuation models for measuring liabilities.

— For shorter-term arrangements, we believe that applying a credit-adjusted risk-free rate of return to determine the discount rate would be reasonable.

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## Question 3.4.120

**What is the effect of noncompete provisions in deferred compensation arrangements?**

**Interpretive response:** Some deferred compensation arrangements include noncompete provisions or requirements related to consulting services after the employee's retirement date. In most situations, the obligation of the employee related to those provisions is not substantive and the entity's resulting benefit is not significant.

In our experience, even if the noncompete provision is enforceable, the arrangement normally will not be one that is substantive because it neither compels the employee to continue working for the entity nor gives rise to significant nonemployee services – particularly if the nonemployee services described in the arrangement are for the former employee to be on call for consulting services.

If the noncompete or consulting arrangement is not considered substantive for accounting purposes, the provisions do not extend the attainment of the full eligibility date. Only if the employee requirements are substantive and the entity receives or expects to receive substantive benefits in the form of nonemployee services, would the full eligibility period include the period after the retirement-eligible date through the periods benefited by the terms of the arrangement. The full eligibility date would extend beyond the date the employee is eligible to retire only in rare situations. [710-10-30-1]

## Question 3.4.130

**How is a cash advance paid on renewal of an employment contract with a service requirement accounted for?**

**Background:** An executive's employment contract is up for renewal. ABC Corp. agrees to pay the executive a $10 million cash advance on the signing of a new contract, which is for a three-year term. The cash advance payment is subject to a pro rata clawback if the executive does not complete all of the required services under a new contract. ABC's outside counsel evaluates the clawback clause and advises that it is enforceable.

**Interpretive response:** The accounting for this arrangement depends on the facts and circumstances. In most cases, the advance payment is charged to expense because we believe there is a rebuttable presumption, based on typical business practice, that repayment of a signing bonus will not be enforced by an entity under most conditions.

However, if all of the following are met, the cash advance payment may be recognized as an asset and amortized over the service period:

— there is an enforceable clawback clause in the contract;

— the entity has the intent to enforce the clawback clause (and there is not any history of nonenforcement of similar clauses in other situations); and

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— the entity has the ability to enforce the clawback clause either through right of offset against other severance payments that would otherwise be due to the executive on termination (e.g. other deferred compensation arrangements) or through the executive's other general assets (assuming it is able to determine the executive's personal financial situation and access the assets if necessary).

### Question 3.4.140

**How is a signing bonus with no service requirement accounted for?**

**Interpretive response:** An entity generally recognizes a signing bonus as an expense when it is paid. In our experience, signing bonuses are usually offered to compensate senior executives for a loss of accumulated benefits (e.g. unvested stock options) at a previous employer and therefore are usually designed to compensate the employee without creating future service requirements.

Topic 805 (business combinations) identifies employment contracts as a contract-based intangible asset. We believe this reference contemplates payment under an employment agreement that requires future service and therefore meets the definition of an asset. In contrast, we believe a signing bonus payment that carries no service conditions does not meet the definition of an asset by virtue of the entity's inability to control any future benefit associated with the cost.

Even when future service conditions are present, we believe there is a rebuttable presumption, based on typical business practice, that repayment of a signing bonus will not be enforced by an entity under most conditions.

## 3.5 Deferred compensation arrangements using rabbi trusts

### Excerpt from ASC 710-10

**20 Glossary**

**Rabbi Trusts –** Rabbi trusts are grantor trusts generally set up to fund compensation for a select group of management or highly paid executives. To qualify as a rabbi trust for income tax purposes, the terms of the trust agreement must explicitly state that the assets of the trust are available to satisfy the claims of general creditors in the event of bankruptcy of the employer.

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**15 Scope and Scope Exceptions**

**> Transactions**

**15-8** The guidance in the Deferred Compensation—Rabbi Trusts Subsections addresses the accounting for deferred compensation arrangements that have the following characteristics:

a. If amounts earned by an employee are invested in the stock of the employer and placed in a **rabbi trust**
b. Where the employee elects to diversify the assets held by the rabbi trust into nonemployer securities.

The guidance in the Deferred Compensation—Rabbi Trusts Subsections does not address the accounting for stock appreciation rights even if they are funded through a rabbi trust.

**25 Recognition**

**25-15** The following are the four types of deferred compensation arrangements involving **rabbi trusts** covered by this Subsection:

a. Plan A—The plan does not permit diversification and must be settled by the delivery of a fixed number of shares of employer stock.
b. Plan B—The plan does not permit diversification and may be settled by the delivery of cash or shares of employer stock.
c. Plan C—The plan permits diversification; however, the employee has not diversified (the plan may be settled in cash, shares of employer stock, or diversified assets).
d. Plan D—The plan permits diversification and the employee has diversified (the plan may be settled in cash, shares of employer stock, or diversified assets).

**> Plan A**

**25-16** For Plan A, employer stock held by the rabbi trust shall be classified in equity in a manner similar to the manner in which treasury stock (see Subtopic 505-30) is accounted for. The deferred compensation obligation shall be classified as an equity instrument.

**> Plans B and C**

**25-17** For Plans B and C, employer stock held by the rabbi trust shall be classified in equity in a manner similar to the manner in which treasury stock (see Subtopic 505-30) is accounted for. The deferred compensation obligation shall be classified as a liability.

**> Plan D**

**25-18** For Plan D, assets held by the rabbi trust shall be accounted for in accordance with generally accepted accounting principles (GAAP) for the particular asset (for example, if the diversified asset is an equity security, that security would be accounted for in accordance with Subtopic 321-10). The deferred compensation obligation shall be classified as a liability. At acquisition, debt securities held by the rabbi trust may be classified as trading.

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**35 Subsequent Measurement**

**35-1** The guidance in this Subsequent Measurement Section addresses the four plans (A to D) as outlined in paragraph 710-10-25-15.

**> Plan A**

**35-2** Subsequent changes in the fair value of the employer's stock shall not be recognized. With respect to the deferred compensation obligation recognized under paragraph 710-10-25-16, changes in the fair value of the amount owed to the employee shall not be recognized.

**> Plans B and C**

**35-3** Subsequent changes in the fair value of the employer's stock, recorded in a manner similar to treasury stock, shall not be recognized. The deferred compensation obligation shall be adjusted with a corresponding charge (or credit) to compensation cost, to reflect the changes in the fair value of the amount owed to the employee.

**> Plan D**

**35-4** The deferred compensation obligation shall be adjusted, with a corresponding charge (or credit) to compensation cost, to reflect changes in the fair value of the amount owed to the employee.

Rabbi trusts are grantor trusts generally set up to fund compensation for a select group of management or highly paid executives. To qualify as a rabbi trust for income tax purposes, the terms of the trust agreement must explicitly state that the assets of the trust are available to satisfy the claims of general creditors in the event of bankruptcy of the employer. See paragraphs 1.042 to 1.052 of KPMG Handbook, Share-based payment. [710-10 Glossary]

## Question 3.5.10

### What is a deferred compensation arrangement using a rabbi trust?

**Interpretive response:** A rabbi trust is an irrevocable trust that is sometimes used to fund deferred compensation arrangements. Assets are set aside in the rabbi trust related to the future payment of benefits under the deferred compensation plan. These assets are also used to provide tax deferral options for those in the plan.

The employer will normally not have access to the trust because the trust is restricted; however, legally the assets remain those of the employer. Generally, the only claim on assets provided to the employer's creditors would be for a bankruptcy or default. Neither the employer nor an acquirer can revoke the trust; the employee has no right to transfer contractual rights in the trust nor does the employee have the ability to assign those rights.

Employees defer receiving compensation amounts earned under a nonqualified deferred compensation plan by placing the amounts earned in a rabbi trust. By deferring receipt of the amounts earned, the employees risk losing those assets

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in the event of a bankruptcy or default, but also defer the taxability of those amounts. The employees are subsequently taxed when they eventually receive the amounts from the rabbi trust. Because the rabbi trust assets remain assets of the employer, the employer reports those assets gross, and does not offset them against the deferred compensation liability.

See paragraphs 1.042 to 1.052 of KPMG Handbook, Share-based payment, for additional guidance and examples of rabbi trust plans.

## Question 3.5.20
### How is a deferred arrangement using a rabbi trust accounted for?

**Interpretive response:** There are four types of arrangements using a rabbi trust. For each type, the following table identifies how to characterize and subsequently measure the deferred compensation liability and the employer stock and other assets held in trust. [710-10-25-15 – 25-18, 35-1 – 35-4]

| Type of plan | Description | Deferred compensation liability | Employer stock in rabbi trust is recognized | Other assets in rabbi trust |
|---|---|---|---|---|
| Plan A | Plan does not permit diversification and must be settled by delivery of a fixed number of shares of employer stock | Equity instrument, with subsequent changes in fair value not recognized | Similar to treasury stock (Subtopic 505-30), with subsequent changes in fair value not recognized | N/A |
| Plan B | Plan does not permit diversification and may be settled by the delivery of cash or shares of employer stock | Liability, with subsequent changes in fair value recognized | Similar to treasury stock (Subtopic 505-30), with subsequent changes in fair value not recognized | N/A |
| Plan C | Plan permits diversification; however, the employee has not diversified; the plan may be settled in cash, shares of employer stock or diversified assets | Liability, with subsequent changes in fair value recognized | Similar to treasury stock (Subtopic 505-30), with subsequent changes in fair value not recognized | N/A |
| Plan D | Plan permits diversification and the employee has diversified; the plan may be settled in cash, shares of employer stock or diversified assets | Liability, with subsequent changes in fair value recognized | – | Apply applicable US GAAP |

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## Question 3.5.30
### What is the treatment of dividends in a deferred compensation arrangement using rabbi trusts?

**Interpretive response:** An accounting issue arises if dividends paid on employer shares in a rabbi trust are retained in the trust instead of being paid to the employees. In this scenario, there are mixed views as to whether this disqualifies the continued use of Plan A accounting (see Question 3.5.20). If disqualified from Plan A accounting, the arrangement would be accounted for as a Plan D arrangement.

At the time the rabbi trust guidance of Topic 710 was developed, the existing guidance for share-based payments would have disqualified the plan from continuing to use Plan A accounting. However, when that guidance was superseded by Topic 718, the guidance for rabbi trust arrangements was not updated. When viewed in the framework of Topic 718, the retention of dividends in the trust would not disqualify the plan from continuing to use Plan A accounting; see discussion in paragraph 1.051 of KPMG Handbook, Share-based payment.

To avoid the possibility of being disqualified from using Plan A accounting, some entities accumulate the dividends on employer shares in the rabbi trust in a separate trust. If Plan A accounting is retained for the original rabbi trust, the dividends paid and accumulated in the separate trust would be recognized by the entity as either of the following.

— **Retained earnings.** Consistent with the premise of Topic 718 that the future dividends have been captured in the grant-date fair value measure of the award, the dividends paid and accumulated in a rabbi trust are recognized as a charge to retained earnings. This accounting treatment is similar to one used for dividends on other nonvested share awards where the paid dividends are charged to retained earnings to the extent that the awards are expected to vest.

— **Compensation cost.** Consistent with the premise of Topic 710 that a Plan A-type arrangement is accounted for like treasury stock, payment of dividends would not be part of the arrangement because dividends are not paid on treasury stock. Under this approach, dividends are recognized as additional compensation cost.

An entity should adopt and apply its policy consistently to all Plan A rabbi trust arrangements.

## Question 3.5.40
### What is the income tax treatment of dividends in a deferred compensation arrangement using rabbi trusts?

**Interpretive response:** For US federal income tax purposes, the entity may receive a tax deduction for dividends paid on shares held in a rabbi trust. The

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tax benefit associated with dividends paid is recognized in income tax expense (benefit) in the income statement.

Consistent with the guidance on dividends received on securities accounted for under Topic 320 (investments in debt securities), an entity accounting for a rabbi trust based on Plan D accounting recognizes the dividends paid to the rabbi trust as compensation cost. Under Plan D accounting, the deferred compensation obligation is classified as a liability and adjusted, with a corresponding charge (or credit) to compensation cost, to reflect changes in the fair value of the amount owed to the employee. See paragraph 1.052 of KPMG Handbook, Share-based payment, for further discussion.

## 3.6 Presentation and disclosure

### Excerpt from ASC 710-10

**45 Other Presentation Matters**

**45-1** For all of the types of plans (A to D) discussed in paragraph 710-10-25-15, the accounts of the rabbi trust shall be consolidated with the accounts of the employer in the financial statements of the employer.

**45-2** For Plan D only, changes in the fair value of the deferred compensation obligation shall not be recorded in other comprehensive income, even if changes in the fair value of the assets held by the rabbi trust are recorded, pursuant to Subtopic 320-10, in other comprehensive income.

**45-3** For all of these types of plans, employer shares held by the rabbi trust shall be treated as treasury stock for earnings per share (EPS) purposes and excluded from the denominator in the basic and diluted EPS calculations. However, the obligation under the deferred compensation arrangement shall be reflected in the denominator of the EPS computation in accordance with the provisions of Section 260-10-45.

**45-4** In accordance with paragraph 260-10-45-13, if an obligation is required to be settled by delivery of shares of employer stock (Plan A), those shares shall be included in the calculation of basic and diluted EPS. If the obligation may be settled by delivery of cash, shares of employer stock, or diversified assets (other than Plan A), those shares shall not be reflected in basic EPS but shall be included in the calculation of diluted EPS in accordance with paragraph 260-10-45-30 and paragraphs 260-10-45-45 through 45-46.

**50 Disclosure**

**> Compensated Absences**

**50-1** If an employer meets the conditions in paragraph 710-10-25-1(a) through (c) and does not accrue a liability because the condition in paragraph 710-10-25-1(d) is not met, that fact shall be disclosed.

Topic 710 does not include significant guidance on presentation, other than that related to deferred compensation arrangements using rabbi trusts.

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## Question 3.6.10

**Is the liability for compensated absences classified as a current or noncurrent liability?**

**Interpretive response:** Because a liability for accrued compensated absences is usually directly related to the entity's operating cycle (i.e. wages and salaries), an entity classifies it as a current liability. However, obligations not contractually due until more than a year from the reporting date (or normal operating cycle, if longer) are classified as noncurrent. [210-10-45-8]

## Question 3.6.20

**How are assets and liabilities in deferred compensation arrangements presented?**

**Interpretive response:** A debtor with a valid right of setoff may offset the related liability and asset and report the amount net in its financial statements. A right of setoff exists when all of the following conditions are met: [210-20-45-1]

- each of two parties owes the other determinable amounts;
- the reporting party has the right to set off the amount owed with the amount owed by the other party;
- the reporting party intends to set off; and
- the right of setoff is enforceable by law.

Based on those conditions, an investment in life insurance or other assets, including those assets in a rabbi trust that fund a deferred compensation obligation, are accounted for and presented separately in the entity's balance sheet because generally no right of offset exists. [TQA 5230.09]

## Question 3.6.30

**What are the disclosures for deferred compensation arrangements?**

**Interpretive response:** US GAAP includes no specific requirements about disclosures related to a deferred compensation arrangement. However, other aspects of US GAAP contain disclosure requirements that need to be considered if deferred compensation arrangements are material to an entity's financial statements.

The following are example disclosures (not exhaustive):

- current accounting policy regarding deferred compensation arrangements and consolidation of related rabbi trusts that fund the arrangement (Topic 235);
- related party transactions, including the dollar amounts of transactions for each period for which an income statement is presented (Topic 850);

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— marketable equity and debt securities that fund deferred compensation obligations (Topic 505);
— treasury stock transactions resulting from entity shares that fund deferred compensation obligations (Topic 505); and
— amount of CSV related to life insurance that funds deferred compensation arrangements (Topic 325).

## Question 3.6.40

### What is the balance sheet presentation for a deferred compensation arrangement funded by life insurance contracts?

**Background:** ABC Corp. has a deferred compensation contract with its president and the estimated amount of future payments was accrued over the period of active employment. In the current period, ABC purchases a life insurance policy on the president, naming itself as beneficiary.

**Interpretive response:** The CSV of a life insurance contract is reported on the balance sheet as an asset, with changes in value reflected as an adjustment of insurance expense for the period. Net presentation of the assets and liabilities related to the arrangement on the entity's balance sheet is not appropriate, regardless of the funding objective pertaining to the purchase of the insurance contract. See Question 3.6.20. [710-10-45]

## Question 3.6.50

### What are the disclosures for deferred compensation arrangements funded by life insurance contracts?

**Interpretive response:** We believe the following disclosures should be provided when investments in life insurance (or the deferred compensation and other employee benefits associated with life insurance) are material to an entity; this includes consideration of amounts currently not recognized under an entity's existing accounting policies.

— A discussion of the primary purposes and objectives of the life insurance arrangements – e.g. providing an investment return or funding retirement benefits;

— A description of the life insurance investments and related compensation or benefit arrangements with the employees. The disclosure should include descriptions of the significant terms of the life insurance policies; contractual restrictions on the ability to surrender a policy; and arrangements to split the premiums, investment value and death benefits with employees or their beneficiaries;

— A discussion of the entity's current accounting policy for life insurance assets, including the significant components and assumptions used to determine the financial statement amount – e.g. surrender charges assumed to be waived, deferred acquisition costs, or claims stabilization

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reserves included in the asset, and the discount rate used if the investment is accounted for as a loan to the employee.

— A discussion of the entity’s current accounting policy for the deferred compensation and other employee benefit arrangements associated with life insurance arrangements.

## Question 3.6.60
**What are the SEC disclosures for deferred compensation arrangements?**

**Interpretive response:** There are no specific SEC disclosures related to deferred compensation arrangements. However, other aspects of SEC disclosure requirements may be relevant if deferred compensation arrangements are material to a registrant’s financial statements, including:

— related party transactions and balances; [S-X Rule 4-08(k)]
— material future funding requirements related to deferred compensation arrangements in MD&A; and [S-K Item 303]
— executive compensation policies and other aspects of an entity's compensation arrangements in CD&A. [S-K Item 402]

These SEC requirements are in addition to the potential US GAAP disclosures in paragraph 710-10-50-1 and Question 3.6.50.

## Question 3.6.70
**What are MD&A disclosures for deferred compensation arrangements?**

**Interpretive response:** The SEC staff has identified a number of disclosures that should be provided for pension, OPEB, and postemployment plans – e.g. information about the selection of a discount rate, comparison of actual and expected results in assumptions used to account for such plans, and funding obligations. We would expect similar disclosures about deferred compensation arrangements material to the financial statements of the entity. See Question 11.2.120.

Registrants are required to disclose material cash requirements from known contractual and other obligations as part of a liquidity and capital resources discussion. [Reg S-K Item 303]

We believe that guidance should also be considered in developing disclosures related to deferred compensation arrangements that are material to the entity’s financial statements.

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## Question 3.6.80

**What are the CD&A disclosure requirements for deferred compensation arrangements?**

**Interpretive response:** The SEC requires disclosure about executive compensation to begin with a narrative CD&A section describing the most important determinants of the registrant's compensation policies and decisions. The disclosure covers the registrant's compensation objectives, what its compensation program is designed to reward, the elements of compensation, why the registrant chooses to pay each element, how amounts for each element are determined, and how each element and the compensation decisions fit into the registrant's overall compensation objectives. [Reg S-K Item 402]

The SEC requires information be included in certain filings about compensation of the entity's named executive officers, including tabular compensation information about directors, principal executive and financial officers, and the three other most highly compensated executive officers (collectively, the named executive officers). The amount earned during the year under deferred compensation arrangements is generally included in the table as either salary or bonus, depending on the terms of the arrangement. This amount is generally the same as that recognized as compensation cost in the financial statements. Further, above-market or preferential earnings on compensation that is deferred on a basis that is not tax-qualified, including such earnings on nonqualified DC plans, are included in the amounts as part of the change in pension value and nonqualified deferred compensation earnings.

The SEC requires disclosure in tabular format for each named executive officer of information with respect to each DC or other plan that provides for the deferral of compensation on a basis that is not tax-qualified. Disclosures include aggregate executive contributions, registrant contributions, interest or other earnings accrued, withdrawals by and distributions to the executive, and the balance as of the end of the year. The table must be supplemented by a narrative description of material factors necessary to understand each plan included in the table, such as the types of compensation permitted to be deferred, limitations on deferral, the measures of calculating interest or other plan earnings and material terms related to payouts, distributions and withdrawals.

The SEC requires that certain material contracts and other information be filed as an exhibit to certain filings made with the SEC. A deferred compensation arrangement with one of the executives included in the compensation tables may be considered material and required to be filed as an exhibit. A registrant should consult with its securities counsel to determine filing requirements.

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# 4. Termination benefits and other nonretirement postemployment benefits

## Detailed contents

**Item significantly updated in this edition #**



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## 4.1 How the standards work

Topic 712 outlines the measurement, recognition, presentation and disclosure requirements for nonretirement benefits provided to employees after they stop working at an organization.

Common examples include voluntary (also known as 'special') termination benefits, and involuntary termination benefits provided under an ongoing benefit arrangement, along with any disability and healthcare benefits provided after employment. This chapter refers to nonretirement benefits provided to employees after employment collectively as termination benefits.

Topic 420 outlines the requirements for costs related to exit or disposal activities, which include involuntary termination benefits under a one-time benefit arrangement. All other costs covered by Topic 420 (including contract termination costs) that are not employee benefits are not addressed in this Handbook.

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## 4.2 Overview

### Excerpt from ASC 712-10

**05 Overview and Background**

**05-1** The Compensation—Nonretirement Postemployment Benefits Topic provides guidance on **nonretirement postemployment benefits**, including **termination benefits** and **other postemployment benefits** provided to former and **inactive employees**. This Topic contains only the Overall Subtopic.

**> Termination Benefits**

**05-2** An employer may provide benefits to employees in connection with their termination of employment. They may be either **special termination benefits** offered only for a short period of time or contractual termination benefits required by the terms of a plan only if a specified event, such as a plant closing, causes employees' services to be terminated involuntarily. Termination benefits may take various forms including lump-sum payments, periodic future payments, or both. They may be paid directly from an employer's assets, an existing pension plan, a new employee benefit plan, or a combination of those means.

**05-3** See Section 712-10-15 for links to other Topics in the Codification that provide guidance on termination benefits, such as the following:

a. One-time termination benefits resulting from an exit or restructuring activity
b. Termination benefits (for example, supplemental early retirement benefits, termination indemnities) paid through a pension or other postretirement plan.

**15 Scope and Scope Exceptions**

**> Overall Guidance**

**15-1** The Scope Section of the Overall Subtopic establishes the pervasive scope for the Compensation—Nonretirement Postemployment Benefits Topic.

**> Entities**

**15-2** The guidance in the Compensation—Nonretirement Postemployment Benefits Topic applies to all entities and all employers that offer or have offered termination or **other postemployment benefits** to employees and former employees in connection with their termination of employment or their transfer to inactive status. The benefits covered by this Topic are paid before retirement and are not paid from a pension or other postretirement plan.

**> Transactions**

**15-3** The guidance in the Compensation—Nonretirement Postemployment Benefits Topic applies to the following **nonretirement postemployment benefits**:

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a. Special or contractual **termination benefits** that are payable before retirement and are not payable from a pension or other postretirement plan.
b. All types of other postemployment benefits provided to former or **inactive employees**, their beneficiaries, and covered dependents after employment but before retirement. Benefits may be provided in cash or in kind and may be paid as a result of a disability, layoff, death, or other event. Benefits may be paid immediately upon cessation of active employment or over a specified period of time. Employees' rights to benefits may accumulate or vest as they render service. See paragraph 710-10-25-1(b) for a description of the meaning of accumulate or vest.

**15-4** The guidance in this Topic does not apply to the following benefits:

a. Benefits provided through a pension or postretirement benefit plan (See Subtopics 715-30 and 715-60, which specify the accounting for those costs.)
b. Individual deferred compensation arrangements that are addressed by Subtopic 710-10
c. Special or contractual termination benefits, payable upon termination, from a defined benefit pension plan, or payable upon retirement, covered by Subtopic 715-30.
d. Special or contractual termination benefits other than pension (for example, welfare benefits), payable upon termination from a defined benefit other postretirement plan, or payable upon retirement, covered under Subtopic 715-60.
e. One-time termination benefits covered in Subtopic 420-10 (see the following paragraph).
f. Stock compensation plans that are addressed by Topic 718.

**> Other Considerations**

**15-5** As indicated in paragraph 420-10-05-4, accounting for termination benefits granted in connection with an exit or disposal activity will differ depending on whether the benefits payable are considered an enhancement to an ongoing benefit arrangement, (covered by this Subtopic or Subtopics referenced in the preceding paragraph) or provided under a one-time termination arrangement covered by Topic 420. For guidance on making this determination, see paragraph 420-10-55-1 and Example 5 (paragraph 420-10-55-16).

**25 Recognition**

**> Special Termination Benefits**

**25-1 Nonretirement postemployment benefits** offered as **special termination benefits** to employees shall be recognized as a liability and a loss when the employees accept the offer and the amount can be reasonably estimated. An employer that offers, for a short period of time, special termination benefits to employees, shall not recognize a loss at the date the offer is made based on the estimated acceptance rate.

Accounting for employment termination benefits not provided through a pension or postretirement benefit plan may fall under either Topic 712 or Topic 420, depending on the specific features of the arrangement. This chapter outlines the accounting for special (voluntary) termination benefits in section 4.3

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and provides an overview of involuntary termination benefits in section 4.4 before the sections covering the accounting for each type of involuntary termination benefit (sections 4.5, 4.6 and 4.7).

The accounting considerations for termination benefits provided through a pension or postretirement benefit plan under Topic 715 are discussed in section 9.6.

## Question 4.2.10
### What are the types of benefits included in the scope of either Topic 712 or Topic 420?

**Interpretive response:** Such benefits (unless provided through a pension or postretirement benefit plan) are categorized into four types, with three being accounted for under Topic 712 and one under Topic 420.

| Type | Description | Liability recognition | Topic |
|---|---|---|---|
| Special termination benefits (see section 4.3) | Benefits that are offered to employees for a short period in exchange for the employees' voluntary termination of service. [712-10 Glossary] | The liability is recognized when the employee irrevocably accepts the entity's offer of voluntary termination and the amount is estimable. [712-10-25-1] | 712 |
| Contractual termination benefits (see sections 4.4 and 4.5) | Benefits that are provided to employees who are involuntarily terminated when a triggering event occurs that is specified in the terms of a plan. [712-10 Glossary] | The liability is recognized when the obligation is probable and estimable. [712-10-25-2] | 712 |
| Other postemployment benefits (see sections 4.4 and 4.6) | Benefits, other than special or contractual termination benefits, that are provided after employment but before retirement. [712-10 Glossary] | The liability is recognized either: [712-10-25-4 – 25-5]<br>— as the employee provides service; or<br>— when probable and estimable. | 712 |
| One-time termination benefits (see sections 4.4 and 4.7) | Benefits provided to current employees who are involuntarily terminated under the terms of a one-time termination benefit arrangement. [420-10 Glossary] | The liability is recognized when there is a present obligation; this depends on the facts and circumstances, but generally occurs on the communication date unless there is an ongoing service requirement. [420-10-25-6 – 25-9] | 420 |

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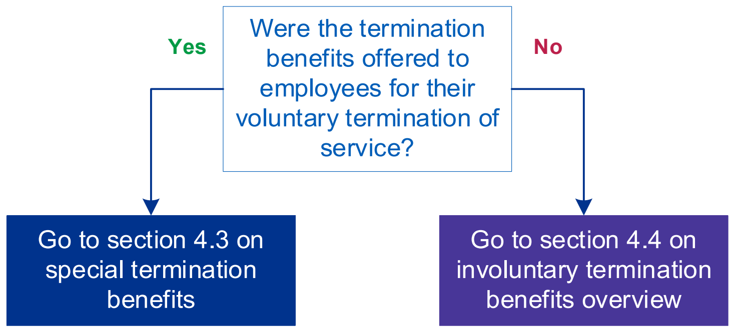
## Question 4.2.20

### How does an entity determine which type of termination benefit it has provided?

**Interpretive response:** Termination benefits fall in one of the categories listed in Question 4.2.10. The following decision tree helps determine the appropriate sections in this chapter under which to analyze given benefits.




## Question 4.2.30

### Are individual employee arrangements to pay termination benefits in the scope of Topic 712 or Topic 420?

**Interpretive response:** No. Topic 712 and Topic 420 generally apply to termination benefits that are available to a group of employees under an ongoing or one-time arrangement. Arrangements for individuals are generally accounted for under Topic 710 (see section 3.4).

# 4.3 Special termination benefits

### Excerpt from ASC 712-10

**20 Glossary**

**Nonretirement Postemployment Benefits –** All types of benefits, other than those provided through a pension or other postretirement plan (see Subtopics 715-30 and 715-60), provided to former or inactive employees, their beneficiaries, and covered dependents.

**Special Termination Benefits –** Benefits that are offered for a short period of time in exchange for employees' voluntary termination of service.

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**25 Recognition**

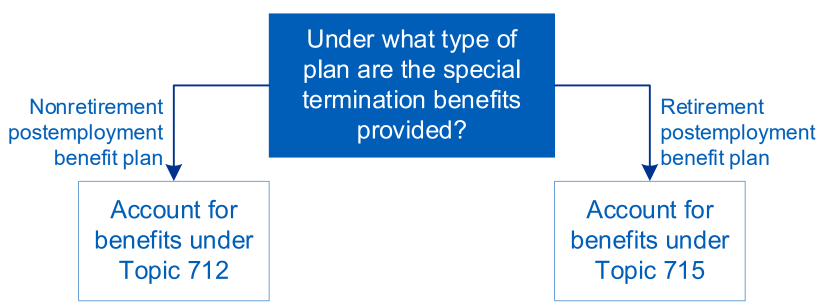
**25-1 Nonretirement postemployment benefits** offered as **special termination benefits** to employees shall be recognized as a liability and a loss when the employees accept the offer and the amount can be reasonably estimated. An employer that offers, for a short period of time, special termination benefits to employees, shall not recognize a loss at the date the offer is made based on the estimated acceptance rate.

Special termination benefits are offered to employees for a short period in exchange for voluntary termination. This may arise when an entity makes an operational decision to encourage its employees to voluntarily leave instead of instituting an involuntary reduction in force. It is the employees, and not the entity, who elect to be voluntarily terminated, and they receive the special termination benefit as payment for that voluntary election.

## Question 4.3.10

### Under what Topic are special termination benefits accounted for?

**Interpretive response:** As the following diagram depicts, special termination benefits are accounted for under either Topic 712 or Topic 715, depending on whether they are nonretirement postemployment benefits or retirement postemployment benefits – i.e. provided through a pension or OPEB plan.




Both Topic 712 and Topic 715 state that an entity recognizes a liability for special termination benefits when the employees accept the offer and the obligation is estimable.

This chapter addresses only the accounting for special termination benefits under Topic 712. The accounting considerations under Topic 715 are further discussed in section 9.6. [712-10-25-1]

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## Question 4.3.20

**When is a liability for a special termination benefit recognized under Topic 712?**

**Interpretive response:** An entity recognizes a liability for special termination benefits when the employees accept the offer and the amount is reasonably estimable. [712-10-25-1]

We believe the employees' acceptance must be irrevocable and if employees have the right to rescind their offers, their acceptance is not considered irrevocable until the rescission period has ended. Therefore, we believe an entity should recognize a liability for a special termination benefit when:

— the employees accept an offer if there is no rescission period; and
— at the end of the rescission period if the employees have a right to rescind.

However, the amount of the liability and the timing of its recognition may be affected if:

— the employees must provide services after accepting the offer (or after the end of the rescission period) (see Question 4.3.30); or
— the special termination benefits are part of a larger plan that includes involuntary termination payments (see Question 4.3.40).

## Example 4.3.10

**Special termination benefits with rescission period**

ABC Corp. has a voluntary severance plan (VSP), which is periodically extended to certain groups of employees. Employees are given a specific period to decide whether they want to participate in the VSP.

Once elected, the employees then have 30 days, by law, to retract their participation (the rescission period) and remain employed. If employees have not retracted their election to participate in the VSP by the end of the rescission period, ABC will terminate them pursuant to the VSP. ABC has a December 31 year-end.

On November 30, Year 1, ABC offers a group of employees the option to participate in the VSP by December 29, Year 1. The rescission period ends during various dates in January Year 2.

The irrevocable acceptance by the employees does not occur until the various rescission periods have expired in January Year 2. Therefore, ABC recognizes a liability for the special termination benefits under the VSP in January Year 2 as the employees' rescission periods expire.

This response assumes the benefits are based entirely on a VSP. Question 4.3.40 discusses a VSP that is part of a larger severance plan that may include involuntary termination.

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## Question 4.3.30
### How are special termination benefits with a future service requirement accounted for?

**Background:** On January 15, ABC Corp. offers voluntary termination benefits to employees who meet specified criteria. These employees must accept the offer by March 15 and must continue to be employed by ABC through December 31. December 31 is the date of termination and the date the employees will receive the termination benefits. ABC accounts for voluntary termination benefits as special termination benefits under Topic 712.

**Interpretive response:** In the background example, employees must provide future services to be eligible for a special termination benefit. In this case, we believe that ABC should recognize the termination benefits over the period during which employment services are rendered – i.e. accrue ratably from the date the employee accepts the offer through the scheduled termination date. The accrual of the termination benefits over that period should reflect an estimate of the number of employees who will stay and receive the termination benefits. This approach is consistent with the 'stay bonus' guidance in Topic 420. [420-10-55-4]

In contrast, if the employees are entitled to receive special termination benefits after they accept the offer regardless of when they leave, ABC recognizes the termination benefits as soon as the employee acceptances become irrevocable and the amount can be reasonably estimated (see Question 4.3.20). This would be when either:

— employees are not required to provide future services; or
— the entity does not enforce the required service period.

## Question 4.3.40
### How is a voluntary termination accounted for if there is a preexisting severance plan or a one-time termination benefit?

**Interpretive response:** When employees are offered to voluntarily terminate in connection with a preexisting severance plan or a one-time termination benefit, the accounting for termination benefits depends on whether any or all of the benefit payments are considered special termination benefits. This determination depends on the specific features of the arrangement in its entirety, as illustrated in the scenarios below.

Once an entity determines which portion of the benefits are considered special termination benefits and which are not, it applies the accounting described in the appropriate box in the following diagram.

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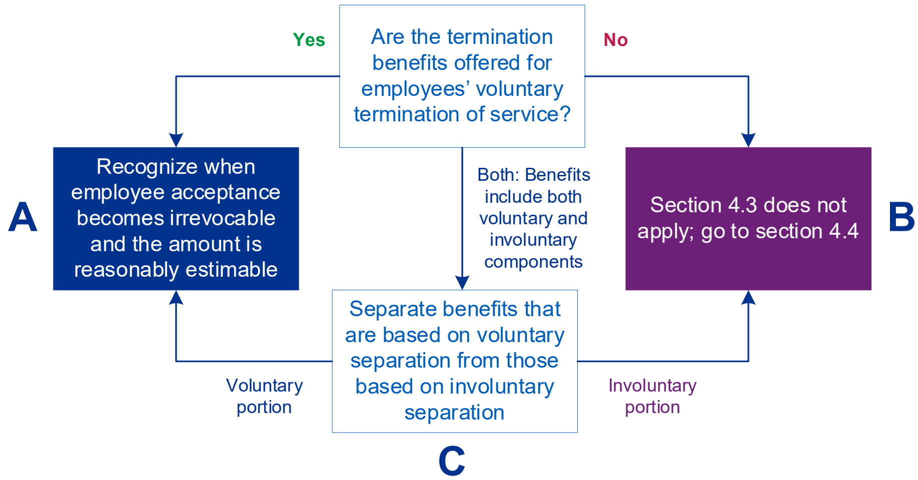


An instance that deviates from how special termination benefits are generally recorded as described in Box A is when employees must provide future services after accepting the offer (or after the end of the rescission period) (see Question 4.3.30).

In all three scenarios below, assume:

— there is no rescission period during which employees may rescind their offer; and
— the entity expects all terminated employees to leave within the minimum retention period; no future services will be required.

### Scenario 1: Employees' offer to voluntarily terminate employment is automatically accepted

ABC Corp. approves a restructuring plan to downsize its operations as part of a broader cost-cutting initiative across the organization. On December 8, Year 1, ABC announces that certain employees can voluntarily terminate their employment in return for the following benefits:

— a one-time termination benefit of $10,000; and
— the cash benefit available under the entity's preexisting severance plan had the termination been involuntary.

Interested employees have 30 days to accept the offer and sign their termination agreement at which time it becomes irrevocable. ABC cannot reject the acceptance of any employee in the affected group of employees.

ABC has a calendar year-end and there is no plan to involuntarily terminate any employees if sufficient employees do not accept.

ABC accounts for both the preexisting severance plan cash benefit and the $10,000 additional benefit as special termination benefits because both amounts are in exchange for the employees' voluntary terminations. Therefore, it recognizes a liability for these amounts (plus related expenses) upon the employees' irrevocable acceptance, which will take place over the 30-day acceptance period.

ABC made the offer on December 8, Year 1, and the offer remains open through the first week of January, Year 2 (the 30-day acceptance period). ABC

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recognizes a liability for any irrevocable acceptances made before year-end on December 31. In contrast, it does not accrue a liability in Year 1 for those offers that have not yet been irrevocably accepted as of December 31 even if the acceptances are known prior to the issuance of the Year 1 financial statements.

Nevertheless, we believe any amounts that are not recognized in Year 1 but are known before issuance of the financial statements should be disclosed, if significant.

**Scenario 2: Entity can accept or reject employees' offer to voluntarily terminate employment**

Assume the same fact pattern as Scenario 1, except that on employee acceptance of the offer ABC decides which resignations to accept. ABC will make all decisions by January 31, Year 2 and will communicate those decisions to the employees on February 15, Year 2.

The benefits are not accounted for as special termination benefits because ABC has the option to accept or reject any employee's offer to voluntarily resign. Because the application by the employee is not considered binding, the benefits are not treated as voluntary even though employees may choose to not apply for ABC's offer.

Instead, the termination benefits offered are accounted for as two separate components of involuntary termination benefits.

- The component that is provided under ABC's preexisting severance plan is an other postemployment termination benefit that is accounted for under Topic 712. It is an other postemployment termination benefit because it is involuntary and subject to an existing plan that does not include a specified triggering event.
- The incremental component is a one-time termination benefit that is accounted for under Topic 420.

Because both of these components are considered involuntary payments, ABC does not apply Box C in the above decision tree. Instead, it follows Box B, in which section 4.4 provides the overview guidance on involuntary termination benefits before the sections covering the accounting for each type of involuntary termination benefit (sections 4.5, 4.6 and 4.7).

ABC will likely recognize a liability for the other postemployment termination component when the liability is probable and estimable (which may be earlier than the February 15, Year 2 communication date) (see section 4.6).

For the one-time termination benefits, it likely will recognize a liability on February 15, Year 2 assuming all criteria specified in section 4.7 are met.

**Scenario 3: Employees receive additional benefit if they accept termination offer before an involuntary reduction in force is implemented**

On November 1, Year 1, ABC announces it will implement a reduction in force on December 31, Year 1. Under ABC's existing HR policy, employees who are terminated as a result will receive two weeks of severance.

To entice employees to leave voluntarily before December 31, ABC also announces that any employees who elect by December 1 to leave voluntarily will be entitled to four weeks of severance instead of two.

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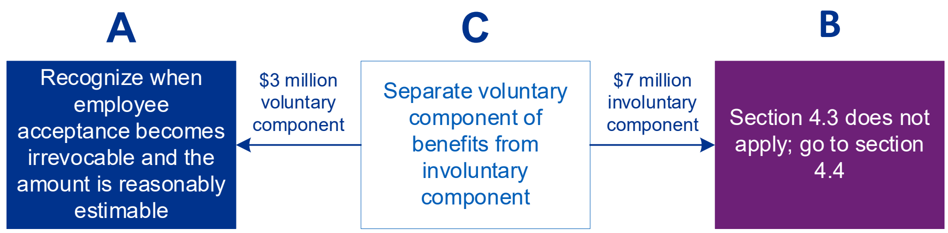
ABC makes $3 million of severance payments to those employees who accepted the offer to leave voluntarily and $7 million of severance payments to those who were involuntarily terminated on December 31.

Unlike in Scenario 1, the $7 million of severance payments made under the preexisting HR policy are not voluntary because the employees receiving them did not volunteer to leave – they were involuntarily terminated. Therefore, some of the termination benefits paid were voluntary (to those who accepted the four-week benefits) and others were involuntary.

This requires the entity to apply Box C in the above decision tree.




In this scenario, the liability for the $3 million voluntary termination benefit is recognized when employee acceptance becomes irrevocable and the amount is estimable.

The liability for the $7 million involuntary portion is recognized as an other postemployment termination benefit when probable and estimable because it does not accumulate or vest. This is likely on or before the November 1, Year 1 announcement date depending on when the probability threshold is reached.

See section 4.4 for an overview of involuntary termination benefits and section 4.6 for the accounting for other postemployment termination benefits.

## 4.4 Involuntary termination: Overview

### Excerpt from ASC 712-10

**20 Glossary**

**Termination Benefits –** Benefits provided by an employer to employees in connection with their termination of employment. They may be either special termination benefits offered only for a short period of time or contractual benefits required by the terms of a plan only if a specified event, such as a plant closing, occurs.

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## Excerpt from ASC 420-10

**20 Glossary**

**One-Time Employee Termination Benefits –** Benefits provided to current employees that are involuntarily terminated under the terms of a one-time benefit arrangement.

A benefit not provided through a pension or postretirement benefit plan that is the result of an involuntary termination is accounted for under one of the following categories:

— contractual termination benefits (section 4.5);
— other postemployment benefits (section 4.6); or
— one-time termination benefits (section 4.7).

These categories are also relevant to the involuntary portion of a termination benefit that is separated into a voluntary and involuntary portion (see Question 4.3.40, Scenario 3).

The accounting considerations for termination benefits provided through a pension or postretirement benefit plan under Topic 715 are discussed in section 9.6.

## Excerpt from ASC 420-10

**05 Overview and Background**

**05-4** Certain postemployment benefit costs that may be associated with exit or disposal activities are covered by other Topics. The accounting for employee termination benefits will differ depending on whether the benefits are provided under a one-time benefit arrangement covered by this Topic or an ongoing benefit arrangement referred to in the following list. As indicated in paragraph 420-10-15-6, this Topic does not change the accounting for termination benefits covered by the following Topics and Subtopics:

a. Postemployment benefits provided through a pension or postretirement benefit plan (Subtopics 715-30 and 715-60 specify the accounting for those costs.)
b. Other nonretirement postemployment benefits covered by Topic 712
c. Special or contractual termination benefits covered by paragraphs 715-30-25-10 and 715-60-25-4 through 25-6
d. Individual deferred compensation arrangements that are addressed by paragraph 710-10-15-4(c)
e. Stock compensation plans addressed by Topic 718.

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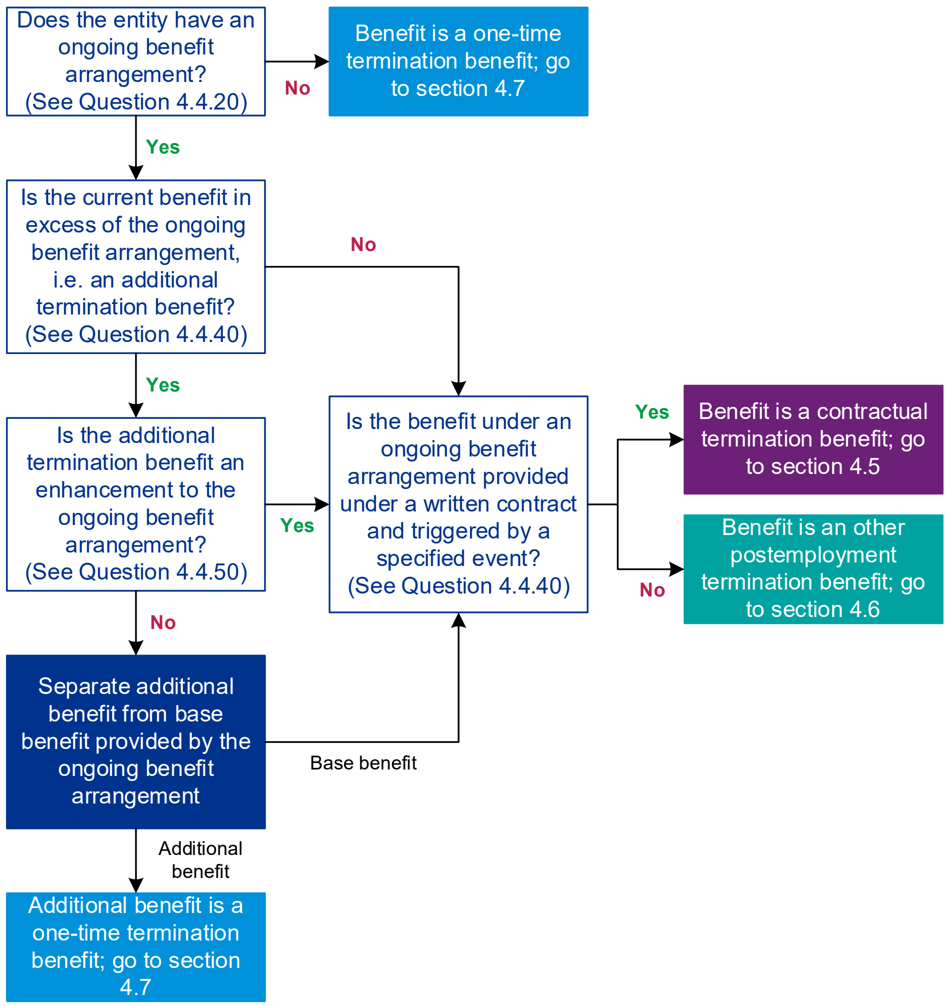
## Question 4.4.10
### How is the appropriate category for an involuntary termination benefit determined?

**Interpretive response:** The following decision tree summarizes the required analysis for determining the appropriate category. See also Question 4.4.50.




As this decision tree indicates, a termination benefit is a one-time termination benefit only if it is not paid as part of an ongoing benefit arrangement.

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## Question 4.4.20
### What constitutes an ongoing benefit arrangement?

**Interpretive response:** Under Topic 712, contractual termination benefits and other postemployment termination benefits are considered to be ongoing benefit arrangements. [420-10-05-4]

Under such arrangements, employees are in possession of sufficient information to have a valid expectation of the nature and amount of benefit that they would receive in the event of involuntary termination.

An ongoing benefit arrangement can be a written plan such as a formal severance plan or a widely distributed HR policy (e.g. an HR website or employee manual). Such a written plan may be used for contractual termination benefits and other postemployment termination benefits under Topic 712.

An ongoing benefit arrangement can also be achieved through a substantive plan for other postemployment benefits. A substantive plan would not be used for a contractual termination benefit arrangement.

## Question 4.4.30
### What constitutes a substantive plan?

**Interpretive response:** A substantive plan is one in which, in the absence of a written plan, the entity and its employees are able to understand the terms of the benefits that would be paid for involuntary termination. Indicators that an entity has a substantive plan include a history of paying termination benefits under an undistributed HR policy that describes the benefits, or a pattern of using a standard or substantially similar formula for paying termination benefits.

Based on these indicators, we believe an entity should be able to establish that the nature and duration of its past practices are sufficient to warrant a presumption that the employees understand the practice and the benefits that they will receive.

For example, an entity has routinely given terminated employees two weeks of severance payments during past reductions in force even though it has no stated policy. On this basis, employees may anticipate that they would receive two weeks of severance if terminated, and a substantive plan may exist regarding reductions in force. In contrast, if the entity has paid different types of termination benefits for past reductions in force, or has never paid any termination benefits, then it does not have a substantive plan.

We believe an entity should consider the following when determining whether similar termination benefits have been paid in the past:

- the nature or type of past and current benefits;
- the variables in the formula used to calculate past and current benefits; and
- the amount of past and current benefits.

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The following are examples.

— If the ongoing benefit arrangement provides severance payments based on employees' service time, a current termination benefit that provides healthcare benefits would not be similar in nature to the ongoing benefit arrangement.

— A current termination benefit based on years or months of service likely would be similar to historical benefits that were also based on years or months of service. This is the case even if the other variables in the formula used to compute the amount of benefits vary.

— When historical arrangements had been computed using a time-based service measurement, a current termination benefit likely would not be similar if it is not determined based on years or other time-based measurement of service (e.g. if it is a lump-sum termination benefit).

Absent evidence to the contrary, an ongoing benefit arrangement is presumed to exist if an entity has a past practice of providing termination benefits similar to the current benefit being analyzed.

This similarity presumption is rebuttable, but it suggests that most termination benefits fail to qualify as one-time termination benefits if past and current benefits are similar. This conclusion is consistent with our experience that relatively few employee termination benefit arrangements are one-time termination benefits.

## Question 4.4.40

### What constitutes a written plan that is triggered by a specified event?

**Interpretive response:** Topic 712 states that contractual benefits are those provided by an entity to employees in connection with their termination of employment as required by the terms of a plan only if a specified event (e.g. a plant closing) occurs. [712-10 Glossary]

We believe that such a plan should be written and include enough specificity to identify both the event that would trigger recognition of the contractual termination benefit and the amount that the employees should expect to receive.

We do not believe a past practice of providing a type of benefit or using a previously established formula would result in contractual termination benefits, but could instead be an other postemployment benefit; this is because contractual termination benefits are only triggered by a specified event.

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## Excerpt from ASC 420-10[1]

**55 Implementation Guidance and Illustrations**

**> Implementation Guidance**

**>> Determining Whether a One-Time Termination Benefit Is, in Substance, an Enhancement to an Ongoing Benefit Arrangement**

**55-1** Additional termination benefits may be included within the scope of this Subtopic as follows. In order to be considered an enhancement to an ongoing benefit arrangement and, therefore, subject to the provisions of the Topics referred to in paragraphs 420-10-05-4 and 420-10-15-6, the additional termination benefits must represent a revision to the ongoing arrangement that is not limited to a specified termination event or a specified future period. Absent evidence to the contrary, an ongoing benefit arrangement is presumed to exist if an entity has a past practice of providing similar termination benefits. Otherwise, the additional termination benefits should be considered **one-time employee termination benefits** and accounted for under the provisions of this Topic. See Example 5 (paragraph 420-10-55-16) for an illustration of such a determination.

**Note 1:** The above excerpt references 'Topics referred to in paragraphs 420-10-05-4 and 420-10-15-6'; those Topics include Topic 712.

## Question 4.4.50

### What is an additional involuntary termination benefit?

**Interpretive response:** When an entity provides involuntary termination benefits in addition to termination benefits provided under an ongoing plan, it must determine whether those additional benefits are one-time termination benefits in the scope of Topic 420 or an enhancement to an ongoing plan in the scope of Topic 712. To make this determination, the entity must first identify whether an additional benefit is being provided.

The entity performs a two-step analysis to determine whether there is an additional benefit.

— It first determines if the total termination benefits currently payable to employees being terminated exceed the benefits that would have been payable solely under the ongoing benefit arrangement.

— If the total current benefits exceed what would have been payable solely under the ongoing benefit arrangement, the excess is an additional benefit. The entity analyzes the additional benefit to determine whether it is an enhancement to the ongoing benefit arrangement or is intended to be limited only to the current, specific termination event. Question 4.4.60 explains how to analyze this second step.

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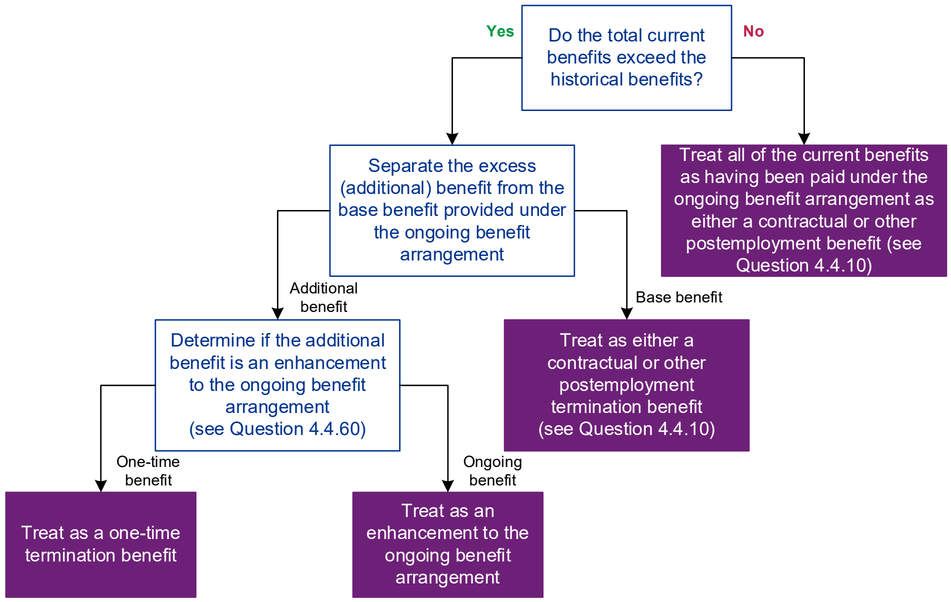
The following decision tree indicates how a current termination benefit is analyzed.




For example, there is an additional benefit to be analyzed if the current termination benefit provides two weeks of severance pay for each year of service and the ongoing benefit arrangement provides one week. The additional benefit is the excess over the ongoing benefit arrangement. Therefore, the entity must further analyze the additional benefit to determine if it is an enhancement to the ongoing benefit arrangement or a one-time termination benefit (see Question 4.4.60).

## Question 4.4.60

### When is the additional benefit an enhancement to the ongoing benefit arrangement?

**Interpretive response:** The additional benefit is considered an enhancement to the ongoing benefit arrangement if the additional benefit will apply to all future involuntary terminations. In contrast, if the additional benefit is limited to the current, specific termination event and is not intended to apply automatically to all future termination events, it is a one-time termination benefit (see section 4.7) and not an enhancement of the ongoing benefit arrangement.

Whether a current termination benefit is an enhancement to an ongoing benefit arrangement is highly dependent on the facts and the nature of the ongoing benefit arrangement, as the scenarios below indicate.

#### Scenario 1: Ongoing benefit arrangement is a formal written plan or policy

If an entity's ongoing benefit arrangement is a formal written plan or policy, evaluating an additional benefit offered in a current reduction in force would likely be based on whether the plan or policy had been amended to include the

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benefit enhancement – e.g. minutes or written formal amendment to the plan or company policy.

Failure to amend a formal plan or policy to include the additional benefit may indicate that the additional benefit is a one-time benefit that is not intended as a permanent enhancement of the formal plan.

**Scenario 2: Ongoing benefit arrangement is established through contract**

If the entity's ongoing benefit arrangement is established through contract, the additional benefit may be negotiated specific to each reduction in force. Therefore, the additional benefit would be, by definition, limited to a specified termination event or specified future period and accounted for as a one-time termination benefit.

**Scenario 3: Ongoing benefit arrangement is a substantive plan**

If the entity's base benefit arrangement is a substantive plan, the entity has to evaluate the facts and circumstances to determine whether the additional benefit is limited to this specific termination event or will apply to all future terminations.

For example, if the substantive plan is an undistributed HR policy, a formal amendment to the policy would evidence that the additional benefit is not limited to a specified termination event or specified future period and is therefore an enhancement to the ongoing benefit arrangement.

## Example 4.4.10
### Additional benefit analyzed

ABC Corp. has a severance plan that provides each employee with benefits that accumulate based on years of service. On December 15, Year 8, ABC determines that it will undergo a restructuring and as a result will initiate a reduction in force (RIF).

In addition to the severance payments, it will pay under its preexisting severance plan to all employees being terminated, ABC and a key employee negotiate an additional $1 million severance benefit and a two-year noncompete agreement.

ABC must determine if this additional $1 million benefit is a one-time termination benefit or an enhancement to its preexisting severance plan. Because this is an additional negotiated benefit that applies only to this key employee and there is no expectation it will be offered in the future to similar employees and in future RIFs, it is a one-time additional termination benefit under Topic 420, and not an enhancement to the ongoing benefit arrangement under Topic 712.

In addition, under Topic 350, the noncompete agreement is considered an intangible asset if there are probable future economic benefits controlled by the entity. Judgment is required to determine if it is probable that a noncompete agreement will provide future economic benefits to the entity and whether the entity has the intent and ability to enforce the agreement. See AICPA Technical Q&A 2250.06 for further considerations.

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## Question 4.4.70

### Does an ongoing benefit arrangement for one component of an entity create a substantive ongoing benefit arrangement for another?

**Interpretive response:** Components of an entity include subsidiaries, segments and business units as well as any other components. If one component is incurring termination benefits for the first time, the entity must determine whether other components have provided similar termination benefits that constitute a substantive ongoing benefit arrangement.

We believe that an entity then evaluates whether the past practice of other components within the consolidated group establishes a substantive plan for the entity as a whole or for a geographic area. Part of that evaluation includes considering relevant labor laws and may include consulting legal counsel to determine whether an entity's past practice for some components creates an obligation to provide similar benefit arrangements for other components of the consolidated group.

This analysis is relevant to both the consolidated financial statements and the separate stand-alone financial statements of the component.

## Example 4.4.20

### Historical severance payments of one subsidiary attributable to another subsidiary

ABC Corp. has two subsidiaries, Sub 1 and Sub 2. Sub 1 is located in close proximity to Sub 2, which is ABC's largest subsidiary.

ABC plans to restructure the operations of Sub 1 and terminate certain employees. The employees in Sub 2 received termination benefits in previous restructurings of that subsidiary's operations.

Legal counsel has advised that the severance benefits history of Sub 2 increases the likelihood that employees of Sub 1 would be able to assert a meritorious case under the relevant labor laws that they are entitled to benefits commensurate with employees terminated by Sub 2.

As a result of legal counsel's assessment, ABC's management concludes that a substantive ongoing benefit arrangement exists for the consolidated group. This means that the termination benefits Sub 1 will pay to its terminated employees will be in the scope of Topic 712 other postemployment benefits, not one-time termination benefits under Topic 420.

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## Question 4.4.80

### What must be communicated to affected employees for an entity to recognize a liability for involuntary termination benefits?

**Interpretive response:** The following table outlines the communication considerations for the three types of involuntary termination benefits.

| Type of benefit | Topic | Communication considerations | Communication of termination event required before liability recognition? |
|---|---|---|---|
| Contractual termination benefits | 712 | Mutual understanding of termination benefits established through a widely available written plan (ongoing benefit arrangement). | No |
| Other postemployment benefits | 712 | Mutual understanding of benefits established through a widely available written or substantive plan (ongoing benefit arrangement). | No |
| One-time termination benefits | 420 | Mutual understanding of benefits established through communication of one-time termination arrangement. | Yes |

#### Topic 712

We believe the benefits offered under Topic 712 are part of an exchange transaction between the entity and the employees. This requires both parties to have a mutual understanding of the amount and type of benefits the employees would receive in the event of an involuntary termination.

Because termination benefits are subject to an ongoing benefit arrangement, the availability of a plan (written or substantive – see Question 4.4.20) gives the employees sufficient information to calculate their termination benefits and a mutual understanding of the terms of the exchange is achieved. Therefore, the liability could be recognized before the entity announces a restructuring or headcount reduction.

#### Topic 420

Topic 420 requires the entity to meet the following four criteria and communicate to the employees before liability recognition: [420-10-25-4]

— management commits to the plan of termination;

— the plan identifies the number of employees to be terminated, their job classifications or functions and their locations, and the expected completion date;

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— the plan establishes the terms of the benefit arrangement in sufficient detail to enable the employees to determine the type and amount of benefits they will receive; and

— actions required to complete the plan indicate it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

Given that the benefits relate to a specific event and there is no ongoing benefit arrangement, communication of the termination event is required to recognize the liability. See section 4.7 for further discussion.

### Question 4.4.90

**What communication is required to recognize an enhancement to an ongoing benefit arrangement?**

**Interpretive response:** Based on informal discussions with the FASB staff, we understand the staff believes that enhancements to an ongoing benefit arrangement should be subject to the communication guidance discussed in Topic 420 (see Question 4.7.20).

Therefore, an entity should communicate an enhancement to an ongoing benefit arrangement in sufficient detail to enable potentially affected employees to determine the benefits they would receive if they are terminated before the entity recognizes a liability for the enhancement.

Because the base benefits are deemed to have been communicated as part of the plan and the enhancement to the benefit arrangement must be communicated to employees to recognize it as a liability, it is possible that a benefit enhancement will not be recognized in the same period as the base benefits.

## 4.5 Involuntary termination: Contractual termination benefits

### 4.5.10 Overview

**Excerpt from ASC 712-10**

**25 Recognition**

**> Contractual Termination Benefits**

**25-2** An employer that provides contractual **termination benefits** shall recognize a liability and a loss when it is probable that employees will be entitled to benefits and the amount can be reasonably estimated. The cost of termination benefits recognized as a liability and a loss shall include the amount of any lump-sum payments and the present value of any expected future

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payments.

**25-3** A situation involving special or contractual termination benefits may also constitute a curtailment to be accounted for under paragraphs 715-30-35-92 through 35-96 and 715-60-35-161 through 35-171.

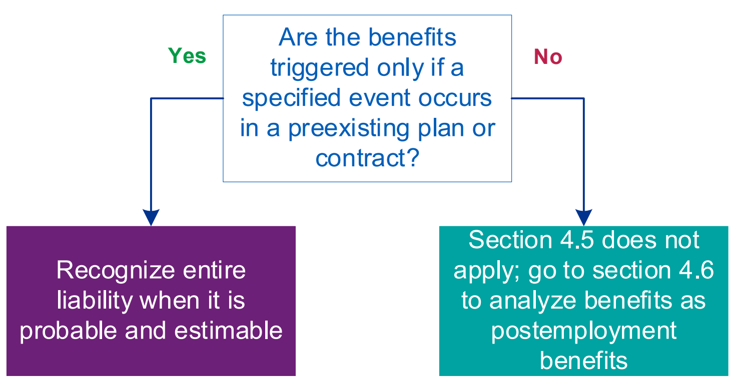
Contractual termination benefits are provided to employees who are involuntarily terminated when a triggering event occurs that is specified in the terms of a plan. A common example is an union contract that includes provisions to pay severance in the event of a plant or office closure. [712-10 Glossary]

Contrast contractual termination benefits, which are payable under a plan when an event specified in the plan occurs, with other postemployment benefits. Other postemployment benefits may also be payable under a plan as a result of involuntary termination but are not triggered by an event specified in the plan (see section 4.6).

## Question 4.5.10

### When is a termination arrangement a contractual termination benefit?

**Interpretive response:** The following decision tree explains when a contractual termination benefit arrangement exists.




The box on the left contains the recognition principle for contractual termination benefits. Under this principle, an entity recognizes a liability for the benefits when: [712-10-25-2]

— it is probable that employees will be entitled to benefits; and
— the amount can be reasonably estimated.

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## Question 4.5.20

**How are termination indemnity benefits payable outside the US accounted for?**

**Background:** An entity that operates outside the US often provides termination allowances or severance indemnities to involuntarily terminated employees based on law, local custom, entity policy or contract.

**Interpretive response:** The FASB staff has indicated that when these benefits are paid only to employees who are involuntarily terminated due to a specific event, they should be viewed as contractual termination benefits. Therefore, a liability and an expense should be recognized when it is probable that the employees will receive benefits and the amount can be reasonably estimated.

If the plan is in substance a pension plan (e.g. benefits are paid for virtually all employee terminations), it is accounted for as a pension plan, under the provisions of Topic 715. See chapter 6.

# 4.6 Involuntary termination: Other postemployment benefits

## 4.6.10 Overview

### Excerpt from ASC 712-10

**20 Glossary**

**Inactive Employees –** Employees who are not currently rendering service to the employer and who have not been terminated. They include those who have been laid off and those on disability leave, regardless of whether they are expected to return to active status.

**Other Postemployment Benefits –** Benefits, other than special or contractual termination benefits, that are provided by an employer to former or **inactive employees** after employment but before retirement including benefits provided to beneficiaries and covered dependents.

**05 Overview and Background**

**> Other Postemployment Benefits**

**05-4** Other postemployment benefits include all benefits listed in the following paragraph. These include benefits that are paid before retirement and not payable from a pension or other postretirement plan.

**05-5** Other postemployment benefits include, but are not limited to, the following:

a. Salary continuation
b. Supplemental unemployment benefits

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c. Severance benefits
d. Disability-related benefits (including workers' compensation)
e. Job training and counseling
f. Continuation of benefits such as health care benefits and life insurance coverage.

**05-6** Generally, other postemployment benefits are part of the compensation provided to an employee in exchange for service.

**25 Recognition**

**> Determining the Timing and Method of Accruing Other Postemployment Benefits**

**25-4 Other postemployment benefits** that meet the conditions in paragraph 710-10-25-1 shall be accounted for in accordance with Subtopic 710-10.

**25-5** Other postemployment benefits that are within the scope of this Subtopic and that do not meet the conditions in paragraph 710-10-25-1 shall be accounted for in accordance with paragraph 450-20-25-2. For example, an employer may provide any former employee on permanent disability with continued medical insurance coverage until that employee meets the requirements for participation in the employer's postretirement medical plan. If the level of benefits provided is the same for any disabled employee regardless of years of service, the cost of those benefits should be recognized when the event causing a permanent disability occurs and a reasonable estimate can be made as specified by that paragraph.

Even though the name 'other postemployment benefits' may seem broad, it is a defined term that applies to a subset of benefits. Other postemployment benefits are benefits paid under an ongoing arrangement or substantive plan to: [712-10 Glossary]

— former employees;
— inactive employees – i.e. those who are not currently rendering services to the entity but who have not been terminated; this is regardless of whether they are expected to return to active status – e.g. laid off employees and those on disability leave); or
— beneficiaries and covered dependents of former or inactive employees.

However, other postemployment benefits do not include payments to the above individuals if the payments meet the requirements of special or contractual termination benefits (see sections 4.3 and 4.5, respectively). Other postemployment benefits also exclude termination benefits provided through a pension or postretirement benefit plan, which are accounted for under Topic 715 and discussed in section 9.6.

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## Question 4.6.10
### What is the difference between a contractual and an other postemployment termination benefit?

**Interpretive response:** A contractual termination benefit requires a written plan (contract or widely distributed HR policy) and involuntary termination benefits that are triggered by an event that is specified in the plan.

An other postemployment termination benefit is an ongoing benefit arrangement that requires a plan that is either written (contract or widely distributed HR policy) or substantive. The benefits are not dependent on a specified event documented in the plan occurring.

## Question 4.6.20
### How are other postemployment benefits accounted for?

**Interpretive response:** Topic 712 is the Codification Topic that addresses nonretirement other postemployment benefits. However, it refers to the application of certain paragraphs in Topic 710 and Topic 450 to determine the accounting for such benefits.

If other postemployment benefits vest or accumulate, they are accounted for using the same model as compensated absences under Topic 710. Otherwise, they are accounted for under the loss contingency model outlined in Subtopic 450-20, which requires that the liability is recorded if the condition currently exists, is probable and estimable. [710-10-25-1, 450-20-25-2]

The following diagram illustrates how the features of an involuntary postemployment benefit arrangement could lead to the different accounting conclusions under Topic 710 and Topic 450.

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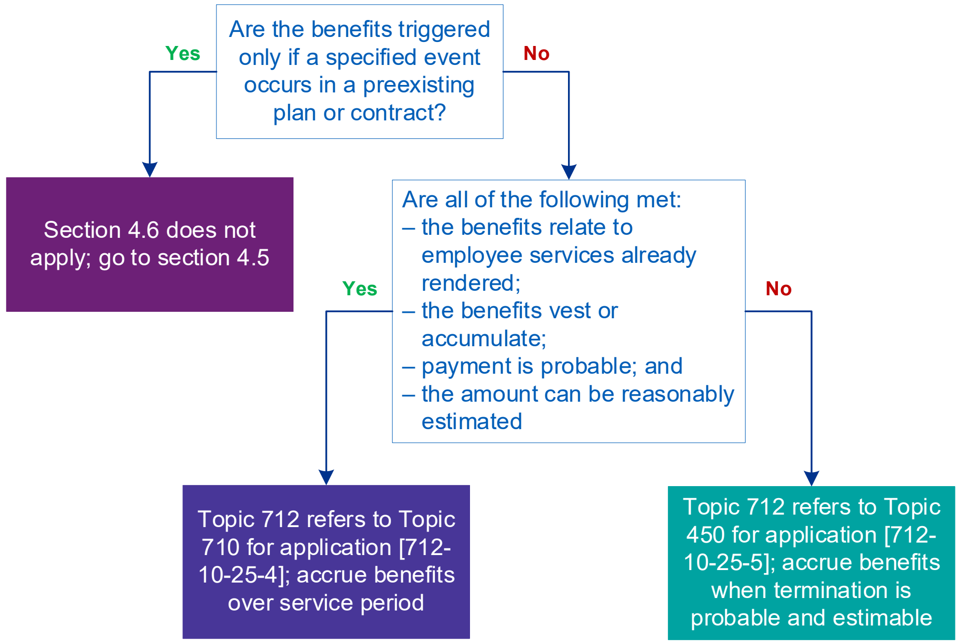


## 4.6.20 Accounting for other postemployment benefits under Topic 710

If an other postemployment benefit meets the conditions in Topic 710, it is accounted for under that Topic. If it does not meet these conditions, it is accounted for under Topic 450.

There are four conditions that must be met to account for an other postemployment benefit under Topic 710:

- the benefits relate to employees' services already rendered;
- the benefits vest or accumulate;
- payment is probable;
- the amount is estimable.

If the other postemployment benefit is a vesting or accumulating right, and is probable and estimable, the expense and liability will be recognized as the employee's service is rendered (i.e. over the service period). [710-10-25-2]

### Question 4.6.30

**What is a vesting benefit?**

**Interpretive response:** Vesting benefits are those for which the entity has an obligation to make payment if the benefits have been earned or vested (e.g.

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vacation accrual), even if an employee terminates. They are not contingent on an employee's future service. See also Question 3.2.20. [710-10-25-1]

## Question 4.6.40
### What is an accumulating benefit?

**Interpretive response:** Accumulating benefits are those that increase based on the length of an employee's service and not based on the level of an employee's salary.

For example, an employee who receives a week of severance for every year they are with the entity would be in receipt of an accumulating benefit. An accumulating benefit would also exist if the benefit formula is not based on an annual accumulation but is still based on time of service – e.g. an employee who receives a week of severance for the first three years of employment, and two weeks of severance for every year thereafter.

In contrast, we believe a benefit equal to a percentage of salary regardless of years of service is not an accumulating benefit even if there is an annual merit increase. This is because the benefit formula is not based on years of service. See Question 3.2.20.

## Example 4.6.10
### Accumulating termination benefits

ABC Corp. has a severance plan that provides each employee with benefits that accumulate based on years of service. The plan provides each employee with two weeks of severance for every year of service on an involuntary termination of employment. No benefits are payable if the employee voluntarily terminates. The written plan is distributed to all employees at the date of hire.

On December 15, Year 8, ABC determines that it will undergo a restructuring, and as part of the restructuring it will initiate a reduction in force (RIF). Management can reasonably estimate the expected number of involuntary terminations that will occur. The entity's year-end is December 31. The RIF is expected to occur on February 15, Year 9.

#### Analysis

Because the benefits are accumulating, they are recognized under Topic 710 once they are probable and estimable, and the employees render the services until their termination date.

The written termination plan was distributed on the date of hire to all employees, which established a mutual understanding of the terms of the benefit arrangement. Further, ABC's decision to undertake the RIF on December 15, Year 8 makes it probable that the benefits will be paid and the amount can be reasonably estimated. Communication of the RIF to the

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impacted employees does not need to occur before recognition because these benefits are under Topic 710.

ABC therefore recognizes a liability in December Year 8 for the cost of benefits earned by employees' services rendered through the end of its fiscal period. The liability for the cost of the benefits is increased in Q1 of the following fiscal year, through February 15, Year 9, for the additional services rendered by the employees to be terminated.

Question 4.6.50

**When is a termination event probable and estimable?**

**Interpretive response:** The determination of whether a termination event is probable and estimable is facts and circumstances dependent.

We believe that if an entity has implemented occasional but unpredictable severance programs in its past, there is likely insufficient information to assume the timing or extent of any future terminations and therefore such a liability is not probable or estimable. The liability for any future terminations would likely not be probable and estimable until the entity has made the decision to terminate employees, meaning the liability would not be recognized until that time.

In contrast, we believe a liability may be probable and estimable before a decision has been made to terminate employees if an entity has a more predictable pattern of past severance programs that provides sufficient information to assume the timing or extent of any future terminations. This is more likely in large organizations that undertake frequent small reorganizations in the normal course of their business operations.

## 4.6.30 Accounting for other postemployment benefits under Subtopic 450-20

**Excerpt from ASC 450-20**

**25 Recognition**

**25-2** An estimated loss from a loss contingency shall be accrued by a charge to income if both of the following conditions are met:

a. Information available before the financial statements are issued or are available to be issued (as discussed in Section 855-10-25) indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements. Date of the financial statements means the end of the most recent accounting period for which financial statements are being presented. It is implicit in this condition that it must

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be probable that one or more future events will occur confirming the fact of the loss.

b. The amount of loss can be reasonably estimated.

The purpose of those conditions is to require accrual of losses when they are reasonably estimable and relate to the current or a prior period. Paragraphs 450-20-55-1 through 55-17 and Examples 1–2 (see paragraphs 450-20-55-18 through 55-35) illustrate the application of the conditions. As discussed in paragraph 450-20-50-5, disclosure is preferable to accrual when a reasonable estimate of loss cannot be made. Further, even losses that are reasonably estimable shall not be accrued if it is not probable that an asset has been impaired or a liability has been incurred at the date of an entity's financial statements because those losses relate to a future period rather than the current or a prior period. Attribution of a loss to events or activities of the current or prior periods is an element of asset impairment or liability incurrence.

Under Topic 712, if a termination benefit does not meet the criteria of Topic 710 (i.e. does not vest or accumulate) and will not be provided through a pension or postretirement benefit plan, then Topic 450's loss contingency model applies. [712-10-25-5]

Under Subtopic 450-20, an entity recognizes a liability when the obligation is probable and estimable as of the date of the financial statements. [450-20-25-2]

## Question 4.6.60

### How is the loss contingency model applied to other postemployment benefits?

**Interpretive response:** Under the loss contingency model in Subtopic 450-20, an entity recognizes a liability when the payment of benefits is both probable and estimable.

In determining whether the obligation is probable, the entity considers whether the event or condition that would lead to a termination liability has occurred before the date of the financial statements. For example, if the employees are being terminated due to a plant closure, the entity considers whether the decision was made before period-end and whether that event or condition meets the probability threshold outlined in Topic 450. [450-20-25]

Estimating the liability is generally based on the formula laid out in the preexisting plan or as a result of past practice.

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## 4.6.40 Non-severance other postemployment benefits

### Question 4.6.70
**How are medical benefits provided to employees under a long-term disability plan accounted for?**

**Background:** Medical benefits are provided to employees under a long-term disability plan. When an employee retires, the medical benefits are provided under the entity's retirement medical plan. The normal retirement age for the entity's employees is 65.

**Interpretive response:** Long-term disability plans are accounted for under Topic 712 as an other postemployment benefit if not provided as part of a postretirement medical plan.

If the employees' rights to these benefits do not accumulate or vest, Subtopic 450-20 applies and the entity records the liability when it is probable that the obligation has been incurred and the amount can be reasonably estimated. In this case, the entity would accrue the cost of the benefits at the date of the disability. If the employees' rights to these benefits accumulate or vest (e.g. they increase based on years of service) and the other criteria in Topic 710 are met, the entity accrues a liability as the employees render services.

The long-term disability obligation recognized under Topic 712 relates to former or inactive employees but before retirement, in this example through the age of 64. When disability benefits are provided as part of a postretirement medical plan, they are included in the measurement of the APBO under Topic 715. See chapter 6 for further discussion.

### Question 4.6.80
**Is a furlough arrangement accounted for under Topic 710 or Topic 712?**

**Interpretive response:** If a furlough arrangement provides benefits that vest or accumulate, an accrual is recognized as services are rendered as long as the furlough costs are probable and reasonably estimable under Topic 710. However, if furlough benefits do not vest or accumulate, Topic 710 does not apply, but the furlough costs are recognized similarly in that it is when they are probable and estimable under Topic 712, which also refers to paragraph 450-20-25-2 for guidance on when to accrue the furlough benefits.

The first step in determining the recognition of the furlough costs is to determine if the employees are considered active during the furlough period.

There is no definition of an active employee, but Topic 712 applies to other postemployment benefits provided to former or inactive employees. It defines inactive employees as those that are not rendering service to their employer and who have not been terminated. Factors to consider in determining whether an employee is active or inactive include the following (not exhaustive).

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| **Indicators that the employee may be considered *active* during the furlough period** | **Indicators that the employee may be considered *inactive* during the furlough period** |
|---|---|
| The employee is required to perform activities that benefit the entity during the furlough period to remain eligible to receive benefits. | The employee is eligible to obtain unemployment benefits while receiving furlough benefits. |
| The terms of the furlough arrangement require the employee to stand ready to return to work while receiving furlough benefits. | The terms of the furlough arrangement permit the employee to seek employment at another entity while receiving furlough benefits. |
| The employee is expected to be compensated without work for a relatively shorter period of time. | The employee is expected to be compensated without work for a relatively longer period of time. |
| | The communications from the entity to the furloughed workforce encourage the employee to find other work or indicate that the employee's job cannot be guaranteed. |

If an entity determines that the furloughed employees are active, they are accounted for under Topic 710. If the benefits for active employees vest or accumulate, they are recognized as services are rendered as long as the costs are probable and reasonably estimable. If the furloughed employees are active but the benefits do not vest or accumulate, the costs are recognized as incurred.

If an entity determines that furloughed employees are inactive, furlough benefit costs are accrued when they are probable and reasonably estimable. Typically, a furlough arrangement would be considered probable if it has been communicated to the employees. However, estimating the amount of the benefits could be more challenging depending on factors such as:

- whether the furlough period is for a fixed minimum period of time or indeterminate; or
- whether it is expected that employees will voluntarily terminate during the furlough period and no longer be entitled to benefits.

If furlough costs are considered probable and reasonably estimable, an accrual for furlough costs is recognized when the event creating the obligations occurs (e.g. an announcement by the entity). However, if the entity concludes that the liability is not probable and reasonably estimable, additional disclosures would be expected under Subtopic 450-20 if there is at least a reasonable possibility that a loss or an additional loss may be incurred. [450-20-50-3 – 50-6]

The following decision tree outlines the various Topic 710 and Topic 712 considerations in determining the appropriate recognition for furlough arrangements.

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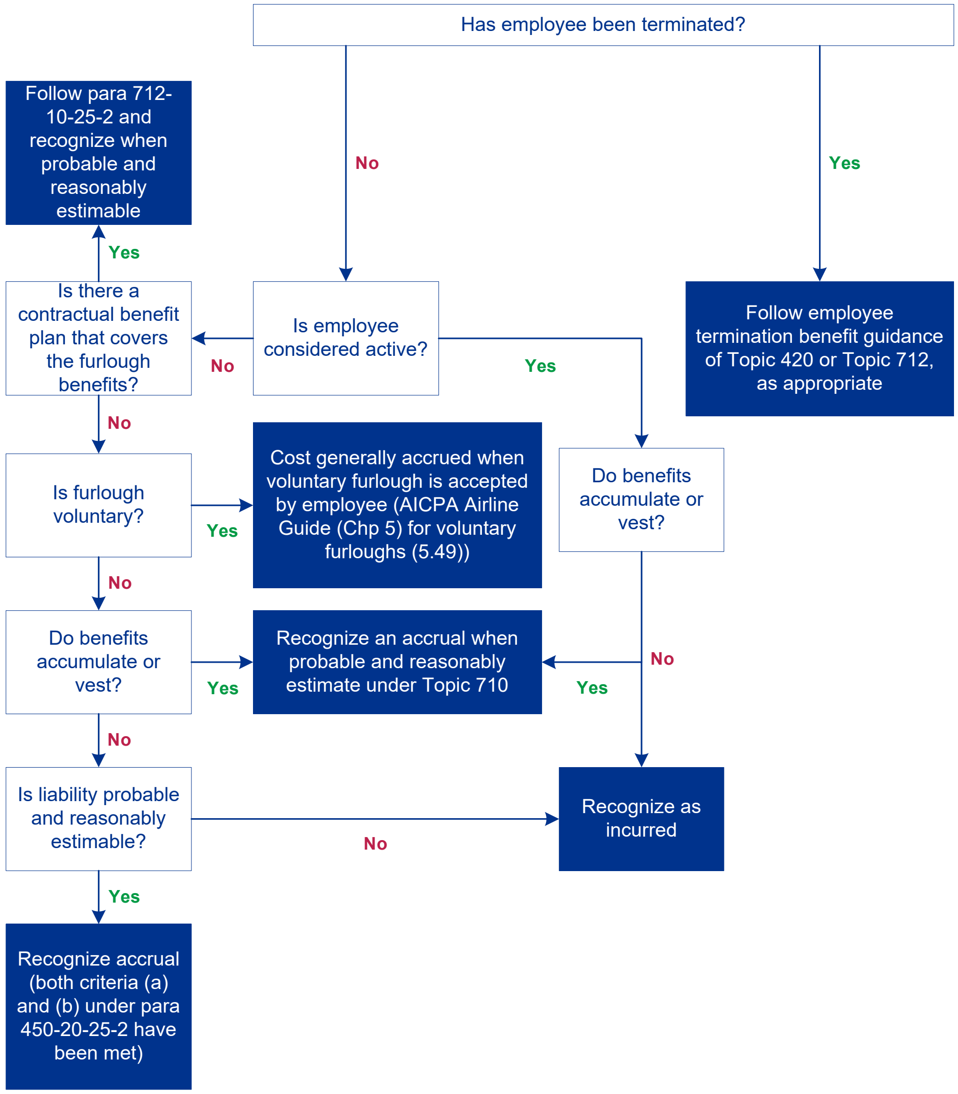


## 4.6.50 Measuring the obligation

### Excerpt from ASC 712-10

**35 Subsequent Measurement**

**35-1** To the extent that similar issues apply to other postemployment benefit plans, employers may refer to Subtopics 715-30 and 715-60 for guidance in measuring their other postemployment obligations in compliance with the requirements of this Subtopic. As a result, the use of discounting in measuring other postemployment benefit obligations will continue to be permitted but not required.

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Once a liability for an other postemployment benefits has been recognized under either the Topic 710 or the Subtopic 450-20 model, the liability must be measured.

## Question 4.6.90#

**Can discounting be applied in measuring an other postemployment benefit liability?**

**Interpretive response:** We understand the SEC expects an entity to discount a liability for other postemployment benefits only if the payments for the benefits are fixed or reliably determinable, and an appropriate discount rate is used.

### Benefits accounted for under Topic 710

The liability for other postemployment benefits accounted for under Topic 710 may be discounted based on the guidance in Topic 715. This means the discount rate may be derived from a hypothetical portfolio of high-quality debt instruments with maturities similar to the payments required under the benefit arrangement and is reevaluated at each measurement date as appropriate.

All of the other measurement provisions in Topic 715 must also be applied. Examples of these other measurement provisions involve attribution methods and the accounting for gains and losses.

### Benefits accounted for under Subtopic 450-20

The liability for other postemployment benefits accounted for under Subtopic 450-20 may also be discounted. The selection of an appropriate discount rate is an accounting policy election and the method used to determine that rate must be applied consistently.

If an entity accounts for the other postemployment benefits under the provisions of Subtopic 450 because the benefits do not accumulate or vest, the SEC staff believes the discount rate used should result in a recorded liability equal to the amount that would be paid currently to settle the liability. This SEC position was stated during a speech at the 1995 AICPA National Conference on Current SEC Developments.

In the absence of a directly observable settlement rate, the SEC staff has indicated in informal discussions that it would not object to using the following rates.

— If the cash flows are reasonably predictable as to timing and amount: either a discount rate that does not exceed the risk-free rate or a discount rate developed under Topic 715. [715-30-35-44]
— If the cash flows are not reasonably predictable as to timing or amount: a discount rate that does not exceed the risk-free rate.

The risk-free rate is the interest rate on direct Treasury obligations of the US government. [815-20-25-6(a)]

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Question 4.6.100
**Do the Subtopic 450-20 disclosures apply to other postemployment benefits?**

**Interpretive response:** Yes, if an entity accounts for an other postemployment benefit under Subtopic 450-20, its disclosure requirements also apply to those arrangements.

## 4.7 One-time termination benefits

### 4.7.10 Overview

**Excerpt from ASC 420-10**

**05 Overview and Background**

**05-1** The Exit or Disposal Cost Obligations Topic addresses financial accounting and reporting for costs associated with exit or disposal activities. An exit activity includes but is not limited to a **restructuring**.

**05-2** Those costs include, but are not limited to, the following:

a. Involuntary employee termination benefits pursuant to a one-time benefit arrangement that, in substance, is not an ongoing benefit arrangement or an individual deferred compensation contract
b. Costs to terminate a contract that is not a **lease**
c. Other associated costs, including costs to consolidate or close facilities and relocate employees.

**05-3** This Topic addresses when to recognize a liability for a cost associated with an exit or disposal activity. An entity's commitment to an exit or disposal plan, by itself, does not create a present obligation to others that meets the definition of a liability.

**15 Scope and Scope Exceptions**

**> Entities**

**15-2** The guidance in the Exit or Disposal Cost Obligations Topic applies to all entities.

**> Transactions**

**15-3** The guidance in the Exit or Disposal Cost Obligations Topic applies to the following transactions and activities:

a. Termination benefits provided to current employees that are involuntarily terminated under the terms of a benefit arrangement that, in substance, is not an ongoing benefit arrangement or an individual deferred compensation contract (referred to as **one-time employee termination benefits**)

…

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**> Other Considerations**

**15-6** Certain postemployment benefits are covered by other Topics or Subtopics. This Topic does not change the accounting for termination benefits, including one-time termination benefits granted in the form of an enhancement to an ongoing benefit arrangement, covered by the following:

a. Subtopic 715-30
b. Subtopic 715-60
c. Topic 712, which includes guidance on accounting for special or contractual termination benefits, payable before retirement and not payable from a pension or other postretirement plan, as indicated in paragraph 712-10-15-3
d. Topic 710, which includes guidance on accounting for individual deferred compensation arrangements
e. Topic 718, which addresses stock compensation plans.

Topic 420 applies to one-time employee termination benefits, which this Handbook refers to as simply one-time termination benefits. These one-time termination benefits may be incurred as part of an exit or disposal activity that may be a restructuring.

For termination benefits to qualify as one-time termination benefits, they: [420-10 Glossary]

— must be paid to current employees who are being involuntarily terminated; and
— cannot be paid under an ongoing benefit arrangement or an individual deferred compensation contract (see section 4.4).

If nonretirement termination benefits are provided under an ongoing benefit arrangement to employees being involuntarily terminated, they are accounted for under Topic 712 either as contractual termination benefits (see section 4.5) or other postemployment benefits (see section 4.6). In this case, they are not one-time termination benefits accounted for under Topic 420. [420-10-15-6]

## Question 4.7.10

### What is the difference between a one-time termination and an ongoing benefit arrangement?

**Interpretive response:** A one-time termination benefit arrangement is a plan that is created specifically for a current termination event and is in the scope of Topic 420. An ongoing benefit arrangement is a plan that establishes a mutual understanding of the benefits that will be paid upon involuntary termination and is in the scope of Topic 712. The ongoing benefit arrangement is established either through a written document or a past practice and is not created specifically for a current termination event.

An entity must carefully evaluate any current benefit arrangements to determine whether the benefits are an enhancement to any of the entity's existing plans under Topic 712 or are one-time termination benefits under 420. See Question 4.4.60 for further discussion.

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Subtopic 420-10's Example 5 (reproduced directly below) illustrates this difference.

## Excerpt from ASC 420-10

**55 Implementation Guidance and Illustrations**

**>> Example 5: Determining Whether a One-Time Employee Termination Benefit Is, in Substance, an Enhancement to an Ongoing Benefit Arrangement**

**55-16** This Example is in the context of a typical involuntary termination benefit plan subject to the provisions of Topic 712.

**55-17** An entity has a written involuntary termination benefit plan that is distributed to all of its employees at date of hire. The plan provides that upon an involuntary termination of employment for other than cause, each terminated employee will receive one week of severance pay for every year of service. In the current year, the entity initiates a reduction in force. In connection with that reduction in force, management decides to amend the ongoing benefit arrangement to provide an additional two weeks of severance pay for every year of service. That additional benefit applies to all employees affected by this reduction in force and all future involuntary terminations.

**55-18** Based on an evaluation of the circumstances, the additional termination benefit is considered an enhancement to the ongoing termination benefit plan because it represents a revision to the ongoing plan that applies to all future involuntary terminations. That is, the amendment to the ongoing benefit arrangement is not limited to a specified termination event or specified future period. Therefore, the additional termination benefit should be accounted for in accordance with Topic 712, which requires that a liability for certain termination benefits provided under an ongoing benefit arrangement be recognized when the likelihood of future settlement is probable, as that term is used in Topic 450. Thus, termination benefits that, based on the benefit formula, are attributable to past service may be recognized initially at a plan date if at that date it becomes probable that employees will be terminated and receive termination benefits under the benefit arrangement (the benefit arrangement having been communicated to employees previously, for example, at the date of hire).

**55-19** If this Example were changed to indicate that the additional termination benefits only applied to the employees affected by that reduction in force and similar benefits had not been provided for a past reduction in force, those additional benefits would not be considered an enhancement to the ongoing termination benefit plan and would, therefore, be accounted for under the guidance in this Subtopic. See paragraph 420-10-55-1 for additional information regarding making this determination.

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## 4.7.20 Recognizing a one-time termination benefit liability

### Excerpt from ASC 420-10

**20 Glossary**

**Legal Notification Period –** The notification period that an entity is required to provide to employees in advance of a specified termination event as a result of an existing law, statute, or contract.

**25 Recognition**

**> One-Time Employee Termination Benefits**

**25-4** An arrangement for **one-time employee termination benefits** exists at the date the plan of termination meets all of the following criteria and has been communicated to employees (referred to as the **communication date**):

a. Management, having the authority to approve the action, commits to a plan of termination.
b. The plan identifies the number of employees to be terminated, their job classifications or functions and their locations, and the expected completion date.
c. The plan establishes the terms of the benefit arrangement, including the benefits that employees will receive upon termination (including but not limited to cash payments), in sufficient detail to enable employees to determine the type and amount of benefits they will receive if they are involuntarily terminated.
d. Actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

**25-5** An entity's communication of a promise to provide one-time employee termination benefits is a promise that creates an obligation at the communication date to provide the termination benefits if employees are terminated.

**25-6** The timing of recognition for one-time employee termination benefits depends on whether employees are required to render service until they are terminated in order to receive the termination benefits and, if so, whether employees will be retained to render service beyond a minimum retention period.

**25-7** The minimum retention period shall not exceed the **legal notification period**, or in the absence of a legal notification requirement, 60 days. For example, in the United States, the Worker Adjustment and Retraining Notification Act, as of 2002 required entities with 100 or more employees to notify employees 60 days in advance of covered plant closings and mass layoffs, unless otherwise specified. Collective bargaining or other labor contracts may require different notification periods.

**25-8** If employees are not required to render service until they are terminated in order to receive the termination benefits (that is, if employees are entitled to receive the termination benefits regardless of when they leave) or if employees will not be retained to render service beyond the minimum

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retention period, a liability for the termination benefits shall be recognized at the communication date. For an illustration of this situation, see Example 1 (paragraph 420-10-55-2).

**25-9** As indicated in paragraph 420-10-30-6, if employees are required to render service until they are terminated in order to receive the termination benefits and will be retained to render service beyond the minimum retention period, a liability for the termination benefits shall be measured initially at the communication date based on the fair value of the liability as of the termination date, and shall be recognized ratably over the future service period. For an illustration of this situation, see Example 2 (paragraph 420-10-55-4).

**25-10** If a plan of termination that meets the criteria in paragraph 420-10-25-4 includes both involuntary termination benefits and termination benefits offered for a short period of time in exchange for employees' voluntary termination of service, a liability for the involuntary termination benefits shall be recognized in accordance with this Subtopic. A liability for the incremental voluntary termination benefits (the excess of the voluntary termination benefit amount over the involuntary termination benefit amount) shall be recognized in accordance with paragraphs 712-10-25-1 through 25-3. For an illustration of this situation, see Example 3 (paragraph 420-10-55-9).

## Question 4.7.20

**What are the requirements to have a communication date?**

**Interpretive response:** Topic 420 requires that one-time termination benefits be communicated to affected employees in sufficient detail to enable them to determine the benefits they will receive if they are terminated. A liability for these benefits cannot be recognized before this communication event. [420-10-25-5]

## Question 4.7.30

**Is communicating details of one-time termination benefits to elected employee representatives a communication event under Topic 420?**

**Interpretive response:** Topic 420 does not explicitly address whether communicating details of the benefits to elected representatives of potentially affected employees (e.g. union representatives) satisfies the communication requirement. However, Topic 420 refers to certain provisions of the Worker Adjustment and Retraining Notification Act (WARN Act) in the US and similar advance notification requirements outside the US as the basis for the minimum retention period. The WARN Act requires entities subject to its requirements to provide each representative of the affected employees or, if there is no such representative, each affected employee, at least 60 days' advance notice of planned plant closings or mass layoffs. [420-10-25-7]

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Determining whether communication to employee representatives creates an obligation to perform (i.e. promissory estoppel or its equivalent outside the US) is a legal question that depends on evaluating particular facts and circumstances and interpreting local labor law. In addition, this determination may not be the same from entity to entity or even within a particular entity if different laws apply to different groups of employees.

As a result, an entity may need to obtain an opinion from legal counsel about the communications required under the applicable laws to demonstrate that a communication event has occurred under Topic 420.

## Question 4.7.40

### What is the communication date?

**Interpretive response:** The communication date is the date the plan of termination for one-time employee termination benefits meets the following recognition criteria and has been communicated to employees: [420-10-25-4]

- management commits to the plan of termination;
- the plan identifies the number of employees to be terminated, their job classifications or functions and their locations, and the expected completion date;
- the plan establishes the terms of the benefit arrangement in sufficient detail to enable the employees to determine the type and amount of benefits they will receive; and
- actions required to complete the plan indicate it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

## Question 4.7.50

### When is the liability for one-time termination benefits recognized?

**Interpretive response:** A liability is typically recognized on the communication date. [420-10-25-8]

However, there is an exception when employees must render future services beyond a 'minimum retention period'. When this exception applies, the liability is measured on the communication date at the termination date fair value and recognized ratably over the service period. This exception exists because the requirement to render service beyond the minimum retention period to receive the benefit creates, in substance, a stay bonus. Section 4.7.30 discusses measuring the liability. [420-10-25-6 – 25-7]

The minimum retention period is a period selected by the entity but can be no longer than the notification period the entity is required to provide to employees in advance of the termination event under existing law or contract (known as the legal notification period).

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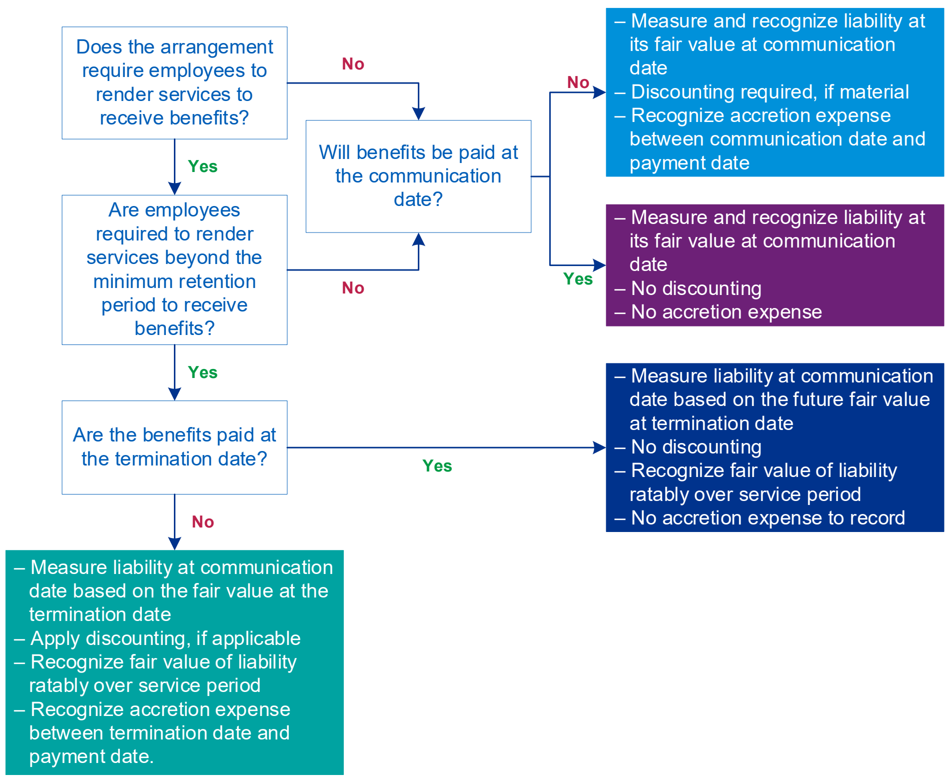
For example, if existing law requires a two-week notification period, but the entity requires services for only one week after the communication date, the minimum retention period is one week. However, if the entity requires services for three weeks after the communication date, the minimum retention period is the two-week legal notification period. If there is no legal notification requirement, the minimum retention period is 60 days. [420-10-25-7]

The following decision tree depicts the questions to ask in determining when to recognize the liability. The measurement information in this decision tree is discussed in section 4.7.30.




## Question 4.7.60

### How is the minimum retention period determined?

**Interpretive response:** We believe the evaluation of whether employees are required to render service beyond the minimum retention period begins on the date a termination plan meeting all of the criteria in Topic 420 is developed and communicated. This is because the act of communicating a promise to provide one-time termination benefits creates an obligation at that date.

The minimum retention period cannot be longer than the legal notification period. Law, statute, or contract defines the legal notification period, which can

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vary by legal jurisdiction and entity. Therefore, it may be necessary for an entity to obtain advice from legal counsel to ascertain the legal notification period. In the absence of a legal notification period, the minimum retention period is 60 days. [420-10-25-7]

## Question 4.7.65

**How are salaries paid during a notification period recognized?**

**Interpretive response:** Some jurisdictions require a notification period for an involuntary termination. For salaries paid during a notification period, the issue is whether to accrue them as a termination benefit or recognize them as normal compensation expense over the notification period. [712-10 Glossary]

We believe the appropriate accounting depends on whether the employee is obligated to work during the notification period.

— If the employee is obligated to work during the notification period, the employee's salary during that period is recognized as compensation expense over the period of service.
— If the employee is not obligated to work during the notification period, the employee's salary during that period is a termination benefit and is accrued.

## 4.7.30 Measuring a one-time termination benefit

### Excerpt from ASC 420-10

**30 Initial Measurement**

**> Fair Value**

**30-1** A liability for a cost associated with an exit or disposal activity shall be measured initially at its fair value in the period in which the liability is incurred, except as indicated in paragraphs 420-10-30-4 and 420-10-30-6 (for a liability for one-time termination benefits that is incurred over time).

**30-2** Quoted market prices are the best representation of fair value. However, for many of the liabilities covered by this Subtopic, quoted market prices will not be available. Consequently, in those circumstances, fair value will be estimated using some other valuation technique. A present value technique is often the best available valuation technique with which to estimate the fair value of a liability for a cost associated with an exit or disposal activity. For a liability that has uncertainties both in timing and amount, an expected present value technique generally will be the appropriate technique.

**30-3** In some situations, a fair value measurement for a liability associated with an exit or disposal activity obtained using a valuation technique other than a present value technique may not be materially different from a fair value measurement obtained using a present value technique. In those situations,

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this Subtopic does not preclude the use of estimates and computational shortcuts that are consistent with a fair value measurement objective.

**> One-Time Employee Termination Benefits**

**30-4** The timing of measurement of a liability for **one-time employee termination benefits** depends on whether employees are required to render service until they are terminated in order to receive the termination benefits and, if so, whether employees will be retained to render service beyond a minimum retention period.

**30-5** If employees are not required to render service until they are terminated in order to receive the termination benefits (that is, if employees are entitled to receive the termination benefits regardless of when they leave) or if employees will not be retained to render service beyond the minimum retention period, a liability for the termination benefits shall be measured at its fair value at the **communication date**. Example 1 (paragraph 420-10-55-2) illustrates the application of this paragraph.

**30-6** If employees are required to render service until they are terminated in order to receive the termination benefits and will be retained to render service beyond the minimum retention period, a liability for the termination benefits shall be measured initially at the communication date based on the fair value of the liability as of the termination date. For an illustration of this situation, see Example 2 (paragraph 420-10-55-4).

The liability for one-time termination benefits is measured at fair value. [420-10-30-1]

## Question 4.7.70

### As of what date is the liability for one-time termination benefits measured?

**Interpretive response:** A liability for one-time termination benefits is measured at fair value on the communication date. However, the fair value measurement is as of the communication date only if the employees either: [420-10-30-4 – 30-5]

— do not have to render future services to receive the benefits; or
— will not be retained beyond the minimum retention period.

If employees will be rendering services beyond the minimum retention period, the liability is measured as of the termination date (and is recognized ratably over the service period). [420-10-30-6]

The following chart summarizes the measurement principles. Question 4.7.100 explains the accretion expense in the last column.

| Measure liability based on FV at the following date: | | | Recognize: | |
|---|---|---|---|---|
| | Comm. | Term. | Cost of benefit | Accretion expense |
| **Service beyond minimum** | | ✓ | Over the service period | Over the period between |

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| Measure liability based on FV at the following date: | | | Recognize: | |
|---|---|---|---|---|
| | **Comm.** | **Term.** | **Cost of benefit** | **Accretion expense** |
| **retention period required** | | | | termination date and payment date |
| **Service beyond minimum retention period not required** | ✓ | | At communication date | Over the period between communication date and payment date |

## Question 4.7.80

### How is the fair value of a liability determined?

**Interpretive response:** The fair value of a liability is the price that would be received to transfer a liability in an orderly transaction between market participants at the measurement date. Liabilities are rarely transferred individually because of contractual or other legal restrictions preventing their transfer. In addition, in many situations there is no observable market to provide pricing information about the transfer of a liability. [820-10 Glossary]

When there is no quoted price for a transfer of an identical or similar liability and there is no corresponding asset, the entity uses a valuation technique to measure the fair value of the item from the perspective of a market participant that owes the liability. When using a present value technique, the entity might estimate the future cash outflows that market participants would expect to incur in fulfilling the obligation, including compensation for risk and the profit margin that a market participant would require to undertake the activity. [820-10-05-1C]

An entity may estimate those future cash outflows using the following steps.

| | |
|---|---|
| **Step 1** | Estimate the future cash flows the entity expects to incur in fulfilling the obligation. |
| **Step 2** | Exclude the cash flows that other market participants would not incur. |
| **Step 3** | Include the cash flows that other market participants would incur but the entity would not incur. |
| **Step 4** | Estimate the compensation that a market participant would require to assume the obligation. This compensation incorporates a profit margin at a rate consistent with undertaking the activity, a risk that the actual cash outflows might differ from estimated cash outflows (including credit risk), an assumption of inflation, and a risk-free rate of interest. |

Measuring the fair value of nonfinancial liabilities is discussed in Question K20 of KPMG Handbook, Fair value measurement.

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## 4.7.40 Subsequently measure one-time termination benefits

### Excerpt from ASC 420-10

**35 Subsequent Measurement**

**> Changes in Estimates**

**35-1** In periods subsequent to initial measurement, changes to the liability, including a change resulting from a revision to either the timing or the amount of estimated cash flows over the future service period, shall be measured using the credit-adjusted risk-free rate that was used to measure the liability initially.

**35-2** The cumulative effect of a change resulting from a revision to either the timing or the amount of estimated cash flows shall be recognized as an adjustment to the liability in the period of the change.

**35-3** If a plan of termination changes and employees that were expected to be terminated within the minimum retention period are retained to render service beyond that period, a liability previously recognized at the **communication date** shall be adjusted to the amount that would have been recognized if the provisions of paragraph 420-10-25-9 had been applied in all periods subsequent to the communication date.

**35-4** Changes due to the passage of time shall be recognized as an increase in the carrying amount of the liability and as an expense (for example, accretion expense). Accretion expense shall not be considered interest cost for purposes of applying Subtopic 835-20.

There may be changes to the liability due to the timing of the termination event (e.g. the exit or disposal activity) or alterations to the termination plan, which are accounted for in the period of change.

For example, an entity measures and records the fair value of one-time termination benefits at the communication date based on the impacted employees being fully eligible for the benefits (see Question 4.7.60). However, as the plan progresses, the date of the termination event is pushed back, and the entity needs to revisit whether the change requires the employees to provide service beyond the minimum retention period, resulting in a change to the liability.

### Question 4.7.90

**How does a change in the termination date affect the liability for termination benefits?**

**Interpretive response:** If a termination plan changes and employees expecting termination within the minimum retention period are retained to render service beyond that period, the fair value of the liability is remeasured with the revised

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termination date and the cumulative liability is calculated based on the service rendered to date. [420-10-35-1]

An entity recognizes the cumulative effect of the change as an adjustment to the liability and compensation or termination expense in the period that the expectations changed, and recognizes remaining service costs ratably over the remaining service period. [420-10-35-2]

### Question 4.7.100

**How is the accretion expense recognized during the service period?**

**Interpretive response:** The accretion expense is recognized using the interest method, described in Topic 835. Accretion expense is not considered interest expense in the income statement. [835-30-35-2 – 35-3, 420-10-45-5]

## 4.7.50 FASB examples

Topic 420 includes several examples of one-time benefits arrangements.

### Excerpt from ASC 420-10

**55 Implementation Guidance and Illustrations**

**> Illustrations**

**>> Example 1: One-Time Employee Termination Benefits—No Future Service Required**

**55-2** This Example assumes that an entity has a one-time benefit arrangement established by a plan of termination that meets the criteria in paragraph 420-10-25-4 and has been communicated to employees.

**55-3** An entity plans to cease operations in a particular location and determines that it no longer needs the 100 employees that currently work in that location. The entity notifies the employees that they will be terminated in 90 days. Each employee will receive as a termination benefit a cash payment of $6,000, which will be paid at the date an employee ceases rendering service during the 90-day period. In accordance with paragraph 420-10-25-8, a liability would be recognized at the **communication date** and, in accordance with paragraph 420-10-30-5, measured at its fair value. In this case, because of the short discount period, $600,000 may not be materially different from the fair value of the liability at the communication date.

**>> Example 2: One-Time Employee Termination Benefits—Stay Bonus-Future Service Required**

**55-4** This Example assumes that an entity has a one-time benefit arrangement established by a plan of termination that meets the criteria in paragraph 420-10-25-4 and has been communicated to employees.

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**55-5** An entity plans to shut down a manufacturing facility in 16 months and, at that time, terminate all of the remaining employees at the facility. To induce employees to stay until the facility is shut down, the entity establishes a one-time stay bonus arrangement. Each employee that stays and renders service for the full 16-month period will receive as a termination benefit a cash payment of $10,000, which will be paid 6 months after the termination date. An employee that leaves voluntarily before the facility is shut down will not be entitled to receive any portion of the termination benefit. In accordance with paragraph 420-10-25-9, a liability for the termination benefits would be measured initially at the communication date and, in accordance with paragraph 420-10-30-6, based on the fair value of the liability as of the termination date and recognized ratably over the future service period. The fair value of the liability as of the termination date would be adjusted cumulatively for changes resulting from revisions to estimated cash flows over the future service period, measured using the credit-adjusted risk-free rate that was used to measure the liability initially (as illustrated in this Example).

**55-6** The fair value of the liability as of the termination date is $962,240, estimated at the communication date using an expected present value technique. The expected cash flows of $1 million (to be paid 6 months after the termination date), which consider the likelihood that some employees will leave voluntarily before the facility is shut down, are discounted for 6 months at the credit-adjusted risk-free rate of 8 percent. In this case, a risk premium is not considered in the present value measurement. Because the amounts of the cash flows will be fixed and certain as of the termination date, marketplace participants would not demand a risk premium.

**55-7** Therefore, a liability of $60,140 would be recognized in each month during the future service period (16 months).

**55-8** After eight months, more employees than originally estimated leave voluntarily. The entity adjusts the fair value of the liability as of the termination date to $769,792 to reflect the revised expected cash flows of $800,000 (to be paid 6 months after the termination date), discounted for 6 months at the credit-adjusted risk-free rate that was used to measure the liability initially (8 percent). Based on that revised estimate, a liability (expense) of $48,112 would have been recognized in each month during the future service period. Thus, the liability recognized to date of $481,120 ($60,140 × 8) would be reduced to $384,896 ($48,112 × 8) to reflect the cumulative effect of that change (of $96,224). A liability of $48,112 would be recognized in each month during the remaining future service period (8 months). Accretion expense would be recognized after the termination date in accordance with the guidance beginning in paragraph 420-10-35-1 and in paragraph 420-10-45-5.

## Example 4.7.10
### Journal entries for one-time benefits with a stay bonus

We believe the entity in the above FASB Example 2 would make the following journal entries in the 22 months between the communication date and the payment date.

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| | Debit | Credit |
|---|---|---|
| Compensation expense | 60,140 | |
| Compensation liability | | 60,140 |
| *To recognize liability and expense in Months 1–8.* | | |
| Compensation expense[1] | 96,224 | |
| Compensation liability | | 96,224 |
| *To recognize catch-up adjustment for revised benefit as of Month 8.* | | |
| Compensation expense | 48,112 | |
| Compensation liability | | 48,112 |
| *To recognize liability and expense in Months 9–16.* | | |
| Accretion expense[2] | 5,035 | |
| Compensation liability | | 5,035 |
| *To recognize accretion expense in Months 17–22.* | | |

Notes:

1. Entry made at end of Month 8 to reflect a catch-up adjustment as if the entity had knowledge of the revised benefit amount estimate in earlier periods (see paragraph 420-10-35-1).
2. For simplicity, the accretion expense is assumed to be recognized ratably: ($800,000 – $769,792) ÷ 6 months.

## Excerpt from ASC 420-10

**55 Implementation Guidance and Illustrations**

**>> Example 3: One-Time Employee Termination Benefits—Voluntary and Involuntary Benefits Offered**

**55-9** This Example assumes that an entity has a one-time benefit arrangement established by a plan of termination that meets the criteria of paragraph 420-10-25-4 and has been communicated to employees.

**55-10** An entity initiates changes to streamline operations in a particular location and determines that, as a result, it no longer needs 100 of the employees that currently work in that location. The plan of termination provides for both voluntary and involuntary termination benefits (in the form of cash payments). Specifically, the entity offers each employee (up to 100 employees) that voluntarily terminates within 30 days a voluntary termination benefit of $10,000 to be paid at the separation date. Each employee that is involuntarily terminated thereafter (to reach the target of 100) will receive an involuntary termination benefit of $6,000 to be paid at the termination date. The entity expects all 100 employees to leave (voluntarily or involuntarily) within the minimum retention period. In accordance with paragraphs 420-10-25-6 through

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25-8, a liability for the involuntary termination benefit (of $6,000 per employee) would be recognized at the communication date and, in accordance with paragraphs 420-10-30-4 through 30-6, measured at its fair value. In this case, because of the short discount period, $600,000 may not be materially different from the fair value of the liability at the communication date. As noted in paragraph 420-10-25-10, a liability for the incremental voluntary termination benefit (of $4,000 per employee) would be recognized in accordance with paragraph 712-10-25-1 through 25-3 (that is, when employees accept the offer).

## 4.7.60 Other associated costs

### Excerpt from ASC 420-10

**15 Scope and Scope Exceptions**

**> Transactions**

**15-3** The guidance in the Exit or Disposal Cost Obligations Topic applies to the following transactions and activities: …

b. Costs to terminate a contract that is not a **lease** (see paragraphs 420-10-25-11 through 25-13 for further description of contract termination costs and paragraph 842-20-40-1 for terminations of a capital lease)
c. Costs to consolidate facilities or relocate employees
d. Costs associated with a disposal activity covered by Subtopic 205-20
e. Costs associated with an exit activity, including exit activities associated with an entity newly acquired in a business combination or an **acquisition by a not-for-profit entity**.

**15-4** An exit activity includes but is not limited to a **restructuring**, such as the sale or termination of a line of business, the closure of business activities in a particular location, the relocation of business activities from one location to another, changes in management structure, and a fundamental reorganization that affects the nature and focus of operations.

**15-5** The guidance in this Topic does not apply to the following transactions and activities:

a. Costs associated with the retirement of a long-lived asset covered by Subtopic 410-20.
b. Impairment of an unrecognized asset while it is being used.

**25 Recognition**

**> Determining When to Recognize a Liability**

**25-1** A liability for a cost associated with an exit or disposal activity shall be recognized in the period in which the liability is incurred, except as indicated in paragraphs 420-10-25-6 and 420-10-25-9 (for a liability for **one-time employee termination benefits** that is incurred over time). In the unusual circumstance in which fair value cannot be reasonably estimated, the liability shall be recognized initially in the period in which fair value can be reasonably estimated

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(see paragraphs 420-10-30-1 through 30-3 for fair value measurement guidance).

**25-2** A liability for a cost associated with an exit or disposal activity is incurred when the definition of a liability included in FASB Concepts Statement No. 6, Elements of Financial Statements, is met. Only present obligations to others are liabilities under the definition. An obligation becomes a present obligation when a transaction or event occurs that leaves an entity little or no discretion to avoid the future transfer or use of assets to settle the liability. An exit or disposal plan, by itself, does not create a present obligation to others for costs expected to be incurred under the plan; thus, an entity's commitment to an exit or disposal plan, by itself, is not the requisite past transaction or event for recognition of a liability.

**25-3** This Subtopic requires that future operating losses expected to be incurred in connection with an exit or disposal activity be recognized in the period(s) in which they are incurred. Because future operating losses are the summation of individual items of revenue and expense that result from changes in assets and liabilities, those expected losses, in and of themselves, do not meet the definition of a liability.

**> Other Associated Costs**

**25-14** Other costs associated with an exit or disposal activity include, but are not limited to, costs to consolidate or close facilities and relocate employees.

**25-15** The liability shall not be recognized before it is incurred, even if the costs are incremental to other operating costs and will be incurred as a direct result of a plan. A liability for other costs associated with an exit or disposal activity shall be recognized in the period in which the liability is incurred (generally, when goods or services associated with the activity are received).

**30 Initial Measurement**

**> Other Associated Costs**

**30-10** A liability for other costs associated with an exit or disposal activity shall be measured at its fair value in the period in which the liability is incurred (generally, when goods or services associated with the activity are received).

The liability for other associated costs is not recognized before it is incurred. Such costs are measured at fair value in the period in which the liability is incurred, generally when goods or services are received. [420-10-25-1, 25-15, 30-10]

These additional costs are defined broadly to include not only costs to consolidate facilities and relocate employees, but also 'costs associated with an exit activity'. [420-10-15-3(e)]

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## Question 4.7.110

**If termination benefits are not in the scope of Topic 420, are their associated costs still in scope?**

**Interpretive response:** Yes. Contract termination costs and other costs associated with the exit or disposal activity are in the scope of Topic 420. This is the case even if the termination benefits paid as a result of an exit or disposal activity are payable under an ongoing benefit arrangement in the scope of Topic 712, Topic 715 or Topic 710 (i.e. not in the scope of Topic 420).

## Question 4.7.120

**Can relocation costs be capitalized?**

**Interpretive response:** No. The predominant practice is to charge relocation costs (i.e. costs to move to a new location) to expense as incurred. Further, as a general rule the SEC staff will object to capitalizing and deferring relocation costs. [420-10-25-14, 25-15]

## Question 4.7.130#

**When is a liability for other associated exit or disposal costs recognized?**

**Interpretive response:** Under Subtopic 420-10, a liability for other exit or disposal costs is recognized when the definition of a liability is met. In December 2021, the FASB issued Chapter 4, *Elements of Financial Statements*, of Statement of Financial Accounting Concepts No. 8 (CON 8), *Conceptual Framework for Financial Reporting*. CON 8 includes revised definitions for liabilities and supersedes CON 6. Under CON 8 a liability is defined as the present obligation of an entity to transfer an economic benefit. Despite this change, Subtopic 420-10 continues to reference CON 6. [420-10-25-2]

While the FASB has proposed to amend the reference to CON 6, the proposed changes have not been finalized and it is unclear what changes it would make. We understand the FASB did not intend to change practice and believe that any difference in definitions generally should not have a significant impact on when to recognize a liability for exit or disposal activities. [420-10-25-2]

The recognition criteria in Subtopic 450-20 (i.e. a loss is probable and the amount of loss is reasonably estimable) does not apply. Under Subtopic 450-20, the past transaction or event that creates the obligation (liability) has already occurred. In contrast, Topic 420 focuses on what constitutes an obligating event for costs associated with exit or disposal activities.

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### 4.7.70 Business combinations

An entity may have exit or disposal activities that impact a newly acquired subsidiary or component. A common example is a synergy or rationalization program where there are overlapping roles of existing employees and employees at the newly acquired entity.

#### Question 4.7.140

**When are costs associated with an exit activity of an acquired business recognized?**

**Interpretive response:** An acquirer only recognizes the acquisition-date fair value of a liability associated with exit or disposal activities of the acquiree as part of a business combination if those costs meet the criteria for recognition under Topic 420 as of the acquisition date (see Question 4.7.130). [420-10-25-1 – 25-2]

If the exit activities of the acquiree do not meet the recognition criteria in Topic 420 as of the acquisition date, or the costs were incurred on behalf of the acquirer, the costs are recognized as post-combination expenses when those criteria are met.

Paragraphs 7.026 to 7.030 in KPMG Handbook, Business combinations, discuss exit activities related to a business combination.

## 4.8 Presentation and disclosure

### 4.8.10 Presentation

Topic 712 does not include specific guidance on presentation matters. Topic 420 does include guidance about the presentation of the cumulative effect of a change in estimate and the classification of exit or disposal costs in the income statement.

#### Excerpt from ASC 420-10

**45 Other Presentation Matters**

**> Changes in Estimates**

**45-1** The cumulative effect of a change resulting from a revision to either the timing or the amount of estimated cash flows shall be reported in the same line item(s) in the income statement (statement of activities) used when the related costs were recognized initially in the period of change.

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**> Exit or Disposal Activity Involving a Discontinued Operation**

**45-2** Costs associated with an exit or disposal activity involving a discontinued operation shall be included within the results of discontinued operations in accordance with Section 205-20-45.

**> Income from Continuing Operations**

**45-3** Costs associated with an exit or disposal activity that does not involve a discontinued operation shall be included in income from continuing operations before income taxes in the income statement of a business entity and in income from continuing operations in the statement of activities of a not-for-profit entity (NFP). Separate presentation of exit and disposal costs in the income statement is not prohibited. If a subtotal such as income from operations is presented, it shall include the amounts of those costs.

**45-5** Accretion expense shall not be considered interest cost for purposes of classification in the income statement (statement of activities).

**45-6** See paragraph 420-10-40-1 for the income statement presentation when the liability is reversed.

## Question 4.8.10

**How are ongoing benefit arrangements and one-time termination benefits presented in the income statement?**

**Interpretive response:** We believe that both ongoing benefit arrangements in the scope of Topic 712 (special termination benefits, contractual termination benefits and other postemployment benefits) and one-time termination benefits in the scope of Topic 420 should be presented in operating income.

One-time termination benefits associated with an exit or disposal activity are included in the entity's restructuring charge (see Question 4.8.20).

## Question 4.8.20#

**What types of employee related costs can be included in an entity's exit or disposal activity restructuring charge?**

**Interpretive response:** We believe the following employee related costs can be appropriately classified as an exit or disposal activity restructuring charge in an entity's income statement when the liability for such costs is incurred:

— one-time employee termination benefits;
— other associated costs including relocation costs for existing employees; and
— accretion expense associated with exit or disposal activities.

However, Topic 420 does not specify whether the accretion expense should be included in the same line item as the original exit or disposal costs or in another

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line within operating activities. We believe an entity should decide on an accounting policy for the classification of accretion expense and apply that policy consistently.

Question 4.6.60 of KPMG Handbook, Financial statement presentation, addresses the income statement presentation of exit and disposal costs.

### Question 4.8.30
**Are costs associated with an exit or disposal activity under Topic 420 classified as infrequent or unusual?**

**Background:** Subtopic 220-20 states that a material event or transaction that an entity considers to be of an unusual nature or of a type that indicates infrequency of occurrence, or both is reported as a separate component of income from continuing operations. The nature and financial effects of each event or transaction is presented as a separate component of income from continuing operations or, alternatively, disclosed in notes to the financial statements. [220-20-45-1]

**Interpretive response:** The costs associated with an exit or disposal activity may meet the criteria to be presented as unusual or infrequent items under Subtopic 220-20.

## 4.8.20 Disclosure

### Excerpt from ASC 712-10

**50 Disclosure**

**> Termination Benefits**

**50-1** For guidance on disclosure requirements related to special and contractual **termination benefits**, see paragraph 715-20-50-1.

**> Other Postemployment Benefits**

**50-2** If an obligation for **other postemployment benefits** is not accrued in accordance with paragraphs 450-20-25-2 or 710-10-25-1 only because the amount cannot be reasonably estimated, the financial statements shall disclose that fact.

### Excerpt from ASC 420-10

**50 Disclosure**

**50-1** All of the following information shall be disclosed in notes to financial

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statements that include the period in which an exit or disposal activity is initiated and any subsequent period until the activity is completed:

a. A description of the exit or disposal activity, including the facts and circumstances leading to the expected activity and the expected completion date
b. For each major type of cost associated with the activity (for example, **one-time employee termination benefits**, contract termination costs, and other associated costs), both of the following shall be disclosed:
    1. The total amount expected to be incurred in connection with the activity, the amount incurred in the period, and the cumulative amount incurred to date
    2. A reconciliation of the beginning and ending liability balances showing separately the changes during the period attributable to costs incurred and charged to expense, costs paid or otherwise settled, and any adjustments to the liability with an explanation of the reason(s) why.
c. The line item(s) in the income statement or the statement of activities in which the costs in (b) are aggregated
d. For each reportable segment, as defined in Subtopic 280-10, the total amount of costs expected to be incurred in connection with the activity, the amount incurred in the period, and the cumulative amount incurred to date, net of any adjustments to the liability with an explanation of the reason(s) why
e. If a liability for a cost associated with the activity is not recognized because fair value cannot be reasonably estimated, that fact and the reasons why.

**S99 SEC Materials**

**>> Comments Made by SEC Observer at Emerging Issues Task Force (EITF) Meetings**

**>>> SEC Observer Comment: Classification of Inventory Markdowns and Other Costs Associated with Restructuring**

**S99-3** The following is the text of SEC Observer Comment: Classification of Inventory Markdowns and Other Costs Associated with Restructuring.

Subtopic 420-10 states that costs associated with exit or disposal activities that do not involve a discontinued operation should be included in income from continuing operations before taxes. If a subtotal such as "income from operations" is presented, that Subtopic indicates that subtotal should include the amounts of exit or disposal costs. However, the guidance does not address where within income from continuing operations or income from operations inventory markdowns associated with an exit or restructuring activity. The SEC staff recognizes that there may be circumstances in which it can be asserted that inventory markdowns are costs directly attributable to a decision to exit or restructure an activity. However, the staff believes that it is difficult to distinguish inventory markdowns attributable to a decision to exit or restructure an activity from inventory markdowns attributable to external market factors that are independent of a decision to exit or restructure an activity. Further, the staff believes that decisions about the timing, method, and pricing of dispositions of inventory generally are considered to be normal, recurring activities integral to the management of the ongoing business. Accordingly, the

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SEC staff believes that inventory markdowns should be classified in the income statement as a component of cost of goods sold.

## Excerpt from SAB Topic 5

**P. Restructuring Charges**

**4. Disclosures**

Beginning with the period in which the exit plan is initiated, FASB ASC Topic 420, Exit or Disposal Cost Obligations, requires disclosure, in all periods, including interim periods, until the exit plan is completed, of the following:

a. A description of the exit or disposal activity, including the facts and circumstances leading to the expected activity and the expected completion date.
b. For each major type of cost associated with the activity (for example, one-time termination benefits, contract termination costs, and other associated costs):

    (1) The total amount expected to be incurred in connection with the activity, the amount incurred in the period, and the cumulative amount incurred to date.

    (2) A reconciliation of the beginning and ending liability balances showing separately the changes during the period attributable to costs incurred and charged to expense, costs paid or otherwise settled, and any adjustments to the liability with an explanation of the reason(s) therefor.

c. The line item(s) in the income statement or the statement of activities in which the costs in (b) above are aggregated.
d. For each reportable segment, the total amount of costs expected to be incurred in connection with the activity, the amount incurred in the period, and the cumulative amount incurred to date, net of any adjustments to the liability with an explanation of the reason(s) therefor.
e. If a liability for a cost associated with the activity is not recognized because fair value cannot be reasonably estimated, that fact and the reasons therefor.

**Question:** What specific disclosures about restructuring charges has the staff requested to fulfill the disclosure requirements of FASB ASC Topic 420 and MD&A?

**Interpretive Response:** The staff often has requested greater disaggregation and more precise labeling when exit and involuntary termination costs are grouped in a note or income statement line item with items unrelated to the exit plan. For the reader's understanding, the staff has requested that discretionary, or decision-dependent, costs of a period, such as exit costs, be disclosed and explained in MD&A separately. Also to improve transparency, the staff has requested disclosure of the nature and amounts of additional types of exit costs and other types of restructuring charges[13] that appear quantitatively or qualitatively material, and requested that losses relating to

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asset impairments be identified separately from charges based on estimates of future cash expenditures.

[13] Examples of common components of exit costs and other types of restructuring charges which should be considered for separate disclosure include, but are not limited to, involuntary employee terminations and related costs, changes in valuation of current assets such as inventory writedowns, long term asset disposals, adjustments for warranties and product returns, leasehold termination payments, and other facility exit costs, among others.

The staff frequently reminds registrants that in periods subsequent to the initiation date that material changes and activity in the liability balances of each significant type of exit cost and involuntary employee termination benefits[14] (either as a result of expenditures or changes in/reversals of estimates or the fair value of the liability) should be disclosed in the footnotes to the interim and annual financial statements and discussed in MD&A. In the event a company recognized liabilities for exit costs and involuntary employee termination benefits relating to multiple exit plans, the staff believes presentation of separate information for each individual exit plan that has a material effect on the balance sheet, results of operations or cash flows generally is appropriate.

[14] The staff would expect similar disclosures for employee termination benefits whether those costs have been recognized pursuant to FASB ASC Topic 420, FASB ASC Topic 712, Compensation—Nonretirement Postemployment Benefits, or FASB ASC Topic 715, Compensation—Retirement Benefits.

For material exit or involuntary employee termination costs related to an acquired business, the staff has requested disclosure in either MD&A or the financial statements of:

1. When the registrant began formulating exit plans for which accrual may be necessary,
2. The types and amounts of liabilities recognized for exit costs and involuntary employee termination benefits and included in the acquisition cost allocation, and.
3. Any unresolved contingencies or purchase price allocation issues and the types of additional liabilities that may result in an adjustment of the acquisition cost allocation.

The staff has noted that the economic or other events that cause a registrant to consider and/or adopt an exit plan or that impair the carrying amount of assets, generally occur over time. Accordingly, the staff believes that as those events and the resulting trends and uncertainties evolve, they often will meet the requirement for disclosure pursuant to the Commission's MD&A rules prior to the period in which the exit costs and liabilities are recorded pursuant to GAAP. Whether or not currently recognizable in the financial statements, material exit or involuntary termination costs that affect a known trend, demand, commitment, event, or uncertainty to management, should be disclosed in MD&A. The staff believes that MD&A should include discussion of the events and decisions which gave rise to the exit costs and exit plan, and the likely effects of management's plans on financial position, future operating results and liquidity unless it is determined that a material effect is not reasonably likely to occur. Registrants should identify the periods in which material cash outlays are anticipated and the expected source of their funding.

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Registrants should also discuss material revisions to exit plans, exit costs, or the timing of the plan's execution, including the nature and reasons for the revisions.

The staff believes that the expected effects on future earnings and cash flows resulting from the exit plan (for example, reduced depreciation, reduced employee expense, etc.) should be quantified and disclosed, along with the initial period in which those effects are expected to be realized. This includes whether the cost savings are expected to be offset by anticipated increases in other expenses or reduced revenues. This discussion should clearly identify the income statement line items to be impacted (for example, cost of sales; marketing; selling, general and administrative expenses; etc.). In later periods if actual savings anticipated by the exit plan are not achieved as expected or are achieved in periods other than as expected, MD&A should discuss that outcome, its reasons, and its likely effects on future operating results and liquidity.

The staff often finds that, because of the discretionary nature of exit plans and the components thereof, presenting and analyzing material exit and involuntary termination charges in tabular form, with the related liability balances and activity (e. g., beginning balance, new charges, cash payments, other adjustments with explanations, and ending balances) from balance sheet date to balance sheet date, is necessary to explain fully the components and effects of significant restructuring charges. The staff believes that such a tabular analysis aids a financial statement user's ability to disaggregate the restructuring charge by income statement line item in which the costs would have otherwise been recognized, absent the restructuring plan, (for example, cost of sales; selling, general, and administrative; etc.).

## Question 4.8.40

**Are the disclosure requirements for termination benefits similar under Topic 712, Topic 715 and Topic 420?**

**Interpretive response:** Termination benefits may meet the recognition criteria in Topic 420, Topic 715 or Topic 712, and each has its own disclosure requirements.

We believe the disclosure requirements for termination benefits subject to Topic 715 or Topic 712 are substantially identical to the requirements of Topic 420. This is notwithstanding that the Topic 715 disclosure requirements are broader to accommodate the FASB's desire to address the disclosure requirements of several pension and other employment benefit-related standards in a single disclosure standard.

The SEC staff expects registrants that recognize one-time termination benefits under the recognition criteria in Topic 712 and Topic 715 to provide disclosures for those benefits comparable to those required by Topic 420. [SAB Topic 5.P.4.n14]

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## Question 4.8.50

**Must the number of employees terminated under a one-time termination benefit arrangement be disclosed?**

**Interpretive response:** Topic 420 does not require disclosure of the number of employees expected to be (or actually) terminated for activity related to one-time employee termination benefits.

## Question 4.8.60

**What are the interim disclosure requirements for one-time termination benefits?**

**Interpretive response:** Disclosure requirements for one-time termination benefits included as part of the restructuring charge (see Question 4.8.20) are for both interim and annual financial statements.

## Question 4.8.70

**What is the impact of an exit or disposal activity, which may include one-time termination benefits, on segment disclosures?**

**Interpretive response:** Topic 420 requires the following disclosures for each reportable segment defined under Topic 280: [420-10-50-1(d)]

- the total amount of costs expected to be incurred in connection with an exit or disposal activity;
- the amount incurred in the period; and
- the cumulative amount incurred to date, net of any adjustments to the liability with an explanation of the reasons why.

In addition, under Topic 280, an entity is required to disclose a reconciliation of key segment amounts to the corresponding items reported in the consolidated financial statements. [280-10-50-30]

Similarly, the SEC expects that when an entity's segment profitability is determined on a basis that differs from consolidated operating profit, or that excludes the effects of items attributable to the segment, the applicable reconciling items will be discussed in MD&A. [FR501.06a]

For example, if a material charge for exit or disposal activity relates to a specific segment, but is not included in management's measure of the segment's profitability, an entity would be expected to discuss in MD&A the applicable portion of the charge, the segment to which it relates, and the circumstances of its incurrence.

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## Question 4.8.80

**What are the non-GAAP disclosure considerations when an exit or disposal activity occurs?**

**Interpretive response:** Any non-GAAP disclosures related to an exit or disposal activity are subject to the SEC's requirements on the use of non-GAAP financial measures.

The SEC has issued rules (Regulation G, Item 10(e) of Regulations S-K and Form 20-F) that address a public company's disclosure or release of certain financial information that is calculated and presented on a non-GAAP basis.

These rules define a non-GAAP financial measure as a numerical measure of a registrant's historical or future financial performance, financial position or cash flows that:

— excludes amounts, or is subject to adjustments that have the effect of excluding amounts included in the most directly comparable measure calculated and presented based on GAAP in the registrant's income statement, balance sheet or cash flow statement (or equivalents); or

— includes amounts, or is subject to adjustments that have the effect of including amounts excluded from the most directly comparable US GAAP measure calculated and presented in conformity with US GAAP.

The SEC prohibits a non-GAAP performance measure from eliminating or smoothing items identified (i.e. labelled) as nonrecurring, infrequent or unusual, when the nature of the charge or gain is such that it is reasonably likely to recur within two years or there was a similar charge or gain in the prior two years. This two-year look-forward and look-back prohibition applies only to those reconciling items that are labelled as nonrecurring, infrequent or unusual.

Determining whether a charge will recur within the two years is a matter of judgment. The SEC has stated that it views 'reasonably likely' as a threshold lower than 'more likely than not'. [SEC Rel 33-8056]

In addition, the SEC staff has informally indicated that it will apply a broad definition of the term similar in assessing whether similar items have occurred or will occur in the future. For example, if a single restructuring plan generates a charge that contains several distinct components (e.g. employee severance, lease termination costs, asset impairments), the SEC staff would view all of the components of the restructuring plan as similar.

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# 5. Retirement plans: General and DC plans

## Detailed contents

**Item significantly updated in this edition #**



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5.4.30 Can an entity change the method it uses to measure a cash balance plan?

5.4.40 Is the discount rate used to measure the benefit obligation of a cash balance plan consistent with the interest-crediting rate? #

5.4.50 How is the ABO for a cash balance plan measured?

5.4.60 How does an entity account for suspending benefits for a subsidiary's participants when they will be added to the parent's cash balance pension plan?

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## 5.1 How the standard works

Topic 715 outlines the recognition, measurement, presentation and disclosure requirements for entities that promise fixed retirement benefits to participating employees. The plans in the scope of Topic 715 are called 'defined' because either the contributions to the plan or the benefits provided by the plan are determinable based on a formula in the plan. Common examples of plans accounted for under Topic 715 are 401(k) plans, DB pension plans and DB postretirement health and welfare plans.

Retirement benefits are generally earned by employees during their employment and paid after retirement. Therefore, under Topic 715, they are considered part of an employee's compensation and recognized over the employee's service period.

Topic 715 differentiates between four types of retirement plans.

| | |
|---|---|
| **DC plans under Subtopic 715-70** | Section 5.4 |
| **DB pension plans under Subtopic 715-30** | Chapters 6 to 9 |
| **DB OPEB plans under Subtopic 715-60** | Chapters 6 to 9 |
| **Multiemployer plans under Subtopic 715-80** | Chapter 10 |

Accounting for retirement benefits can seem complicated because of the different types of plans. Added to its complexity are actuarial assumptions that require specialized knowledge.

Chapters 5 to 11 analyze the requirements, assumptions and approaches involved in accounting for retirement benefits under Topic 715:

- DC plans and cash balance plans:
  - Chapter 5
- DB pension and OPEB plans:
  - Chapter 6, plan assets and benefit obligations
  - Chapter 7, the costs of DB plans
  - Chapter 8, actuarial assumptions and attribution
  - Chapter 9, settlements, curtailments and certain termination benefits
- Multiemployer plans and other special topics:
  - Chapter 10
- Disclosure and reporting:
  - Chapter 11.

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## 5.2 General principles

This section introduces the key concepts in Topic 715 and provides a foundation for understanding chapters 5 to 11.

### Excerpt from ASC 715-10

**05 Overview and Background**

**05-1** The Compensation—Retirement Benefits Topic establishes standards of financial accounting and reporting for an employer that offers pension, other postretirement, and certain special or contractual termination benefits to its employees.

**05-2** This Topic contains the following Subtopics:

a. Overall (Subtopic 715-10)
b. Defined Benefit Plans—General (Subtopic 715-20)
c. Defined Benefit Plans—Pension (Subtopic 715-30)
cc. Defined Benefit Plans—Other Postretirement (Subtopic 715-60)
d. Defined Contribution Plans (Subtopic 715-70)
e. Multiemployer Plans (Subtopic 715-80)

**05-3** Throughout the Codification, content is structured and authored using an asset and liability model as its underlying premise. However, the original content used to populate this Topic was based on an expense recognition model rather than an asset and liability model. Because the expense recognition model focuses primarily on remeasurement, the majority of the guidance throughout this Topic is contained in the Subsequent Measurement Sections of the applicable Subtopics.

**05-6** The guidance in this Topic is derived from the basic idea that a benefit plan is an exchange between the employer and the employee. In exchange for services provided by the employee, the employer promises to provide, in addition to current wages and other benefits, an amount of retirement income or benefit. It follows from that basic view that benefits are not gratuities but instead are part of an employee's compensation, and because payment is deferred, the benefit plan is a type of deferred compensation. It also follows that the employer's obligation for that compensation is incurred when the services are rendered.

**05-7** A benefit plan is an arrangement that is mutually understood by an employer and its employees, whereby an employer undertakes to provide its current and former employees with benefits after they retire in exchange for the employees' services over a specified period of time, upon attaining a specified age while in service, or both. Benefits may commence immediately upon termination of service or may be deferred until retired employees attain a specified age.

**05-9** Because the obligation to provide benefits arises as employees render the services necessary to earn the benefits pursuant to the terms of the plan, this Topic provides guidance regarding when the cost of providing the benefits should be recognized over those employee service periods.

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**10 Objectives**

**10-1** The objectives of this Topic are as follows:

a. To enhance the relevance and representational faithfulness of the employer's reported results of operations by recognizing net periodic pension cost and net periodic other postretirement benefit cost as employees render the services necessary to earn their pension and other postretirement benefits
b. To enhance the relevance and representational faithfulness of the employer's statement of financial position by including a measure of the obligation to provide pension and other postretirement benefits based on a mutual understanding between the employer and its employees of the terms of the underlying plan
c. To enhance the ability of users of the employer's financial statements to understand the extent and effects of the employer's undertaking to provide pension and other postretirement benefits to its employees by disclosing relevant information about the obligation and cost of the pension and other postretirement benefit plans and how those amounts are measured
d. To improve the understandability and comparability of amounts reported by requiring employers with similar plans to use the same method to measure their pension and other postretirement benefit obligations and the related costs of the postretirement benefits.

**15 Scope and Scope Exceptions**

**> Overall Guidance**

**15-1** The Scope Section of the Overall Subtopic establishes the pervasive scope for all Subtopics of the Compensation—Retirement Benefits Topic. Unless explicitly addressed within specific Subtopics, the following scope guidance applies to all Subtopics of the Compensation—Retirement Benefits Topic.

**> Entities**

**15-2** The guidance in the Compensation—Retirement Benefits Topic applies to all employers, including not-for-profit entities (NFPs), that offer pension or other postretirement benefits to their employees, regardless of whether the benefit obligation is funded. NFPs should refer to Subtopic 958-715 when applying the provisions of this Topic.

**> Transactions**

**15-3** The guidance in the Compensation—Retirement Benefits Topic applies to the following types of benefit arrangements:

a. Any arrangement that is in substance a pension or other postretirement benefit plan, regardless of its form or the means or timing of its funding
b. Written plans and unwritten plans whose existence is discernible either from a practice of paying pension or other postretirement benefits or from oral representations made to current or former employees
c. Deferred compensation contracts with individual employees if those contracts, taken together, are equivalent to a plan that provides pension or other postretirement benefits

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d. Health and other welfare benefits expected to be provided to employees deemed to be on a disability retirement.

**15-4** The guidance in this Topic also applies to settlement of all or a part of an employer's pension or other postretirement benefit obligation or curtailment of a pension or other postretirement benefit plan. The guidance applies to employers that provide pension or other postretirement benefits as part of a special termination benefit or special or contractual termination benefits not otherwise addressed in other Subtopics (for example, benefits paid at or before retirement and not paid out of a pension or other postretirement plan).

**15-5** The guidance in this Topic does not apply to the following types of benefit arrangements:

a. An employer's practice of providing pension or other postretirement benefits to selected employees under individual contracts with specific terms determined on an individual-by-individual basis. Those contracts shall be accounted for individually, following the terms of the contract. See Topic 710.
b. Postemployment benefits paid after employment but before retirement (for example, layoff benefits), unless payable from a pension or other postretirement plan. See Topic 712.

**> Other Considerations**

**15-6** For purposes of preparing financial statements in accordance with accounting principles generally accepted in the United States, the Compensation—Retirement Benefits Topic includes no special provisions applicable to pension or other postretirement benefit plans or arrangements outside the United States. To the extent that those arrangements are in substance similar to pension or other postretirement benefit plans in the United States, they are subject to the provisions of this Topic.

**15-7** The applicability of this Topic to those plans or arrangements is determined by the nature of the obligation and by the terms or conditions that define the amount of benefits to be paid, not by whether or how a plan is funded, whether benefits are payable at intervals or as a single amount, or whether the benefits are required by law or custom or are provided under a plan the employer has elected to sponsor.

**15-8** This Topic does not change or supersede any of the requirements set forth in Topic 960 for the financial statements of a defined benefit pension plan.

## Excerpt from ASC 715-30

**15 Scope and Scope Exceptions**

**> Transactions**

**15-4** The guidance in this Subtopic does not apply to the following types of benefit plans or arrangements:

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a. Life insurance benefits provided outside a pension plan or other postretirement health and welfare benefits
b. Health care benefits provided through a pension plan. The accounting for those benefits is set forth in Subtopic 715-60.

## Excerpt from ASC 715-60

**15 Scope and Scope Exceptions**

**> Overall Guidance**

**15-1** This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic, see Section 715-10-15, with specific qualifications and exceptions noted below.

**15-2** The General Subsection of this Section establishes the pervasive scope of this Subtopic, with specific exceptions noted in the other Subsections of this Section.

**> Transactions**

**15-3** The guidance in the General Subsections applies to the following plans and **benefits**:

a. A **single-employer plan** that defines the **postretirement benefits** to be provided to **retirees**. This includes postretirement benefits expected to be provided by an employer to current and former employees (including retirees, disabled employees, and other former employees who are expected to receive postretirement benefits), their beneficiaries, and covered dependents, pursuant to the terms of an employer's undertaking to provide those benefits.

**15-4** Other postretirement benefits include, but are not limited to, postretirement health care; life insurance provided outside a pension **plan** to retirees; and other welfare benefits such as tuition assistance, day care, legal services, and housing subsidies provided after retirement. Often those benefits are in the form of a reimbursement to plan participants or direct payment to providers for the cost of specified services as the need for those services arises, but they may also include benefits payable as a lump sum, such as death benefits. Much of the guidance in this Subtopic focuses on postretirement health care plans. Nevertheless, this Subtopic applies equally to all **postretirement benefits other than pensions**.

**15-5** The guidance in the General Subsections applies to health and other welfare benefits expected to be provided to disabled employees, whether in cash or in kind, for example, disability medical benefits. For example, the provisions of the postretirement health care plan may provide postretirement health care coverage after a disabled employee attains a specified number of years of credited service (which may include credit for periods after the employee is disabled), with a separate disability plan that provides health benefits before that date. Or, the postretirement health care plan may have special provisions for disabled employees that entitle them to benefit coverage under the **postretirement benefit plan** at a date earlier than that coverage

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would commence for other employees who are not disabled.

**15-6** The guidance in the General Subsections does not apply to the following plans and benefits:

a. Pension or life insurance benefits provided through a pension plan. The accounting for those benefits is set forth in Subtopic 715-30.
b. Disability benefits paid to former or inactive employees not on disability retirement (such benefits shall be accounted for under Topic 712). However, the measurement guidance in this Subtopic may be useful in applying the provisions of that topic.
c. Disability income benefits paid pursuant to a pension plan (such benefits shall be accounted for under Subtopic 715-30).
d. An employee's right to continue health care coverage under the provisions of the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA). This right does not constitute a postretirement benefit plan per se because an employee need not be a retiree to receive that benefit. It is a right generally available upon termination of employment. If an employee voluntarily elects at retirement to continue health care coverage provided through the active employee health care plan and the cost to the employer of their continuing coverage exceeds the retirees' contributions, the employer shall account for the excess cost in accordance with Topic 712.

**> Other Considerations**

**15-7** A postretirement benefit plan may be part of a larger plan or arrangement that provides benefits currently to active employees as well as to retirees. In those circumstances, the promise to provide benefits to present and future retirees under the plan shall be segregated from the promise to provide benefits currently to active employees and shall be accounted for in accordance with the provisions of this Subtopic.

**15-8** In some cases, an employer may limit its obligation through an individual or an aggregate cap on the employer's cost or benefit obligation. For example, an employer may elect to limit its annual postretirement benefit obligation for each retired **plan participant** to a maximum of $5,000. Or, an employer may elect to limit its share of the aggregate cost of covered **postretirement health care benefits** for a period to an amount determined based on an average per capita cost per retired plan participant. Plans of that nature are considered to be defined benefit postretirement plans. See paragraphs 715-60-55-96 through 55-102 for an illustration of the measurement considerations for defined dollar capped plans and paragraphs 715-60-55-2 through 55-3 for implementation guidance on capped plans.

**15-9** Absent evidence to the contrary, it shall be presumed that an employer that has provided postretirement benefits in the past or is currently promising those benefits to employees will continue to provide those future benefits.

**> Plans with Characteristics of both a Defined Contribution and a Defined Benefit Plan**

**15-9A** See paragraph 715-70-15-2 for guidance for plans with characteristics of both a defined contribution and a defined benefit plan.

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**55 Implementation Guidance and Illustrations**

**>>> Full Eligibility Date**

**55-40** Paragraphs 715-60-55-41 through 55-56 are presented to assist in understanding the **full eligibility date**.

**>>>> Plans that Provide Incremental Benefits for Additional Years of Service**

**>>>>> Graded Benefit Formula**

**55-41** Some plans have benefit formulas that define different benefits for different years of service.

**55-42** To illustrate, assume a plan in which the percentage of postretirement health care coverage to be provided by an employer is defined by groups of years of service. The plan provides 20 percent postretirement health care coverage for 10 years of service after age 35, 50 percent for 20 years of service after age 35, 70 percent for 25 years of service after age 35, and 100 percent for 30 years of service after age 35. The full eligibility date for an employee who was hired at age 35 and is expected to retire at age 62 is at age 60. At that date the employee has rendered 25 years of service after age 35 and is eligible to receive a benefit of 70 percent health care coverage after retirement. The employee receives no additional benefits for the last two years of service.

**>>>>> Pay-Related Plans**

**55-43** Some plans may base the amount of benefits or level of benefit coverage on employees' compensation, for example, as a percentage of their final pay. To the extent the plan's postretirement benefit formula defines benefits wholly or partially as a function of future compensation (that is, the plan provides incremental benefits for additional years of service when it is assumed that final pay will increase), determination of the full eligibility date or an employee is affected by those additional years of service the employee is expected to render.

**55-44** In addition, measurements of the postretirement benefit obligation and service cost reflect the best estimate of employees' future compensation levels (see paragraphs 715-60-35-88 through 35-89).

**55-45** For example, assume a plan provides life insurance benefits to employees who render 20 years of service and attain age 55 while in service; the benefit is equal to 20 percent of final pay. A 55-year-old employee, who currently earns a salary of $90,000, has worked 22 years for the entity. The employee is expected to retire at age 60 and is expected to be earning $120,000 at that time. The employee is eligible for life insurance coverage under the plan at age 55, when the employee has met the age and service requirements. However, because the employee's salary continues to increase each year, the employee is not fully eligible for benefits until age 60 when the employee retires because the employee earns an incremental benefit for each additional year of service beyond age 55. That is, the employee earns an additional benefit equal to 20 percent of the increase in salary each year from age 55 to retirement at age 60 for service during each of those years.

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**>>>>> Spousal Coverage**

**55-46** Some postretirement benefit plans provide spousal or dependent coverage or both if the employee works a specified number of years beyond the date at which the employee attains eligibility for single coverage.

**55-47** For example, a postretirement health care plan provides single coverage to employees who work 10 years and attain age 50 while in service; the plan provides coverage for dependents if the employee works 20 years and attains age 60 while in service. Because the additional 10 years of service may provide an incremental benefit to employees, for employees expected to satisfy the age and service requirements and to have covered dependents during the period following the employee's retirement, their full eligibility date is the date at which they have both rendered 20 years of service and attained age 60 while in service. For employees not expected to have covered dependents after their retirement or who are not expected to render at least 20 years of service or attain age 60 while in service, or both, their full eligibility date is the date at which they have both rendered 10 years of service and attained age 50 while in service.

**>>>> Single Plan Provides Health Care and Life Insurance Benefits**

**55-48** Some postretirement benefit plans may have different eligibility requirements for different types of benefits.

**55-49** For example, assume a plan provides a postretirement death benefit of $100,000 to employees who render 20 or more years of service. Fifty percent health care coverage is provided to eligible employees who render 10 years of service, 70 percent coverage to those who render 20 years of service, and 100 percent coverage to those who render 30 years of service. Employees are eligible for the health care and death benefits if they attain age 55 while in service.

**55-50** The full eligibility date for an individual hired at age 30 and expected to terminate employment at age 62 is the date on which that employee has rendered 30 years of service and attained age 55 while in service (age 60 in this example). At that date the employee is eligible for all of the benefits expected to be paid to or on behalf of that employee under the postretirement benefit plan ($100,000 death benefits and 100 percent health care coverage). The full eligibility date for an employee hired at age 37 and expected to retire at age 62 is the date on which that employee has rendered 20 years of service and attained age 55 while in service (age 57 in this example). At that date the employee is eligible for all of the benefits expected to be paid to or on behalf of that employee under the postretirement benefit plan ($100,000 death benefits and 70 percent health care coverage).

**>>>> Plans that Provide Benefits Based on Status at Date of Termination**

**55-51** Some postretirement benefit plans provide coverage for the spouse to whom an employee is married when the employee terminates service; that is, the marital status of an employee upon termination of employment determines whether single or spousal coverage is to be provided.

**55-52** In measuring the expected postretirement benefit obligation, consideration is given to factors such as when benefit coverage will commence, who will receive benefits (employee and any covered

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dependents), and the expected need for and utilization of benefit coverage.

**55-53** For example, assume a plan provides postretirement health care coverage to employees who render at least 10 years of service and attain age 55 while in service; health care coverage also is provided to employees' spouses at the date of the employees' retirement. A 55-year-old employee is single, has worked for the entity for 30 years, and is expected to marry at age 59 and to retire at age 62. Although the employee is entitled to spousal coverage only if married at retirement, at age 55 the employee has earned the right to spousal coverage. The probability that the employee will be married when the employee retires is included in the actuarial **assumptions** developed to measure the expected postretirement benefit obligation for that plan participant. The full eligibility date (age 55 in this example) is not affected by that measurement assumption.

**>>>> Postretirement Benefits to Be Received by Disabled Plan Participants**

**55-54** Some plans provide postretirement benefits to disabled employees.

**55-55** For example, Entity B provides disability income and health care benefits to employees who become disabled while in service and have rendered 10 or more years of service. Retiree health care benefits are provided to employees who render 20 or more years of service and attain age 55 while in service. Employees receiving disability benefits continue to accrue credit toward their eligibility for retiree health care benefits. Under this plan, an employee hired at age 25, who becomes permanently disabled at age 40, is entitled to receive retiree health care benefits commencing at age 55 (in addition to any disability income benefits commencing at age 40) because that employee worked for Entity B for more than 10 years before becoming disabled. Under the terms of the plan the employee is given credit for working to age 55 even though no actual service is rendered by the employee after the disabling event occurs.

**55-56** Because the employee is permanently disabled, the full eligibility date is accelerated to recognize the shorter period of service required to be rendered in exchange for the retiree health care benefits—in this case the full eligibility date is age 40, the date of the disabling event. For a similar employee who is temporarily disabled at age 40 but returns to work and attains age 55 while in service, the full eligibility date is age 55. Entity B's expected postretirement benefit health care obligation for the permanently disabled employee is based on the employee's expected health care costs commencing at age 55 and is attributed ratably to that employee's active service to age 40.

This section explains terms and concepts that are used throughout chapters 5 to 11 about retirement benefits. The terms discussed have definitions specific to Topic 715. Some may be found in other accounting standards (e.g. gain or loss), but these definitions do not necessarily apply outside of Topic 715.

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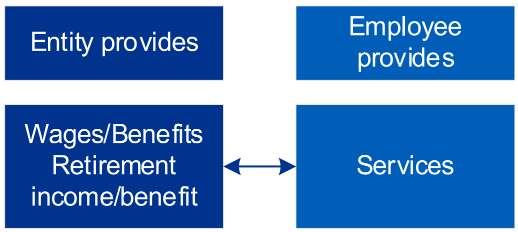
## Question 5.2.10
### What is a benefit plan?

**Interpretive response:** Under Topic 715, a benefit plan is viewed as an exchange between the entity and employee.




In return for employees providing services to the entity, the entity promises to provide income and benefits to its employees after they retire. The income and benefits are considered part of employee compensation so the obligation to provide retirement income and benefits is recognized as the employee provides services. The arrangement must be mutually understood by both parties for it to be considered an exchange between the entity and the employee and accounted for under Topic 715. [715-10-05-6 – 05-7, 715-10-05-9]

## Question 5.2.20
### What is a retirement plan?

**Interpretive response:** A retirement plan is an employee benefit plan that provides payments or benefits to plan participants during retirement. These plans include DC or DB pension, OPEB and health and welfare benefit plans.

Retirement plans in the US are governed by federal law under the Employee Retirement Income Security Act (ERISA). ERISA establishes minimum regulatory standards applicable to most non-government, private entities that offer these plans to their employees and includes:

- reporting and disclosure requirements for plan participants about plan features and funding;
- fiduciary responsibilities; and
- an appeals process.

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## Question 5.2.30

### What is a qualified retirement plan?

**Interpretive response:** A qualified retirement plan meets IRS Code (IRC) 401(a) requirements and offers certain tax benefits. A qualified plan may be a DC or DB plan. A qualified plan meets ERISA guidelines and a nonqualified plan does not. Question 5.2.40 provides examples of qualified and nonqualified retirement plans.

## Question 5.2.40

### What are examples of retirement plans?

**Interpretive response:** The following table provides examples of common qualified and nonqualified retirement plans. See also Question 5.3.10.

| Retirement plan | Description |
|---|---|
| **Qualified DC plans** | |
| 401(k) | Allows an employee to elect to have their employer contribute a portion of their wages to an individual account. The deferred wages are not subject to federal income tax withholding at the time of the deferral or reported as taxable income. |
| Profit-sharing | Accepts discretionary employer-only contributions with separate accounts for each employee. If it includes a salary deferral, it is a 401(k) plan. |
| ESOP | A stock bonus plan designed to invest primarily in qualifying employer securities that meet IRC requirements. |
| **Nonqualified DB plans** | |
| Split-dollar life insurance | Either the employer or employee owns and controls the insurance policy. The employer and employee share benefits of the life insurance policy. See chapter 10. |
| Top Hat (SERP) | Entity-sponsored excess benefit unfunded plan. Offered to [high-level] executives to provide benefits incremental to those provided by an entity's standard retirement plan for its employees. Also referred to as a SERP. [715-30-55-14] |
| **Qualified DB pension plan** | |
| DB pension plan | Provides a determinable pension benefit to plan participants based on a formula. Generally, the entity makes the contributions. Employees may be permitted or required to contribute, depending on the plan. DB pension plans under Subtopic 715-30 are discussed in chapters 6 to 11. [715-30 Glossary] |

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| Retirement plan | Description |
|---|---|
| Cash balance plan | Communicates to employees a pension benefit in the form of a current account balance that is based on principal credits and related future interest credits. See section 5.4. [715-20-25-2] |

## Question 5.2.50

### What obligations does an entity incur under a retirement plan?

**Interpretive response:** Regardless of the type of retirement plan, the entity sponsoring the plan – also referred to as the plan sponsor – incurs an obligation to either contribute to the plan or pay retirement benefits to plan participants in the future.

For DC plans, an entity's obligation is fully satisfied when it makes its contribution for the period. For DB plans, the obligation is satisfied as benefits are paid to retirees or are settled; chapter 9 discusses settlements. [715-30-35-1A, 715-60- 35-1A, 715-70-05-2]

Sections 5.3 and 5.4 address benefit obligations for DC plans and cash balance plans, respectively. Chapter 6 addresses obligations for DB pension and OPEB plans.

## Question 5.2.60#

### What costs does an entity recognize under a pension plan?

**Interpretive response:** For a DC plan, the benefit cost recognized is the contribution required for that period. [715-70-35-1, 715-70 Glossary]

Components of net periodic benefit cost for DB pension and OPEB plans include service cost, interest cost, expected return on plan assets (EROA), gain or loss, and amortization of prior service cost/credit.

The following are some of the reasons that these costs arise each period: [715-30-35-3 – 35-5, 715-60-35-7 – 35-9]

- service provided by the employee to the entity for that period;
- the passage of time;
- changes in estimates made to measure the benefit obligation (recognition of the effect is delayed and amortized from AOCI into income unless an entity has adopted a policy of immediate recognition);
- differences between expected and actual results when measuring plan assets (recognition of the effect is delayed and amortized from AOCI into income unless an entity has adopted a policy of immediate recognition); and
- amortization of the effects of prior plan amendments that increased or reduced an entity's benefit obligation under the plan.

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The term ‘cost’ is used instead of ‘expense’ because service cost may be eligible for capitalization in inventory or other assets before being recognized in the income statement. [715-30 Glossary, 715-60 Glossary]

Sections 5.3 and 5.4 address accounting for costs of DC plans and cash balance plans, respectively. Chapter 7 addresses accounting for costs of DB pension and OPEB plans.

# 5.3 Defined contribution plans

## 5.3.10 Scope considerations#

### Excerpt from ASC 715-70

**05 Overview and Background**

**05-1** This Subtopic provides guidance on the accounting and reporting of **defined contribution plans**.

**05-2** An employer's present obligation under the terms of a plan is fully satisfied when the contribution for the period is made, provided that costs (defined contributions) are not being deferred and recognized in periods after the related service period of the individual to whose account the contributions are to be made.

**05-3** In a postretirement health plan, an employer may establish individual postretirement health care accounts for each employee, each year contributing a specified amount to each active employee's account. The balance in each employee's account may be used by that employee after the employee's retirement to purchase health care insurance or for other health care benefits. Rather than providing for defined health care benefits, the employer is providing a defined amount of money that may be used by retirees toward the payment of their health care costs.

**15 Scope and Scope Exceptions**

**15-1** This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic, see Section 715-10-15.

**> Plans with Characteristics of both a Defined Contribution and a Defined Benefit Plan**

**15-2** A pension or other postretirement benefit plan having characteristics of both a defined benefit plan and a **defined contribution plan** requires careful analysis. If the substance of the plan is to provide a defined benefit, as may be the case with some target benefit plans, the accounting requirements shall be determined in accordance with the provisions of Subtopic 715-30 or 715-60 applicable to a defined benefit plan and the disclosure requirements shall be determined in accordance with the provisions of paragraphs 715-20-50-1 and 715-20-50-5.

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**20 Glossary**

**Defined Contribution Plan –** A plan that provides an individual account for each participant and provides benefits that are based on all of the following: amounts contributed to the participant's account by the employer or employee; investment experience; and any forfeitures allocated to the account, less any administrative expenses charged to the plan.

a. Defined contribution health and welfare plans—Defined contribution health and welfare plans maintain an individual account for each plan participant. They have terms that specify the means of determining the contributions to participants' accounts, rather than the amount of benefits the participants are to receive. The benefits a plan participant will receive are limited to the amount contributed to the participant's account, investment experience, expenses, and any forfeitures allocated to the participant's account. These plans also include flexible spending arrangements.
b. Defined contribution postretirement plan—A plan that provides postretirement benefits in return for services rendered, provides an individual account for each plan participant, and specifies how contributions to the individual's account are to be determined rather than specifies the amount of benefits the individual is to receive. Under a defined contribution postretirement plan, the benefits a plan participant will receive depend solely on the amount contributed to the plan participant's account, the returns earned on investments of those contributions, and the forfeitures of other plan participants' benefits that may be allocated to that plan participant's account.

**55 Implementation Guidance and Illustrations**

**> Implementation Guidance**

**55-1** This Section, which is an integral part of the requirements of this Subtopic, provides general guidance related to accounting and disclosure requirements of defined contribution pension and other postretirement benefit plans.

Although the accounting for defined contributions is not generally complex, it can be difficult to determine when an arrangement is in the scope of guidance for DC or DB plans, especially when it has features of both. Any pension plan that is not a defined contribution pension plan is, for purposes of Subtopic 715-30, a defined benefit pension plan. Similarly, any postretirement benefit plan that is not a defined contribution postretirement plan is, for purposes of Subtopic 715-60, a defined benefit postretirement plan. [715-30 Glossary, 715-60 Glossary]

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## Question 5.3.10
### What is the difference between a DC plan and a DB plan?

**Interpretive response:** Sometimes it is difficult to distinguish between DC and DB pension plans. The following table provides an overview of their common features and distinguishing characteristics.

| Defined contribution plan | Defined benefit plan |
|---|---|
| **Entity responsibility** | |
| Depending on the terms of the DC plan, an entity may have a contribution responsibility. For example, a DC plan may contribute to an individual employee account based on a contribution formula associated with service.<br>However, depending on the plan, entity contributions may be discretionary and there may be no entity responsibility to contribute to the plan.<br>See Question 5.2.40 for DC plan examples. | To provide income and benefits to the employee after retirement based on fixed timing and/or amounts. |
| **Retirement benefit to employee** | |
| Not fixed | Fixed |
| **Typical features** | |
| — Entity contributes, often from employees' wages, based on an employee elected percentage of periodic salary or matching of employee contributions.<br>— Entity maintains individual accounts for each employee.<br>See Question 5.2.40 for DC plan examples. | — Entity funds the plan throughout the employee service period using actuarial calculations to ensure cash flows that are adequate to pay out the fixed benefits.<br>— Entity does not maintain individual accounts; an exception is a cash balance plan (see section 5.4). |
| **Risks and rewards** | |
| Generally, the employee assumes the risks and rewards related to the plan benefits they receive on retirement. | Generally, the risks rest with the entity to provide the fixed retirement benefits to the employee. |
| **Examples** | |
| 401(k), profit-sharing plan, plans that specify employee pay-in formulas (describing a contribution related to service). | DB pension plans, DB OPEB plans, plans that specify pay-out formulas (describing a benefit to be received). |

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| Defined contribution plan | Defined benefit plan |
|---|---|
| **Entity responsibility** | |
| **Accounting** | |
| Entity records a liability for the contribution payable and related expense each period. | Entity records various components related to its benefit obligation and offsetting plan assets, actuarial gains and losses, net benefit costs and amortization. |

Uncertainty about the ultimate benefit paid to the employee does not mean that a pension plan is a DC plan. Judgment based on the individual facts and circumstances of a plan may be required to determine its classification and the resulting accounting requirements. [715-20-25-1 – 25-4]

## Example 5.3.10
## Defined benefit vs defined contribution

### Background

ABC Corp. established a new deferred compensation plan (the Arrangement) for 12 of its executive employees. Further:

— a formal plan document exists that was approved by ABC's board of directors;

— ABC calculates benefits under the Arrangement based on a formula of prior year compensation in excess of the IRC Section 415 retirement benefit limit, which participants can receive annually, multiplied by ABC's matching contribution percentage;

— the plan is unfunded; and

— plan participants have a notional account that is credited with a pay credit and an interest credit on an annual basis.

### Analysis

ABC performs the following assessment to determine how to account for the Arrangement.

| | In scope of guidance for | | | |
|---|---|---|---|---|
| | **General employee benefit arrange-ments?** | **DB plans** | **DC plans** | |
| **Arrangement feature** | **Topic 710** | **Subtopic 715-30** | **Subtopic 715-70** | **Explanation** |
| Deferred compensation contract with 12 | No | Yes | Yes | See section 2.2.40 for analysis |

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<table>
<tr><th></th><th colspan="4">In scope of guidance for</th></tr>
<tr><th rowspan="2">Arrangement feature</th><th>General employee benefit arrange-ments?</th><th>DB plans</th><th>DC plans</th><th rowspan="2">Explanation</th></tr>
<tr><th>Topic 710</th><th>Subtopic 715-30</th><th>Subtopic 715-70</th></tr>
<tr><td>executive employees</td><td></td><td></td><td></td><td rowspan="3"></td></tr>
<tr><td>A written, approved plan document</td><td>No</td><td>Yes</td><td>Yes</td></tr>
<tr><td>A prescribed plan formula</td><td>No</td><td>Yes</td><td>Yes</td></tr>
<tr><td>The plan is unfunded</td><td>No</td><td>Yes</td><td>No</td><td rowspan="2">Based on individual facts and circumstances, arrangement meets the definition of a cash balance plan and is accounted for as a DB plan.<br>It does not meet the definition of a DC plan under Subtopic 715-70 because: [715-20-25-1 – 25-4]<br>— plan participants do not have individual accounts that contain underlying assets and allow for the contributed assets to be invested at the discretion of the participant; and<br>— plan is unfunded such that the participants have a notional account that is credited with pay credits and an interest credit that prevents the participants from being subject to market losses.</td></tr>
<tr><td>Plan participants receive pay and interest credits to a notional account</td><td>No</td><td>Yes</td><td>No</td></tr>
</table>

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## Question 5.3.20

**Are target benefit plans DC plans?**

**Interpretive response:** It depends. Such a plan is accounted for as either a DC or DB plan depending on the individual facts and circumstances of the arrangement.

A target benefit plan is a form of money purchase pension plan. The entity calculates its annual contribution for each participant based on an actuarially determined amount required to fund a target benefit established by a plan formula. The fixed formula is usually based on compensation and length of service.

Typically, the entity does not commit to a specific benefit, but only contributes to achieve that benefit. However, in some target benefit plans the substance of the plan may be to provide a defined benefit. For those plans, DB accounting is appropriate. [715-30-15-4A, 715-70-15-2]

In assessing the substance of those plans, an entity should consider the level of risk it bears with respect to the assets held by the plan and the level of risk borne by the employee. If the plan pays benefits based on the account balance (not on the target benefit), that suggests the plan is a DC plan. In contrast, if the entity otherwise substantively guarantees a certain level of benefit or return on the plan assets, that suggests the plan is a DB plan. [715-30-15-4A, 715-70-15-2]

# 5.3.20 Measuring the obligation and related costs

## Excerpt from ASC 715-70

**35 Subsequent Measurement**

**> Defined Contribution Plans**

**35-1** To the extent a plan's defined contributions to an individual's account are to be made for periods in which that individual renders services, the net pension or other postretirement benefit cost for a period shall be the contribution called for in that period. If a plan calls for contributions for periods after an individual retires or terminates, the estimated cost shall be accrued during the employee's service period.

**55 Implementation Guidance and Illustrations**

**>> Employer Contributions from a Terminated Defined Benefit Plan to a Defined Contribution Plan**

**55-4** When an employer terminates a defined benefit plan and contributes the assets withdrawn to a defined contribution plan and the amount contributed is in excess of the employer's required (or maximum) annual contribution to the plan, the assets in excess of the required contribution are maintained in a suspense account pending allocation to plan participants. Those assets are not

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allocated to individual participants' accounts, and the employer retains the risks and rewards of ownership of the assets.

**55-5** The excess contribution that is not allocated to individual participants shall be accounted for as an asset regardless of the source of funds to make the excess unallocated contribution (for example, either from an asset reversion of a defined benefit plan or otherwise).

**55-6** The unallocated amount shall be treated as if it were part of the employer's investment portfolio and recorded as an asset until allocation to individual participants. For example, if the unallocated amount consists of equity securities, the accounting as required by Subtopic 321-10 shall apply. If the employer is subject to specialized industry accounting rules, as indicated in paragraph 320-10-15-3 or paragraph 321-10-15-3, such specialized industry rules would apply. Income attributable to such securities, including dividends, interest, and realized gains and losses, should be reported in a manner consistent with the employer's reporting of similar items.

**55-7** Compensation expense shall be reflected at the time the allocation is made by the plan based on the **fair value** of the assets at that time.

**55-8** The employer shall report the portion of the unallocated assets of the plan that consist of employer common stock as treasury stock in the employer's financial statements.

**55-9** With respect to the employer's own debt securities and a third party's debt securities the employer shall report the portion of the unallocated assets of the plan that consist of employer debt securities as an asset rather than as an extinguishment of debt. This Subtopic applies only to employer debt securities included in the unallocated assets of a defined contribution plan and shall not apply to other circumstances in which an entity acquires its own debt securities. Debt securities, both of third parties and of the employer, included in the unallocated assets of a defined contribution plan shall be measured at the lower of cost or fair value with any write-downs reflected in the income statement.

Although accounting for a DC plan is relatively simple, this section clarifies some of the more complex aspects when calculating the obligation and related benefit cost.

## Question 5.3.30

### How is the obligation and cost of contributions calculated?

**Interpretive response:** An entity accrues an obligation for a DC plan based on contributions due to the employees' individual accounts for that period and records the related benefit cost.

Entity contributions are separate from employee contributions and are often at the entity's discretion (e.g. as a match to employee contributions). Further, during an individual participant's service period, the entity accrues the contributions it will make under the plan after that employee retires or is

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terminated. The entity reduces its obligation as it makes payments to the employee from its individual account under the plan. Question 5.2.40 discusses DC plan features and ways that entities may contribute to them. [715-70-35-1]

For a plan that specifies contributions after retirement or termination, the entity considers whether those payments indicate that the substance of the plan provides a defined benefit instead of a defined contribution. [715-70-35-1]

### Question 5.3.40

**How is the cost of contributions that are subject to a vesting schedule calculated?**

**Interpretive response:** Contributions to a DC plan may be subject to a vesting schedule. Under the subsequent measurement guidance for DC plans, the net benefit cost for the period is the contribution in that period, regardless of vesting. An entity accounts for forfeitures related to vesting conditions as a reduction of expense in the period of forfeiture. [715-70-15-2, 35-1]

## 5.3.30 Floor offset plans

### Excerpt from ASC 715-70

**55 Implementation Guidance and Illustrations**

**>> Floor-Offset Plans**

**55-2** An employer has two legally separate pension or other postretirement benefit plans—a defined benefit plan and a **defined contribution plan**. The terms of the defined benefit plan specify that the employer's obligation under that plan is reduced to the extent that a participant's account balance in the defined contribution plan shall be used to pay incurred benefits covered by the defined benefit plan. Those plans shall be considered two plans for purposes of applying this Subtopic.

**55-3** The defined benefit plan is commonly described as a floor-offset plan. As participants' account balances in the defined contribution plan grow, the employer's obligation under the defined benefit plan diminishes. However, the nature of the employer's obligation under each plan, how that obligation is satisfied, the availability of plan assets to pay benefits, and the accounting for a defined benefit versus a defined contribution plan are sufficiently dissimilar for the two plans that they cannot be considered a single plan for purposes of applying the guidance in this Subtopic. See paragraphs 715-60-55-32 through 55-34 for additional guidance on floor-offset plans.

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## Excerpt from ASC 715-60

**55 Implementation Guidance and Illustrations**

**>> Floor Offset Plans**

**55-32** Any assets of the defined contribution plan described in paragraph 715-70-55-3 that have not yet been allocated to participants' individual accounts do not reduce the accumulated postretirement benefit obligation of the defined benefit plan. The terms of the defined benefit plan require the payment of benefits that exceed those payable using participants' individual account balances in the defined contribution plan. Pursuant to those terms, assets of a defined contribution plan that have not yet been allocated to participants' individual accounts do not reduce the employer's present obligation under the defined benefit plan.

**55-33** Although an employer's intent may be to allocate the unallocated assets in the future so that participants can use those assets to pay health care costs, that intent is insufficient to offset the present defined benefit plan obligation. When the unallocated assets in the defined contribution plan are allocated, the benefits payable under that plan are increased and the obligation of the defined benefit plan is reduced. That reduction is recognized immediately in determining the net periodic postretirement benefit cost for the defined benefit plan.

**55-34** Because the two plans are legally separate and, thus, the assets of one plan are not available to pay the benefits of the other, neither the allocated nor the unallocated assets of the defined contribution plan would be considered plan assets of the defined benefit plan.

## Question 5.3.50

### What is a floor-offset plan and how is it accounted for?

**Interpretive response:** An entity may use a participant's account balance in a DC plan to reduce its obligation to the employee under the terms of a legally separate DB plan (e.g. a DB pension plan). The DB plan is commonly referred to as a floor-offset plan. [715-70-55-2 – 55-3]

To account for a floor-offset plan at each measurement date the entity calculates its PBO as follows.

**PBO** = Net present value of the pledged defined benefit − Current value of assets in the defined contribution plan

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## 5.4 Cash balance plans

### Excerpt from ASC 715-20

**25 Recognition**

**> Cash Balance Plans**

**25-1** A cash balance plan is a defined benefit plan.

**25-2** A cash balance plan communicates to employees a pension benefit in the form of a current account balance that is based on principal credits and future interest credits based on those principal credits.

**25-3** In a cash balance plan, individual account balances are determined by reference to a hypothetical account rather than specific assets, and the benefit is dependent on the employer's promised interest-crediting rate, not the actual return on plan assets. The employer's financial obligation to the plan is not satisfied by making prescribed principal and interest credit contributions – whether in cash or as a hypothetical contribution to participants' accounts – for the period; rather, the employer must fund, over time, amounts that can accumulate to the actuarial present value of the benefit due at the time of distribution to each participant pursuant to the plan's terms. The employer's contributions to a cash balance plan trust and the earnings on the invested plan assets may be unrelated to the principal and interest credits to participants' hypothetical accounts.

**25-4** The determination of whether a plan is pay-related and the appropriate benefit attribution approach for a cash balance plan with other characteristics or for other types of defined benefit pension plans depend on an evaluation of the specific features of those benefit arrangements. See paragraphs 715-30-35-36 through 35-39, 715-30-55-7 through 55-15, and 715-30-55-127A (Example 8) for guidance on attribution approaches.

### Excerpt from ASC 715-30

**15 Scope and Scope Exceptions**

**>> Transactions**

**15-3** The guidance in this Subtopic applies to **defined benefit pension plans**, including but not limited to the following types of arrangements:

a. Cash balance plans

…

**55 Implementation Guidance and Illustrations**

**>> Example 8: Cash Balance Plans**

**55-127A** For the purposes of this Example, a cash balance plan has the following characteristics:

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a. A defined principal-crediting rate as a percentage of salary
b. A defined, noncontingent interest-crediting rate that entitles participants to future interest credits at a stated, fixed rate until retirement.

The benefit promise in a cash balance arrangement for a cash balance plan as described in (a) through (b) is not pay-related, and use of a projected unit credit method is neither required nor appropriate for purposes of measuring the benefit obligation and annual cost of benefits earned under this Subtopic. The appropriate cost attribution approach, therefore, is the traditional unit credit method. See paragraphs 715-30-35-36 through 35-39 and 715-30-55-7 through 55-15 for guidance on attribution approaches.

A cash balance plan is an account-based DB plan. These arrangements may also be referred to as hybrid plans because they combine features of DC and DB plans. Cash balance plans are account-based (like DC plans) but they are accounted for as DB plans. [715-20-25-1 – 25-3]

## Question 5.4.10#
### What is a cash balance plan?

**Interpretive response:** In a typical cash balance plan, each employee has a separate hypothetical account that is credited with the following.

— **Pay (principal) credits.** This annual crediting rate is generally expressed as a percentage of the employee's salary.

— **Future interest credits.** This defined non-contingent interest-crediting rate is generally expressed as a variable rate index or a fixed interest crediting percentage – e.g. 30-year US Treasury rate, market-based index or fund. [715-30-55-127A]

Even though each employee has a separate hypothetical account, the entity bears the investment risks and rewards because the interest credits are non-contingent. Employees are not subject to market losses (because the entity commits to an interest-crediting structure) and can convert their account balance to an annuity or receive a lump-sum payment on retirement. [715-20-25-1]

The following table summarizes key features outlined in Subtopic 715-20 for cash balance plans to illustrate why they are accounted for as DB plans and not DC plans.

| | Is it a characteristic of a | |
|---|---|---|
| **Cash balance plan feature** | **DB plan?** | **DC plan?** |
| The entity commits to provide a stated rate of interest (whether fixed or tied to a specified index). [715-20-25-3] | Yes. The entity commits to a defined benefit by defining a stated rate of interest due on retirement.<br>Like a DB plan, the entity has the | No |

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| Cash balance plan feature | Is it a characteristic of a DB plan? | Is it a characteristic of a DC plan? |
|---|---|---|
| | investment risks and rewards if actual earnings do not meet this guaranteed interest-credit rate. | |
| The entity funds amounts that accumulate toward a benefit due to each participant on distribution under the plan's terms. [715-20-25-3] | Yes. Like in a DB plan, the entity's obligation goes beyond its obligation to contribute to the plan. | No |
| Individual account balances refer to a hypothetical account and depend on a promised interest-crediting rate. [715-20-25-3] | Yes. A DB plan under Topic 715 is any plan in its scope that is not a DC plan. | No. Although cash balance plans are account-based like DC plans, they differ because in a DC plan each benefit is based solely on the assets invested and the return on those assets. Also, separate accounts are maintained on paper only and are not actually separate investment accounts for each participant. |
| Accounting based on an attribution of benefits over a service period | Yes | No |

While cash balance or other hybrid plans are generally accounted for as DB plans, entities consider their individual facts and circumstances to determine whether a cash balance or other hybrid plan is a DC or DB plan under Subtopic 715-70. [715-20-25-1 – 25-4]

## Question 5.4.20#

### How are benefits attributed to a cash balance plan?

**Interpretive response:** To determine the attribution approach for a cash balance (or similar hybrid) plan that is a DB plan, the entity determines whether the benefit provided is pay-related or non-pay-related. [715-20-25-4]

— **Pay-related DB plans.** Such plans are affected by future pay increases. The benefit obligation and periodic benefit costs of these plans are measured using the projected unit credit method. This method measures the benefit obligation based on service earned to date but considers future expected salary increases. [715-20-25-4]

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— **Non-pay-related DB plans**. Such plans are not affected by future pay increases. The benefit obligation and periodic benefit costs of these plans are measured using the traditional unit credit method, which considers only the current hypothetical contribution and the present value of future interest credits related to that contribution. [715-30-55-127A]

Under both of these actuarial methods, an employee's service earns additional units of future benefit. The accrued liability is measured as the present value of the units of benefits. See Examples 8.6.20 and 8.6.30 for an illustration of the application of the projected unit credit method and the traditional unit credit method, respectively.

## Question 5.4.30

**Can an entity change the method it uses to measure a cash balance plan?**

**Interpretive response:** In general, entities do not change their method for measuring their cash balance plans, because the approach is determined based on whether the cash balance plan is a pay-related or non-pay-related plan (see Question 5.4.20). However, any change in method for measurement related to a DB plan is a change in accounting principle that must be determined to be preferable. Section 3.3.20 of KPMG Handbook, Accounting changes and error corrections, discusses preferability.

## Question 5.4.40#

**Is the discount rate used to measure the benefit obligation of a cash balance plan consistent with the interest-crediting rate?**

**Interpretive response:** Plans may specify a variable interest-crediting rate tied to market conditions. This may not be relevant to calculate the assumed discount rate used to measure the benefit obligation of a DB cash balance plan. If the variable interest-crediting rate were used, the resulting periodic cost would often match the cost as if that plan had been accounted for as a DC plan.

We believe entities should use an assumed discount rate consistent with the subsequent measurement guidance for DB pension plans regardless of the rate used for crediting purposes (i.e. the interest-crediting rate). The assumed discount rate should be based on the interest rate inherent in high-quality fixed-income investments (e.g. bonds). The bonds should have maturities similar to the estimated benefit payments to best reflect the inherent interest rates at which the pension benefits could be effectively settled. Section 8.3 discusses discount rates. [715-30-35-43 – 35-46]

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## Question 5.4.50
**How is the ABO for a cash balance plan measured?**

### Excerpt from ASC 715-30

**55 Implementation Guidance and Illustrations**

**>> Pension Arrangements Outside the United States**

**55-65** Paragraphs 715-10-15-6 through 15-7 establish that there are no special provisions applicable to plans or arrangements outside the United States and specifies that, to the extent that those arrangements are in substance similar to plans in the United States, they are subject to the provisions of this Topic.

**55-66** A non-U.S. pension plan may provide death and disability benefits that are greater than the incidental death and disability benefits allowed in U.S. tax-qualified pension plans. 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.

**55-67** Under certain plans (typically non-U.S. plans) 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, to determine the **vested benefit obligation**, 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 as provided for in paragraphs 715-30-35-40 through 35-41.

**Interpretive response:** The ABO as of a date is the actuarial present value of benefits attributed by the pension benefit formula to employee service rendered before that date.

In general, when applying the attribution approach described in Subtopic 715-30, the PBO will always equal or exceed the ABO because the PBO considers future salary increases (for pay-related plans). The ABO does not reflect future salary increases and therefore is measured using the traditional unit credit method. Section 8.6 discusses attribution methods under Topic 715. [715-30-35-1A – 35-2, 715-30-35-36 – 35-38]

For cash balance plans, the ABO serves as a minimum for the PBO when a projected unit credit method is used to calculate the PBO. This minimum approach applies when calculating each participant's ABO and PBO. [715-30-35-2, 715-30-35-36 – 35-38]

Because a cash balance plan may be considered analogous to *certain plans* under the guidance for pension arrangements outside the US, actuaries might take different approaches to measuring the ABO for a cash balance plan. In general, different approaches might include computing the ABO: [715-30-55-67]

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- as being equal to the cash balance account at the measurement date;
- by projecting the cash balance account into the future using an assumed interest-crediting rate only (no future pay-related or fixed-dollar crediting rate) and discounting the projected cash balance accounts (or related annuity benefits) back to the measurement date;
- as the greater of (1) or (2); or
- using the same techniques as those used for the PBO without using assumed future compensation increases when determining projected future pay credits.

General guidance about measuring the ABO is discussed in section 5.4, and Question 5.4.20 discusses measuring the obligation for a cash balance plan.

## Question 5.4.60

**How does an entity account for suspending benefits for a subsidiary's participants when they will be added to the parent's cash balance pension plan?**

**Background:** Assume a subsidiary is the sponsor of a single-employer DB pension plan in which all participants' benefits will be frozen at current levels. The subsidiary's plan will continue to exist to pay accrued benefits to existing retirees and to pay benefits to vested employees when they retire. All active employees will become participants in the parent's cash balance plan and will accrue benefits for future services. The benefits provided under the parent's cash balance plan are less than the benefits provided under the subsidiary's DB plan.

**Interpretive response:** The entity accounts for the events differently at the consolidated and subsidiary levels.

At the consolidated level, this transaction is accounted for as a negative plan amendment (see chapter 9) because the parent's cash balance plan is viewed as a successor plan to the subsidiary's plan in which reduced benefits are to be provided to employees for future services. There is no settlement of the subsidiary's plan nor is there any reduction in the expected years of future service to the consolidated entity.

At the subsidiary level, this transaction is accounted for as a curtailment because the parent's cash balance plan is viewed as a multiemployer plan (see chapter 10) in the subsidiary's separate financial statements under Topic 715.

In addition, this transaction is viewed as being analogous to when a company terminates its single-employer plan and joins a multiemployer plan, but the multiemployer plan is not considered a successor plan. A multiemployer plan is not viewed as a successor plan to a single-employer plan, because the nature of an employer's promise is different in a multiemployer plan. [715-80-55-4]

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# 6. DB pension and OPEB plans: Plan assets and obligations

## Detailed contents



[1] Questions 6.3.140 to 6.3.210 have been moved to section 7.5.

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## 6.1 How the standard works

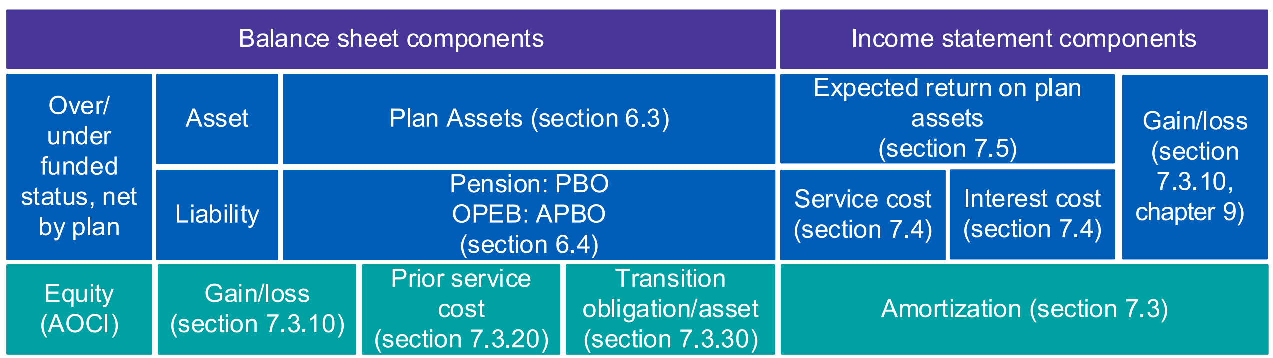
Accounting for DB plans – i.e. DB pension and OPEB plans – is complicated, especially because of the different types of DB plans. In addition, the accounting for DB plans relies on developing estimates that often require an actuarial specialist's expertise, adding to the overall complexity.

In simple terms, the objectives of DB plan accounting under Topic 715 are to:

— reflect the entity's benefit obligation, offset by any qualifying assets the entity will use to fund the benefits, resulting in a recognized net liability (if underfunded) or a recognized net asset (if overfunded) for each plan; and
— recognize as a current period expense the net periodic benefit cost as employees render the services necessary to earn their pension and other postretirement benefits.

Entity contributions to a funded plan decrease a recognized net liability or increase a recognized net asset. Benefit payments from a funded plan reduce the benefit obligation and the plan assets equally, with no effect on the entity's balance sheet. Any other changes in the benefit obligation or the plan assets (other than contributions and benefit payments) are either initially recognized in OCI or included in net periodic benefit cost for the period.

The following diagram illustrates the various balance sheet and income statement components and where they are discussed in chapters 6 and 7.

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## Organization of chapters on DB pension and OPEB plans under Topic 715

This Handbook divides the discussion of DB plans into several chapters.

- This chapter examines the accounting requirements for plan assets and benefit obligations.
- Chapter 7 examines costs of DB plans.
- Chapter 8 explains actuarial assumptions used to measure these financial statement components and attribution.
- Chapter 9 discusses settlements, curtailments and certain termination benefits.
- Chapter 10 discusses special topics including multiemployer plans.
- Chapter 11 reviews disclosure and reporting requirements.

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# 6.2 Overview

## 6.2.10 Alignment of Subtopics 715-30 and 715-60

Topic 715 provides guidance for all entities that offer DB pension, OPEB and certain special or contractual termination benefits to employees, regardless of whether the benefit obligation is funded.

A retirement benefit plan is an arrangement that is mutually understood by an entity (i.e. employer) and its employees, whereby an entity provides its employees with benefits after they retire:

— in exchange for the employees' services over a specified period of time; and/or
— upon attaining a specified age while in service.

Benefits may begin immediately upon termination of service or may be deferred until retirement based on a DB plan’s provisions.

While Subtopic 715-30 addresses the accounting for DB pension plans, Subtopic 715-60 addresses the accounting for DB OPEB plans. As shown in the following Topic 715 excerpts, Subtopics 715-30 and 715-60 align closely in many respects. In fact, the guidance states that many provisions are the same or similar in both Subtopics. This Handbook displays the Codification excerpts for Subtopics 715-30 and 715-60 side by side – to make it easier to understand if the guidance aligns or is not relevant between Subtopics. [715-30-05-2, 715-60-05-7]

However, because the Subtopics may use different terminology to describe a similar component of DB plan accounting, this Handbook may use a more generic term for ease of reference. For example, we may use the term ‘benefit obligation’ to generically refer to the projected benefit obligation (PBO) recognized for a DB pension plan or the accumulated postretirement benefit obligation (APBO) recognized for a DB OPEB plan as the ‘benefit obligation’.

| Excerpt from ASC 715-30 | Excerpt from ASC 715-60 |
|---|---|
| **20 Glossary** | **20 Glossary** |
| **Defined Benefit Plan –** A defined benefit plan provides participants with a determinable benefit based on a formula provided for in the plan.<br>a. Defined benefit health and welfare plans—Defined benefit health and welfare plans specify a determinable benefit, which may be in the form of a reimbursement | **Defined Benefit Plan –** A defined benefit plan provides participants with a determinable benefit based on a formula provided for in the plan.<br>a. Defined benefit health and welfare plans—Defined benefit health and welfare plans specify a determinable benefit, which may be in the form of a reimbursement |

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to the covered plan participant or a direct payment to providers or third-party insurers for the cost of specified services. Such plans may also include benefits that are payable as a lump sum, such as death benefits. The level of benefits may be defined or limited based on factors such as age, years of service, and salary. Contributions may be determined by the plan's actuary or be based on premiums, actual claims paid, hours worked, or other factors determined by the plan sponsor. Even when a plan is funded pursuant to agreements that specify a fixed rate of employer contributions (for example, a collectively bargained multiemployer plan), such a plan may nevertheless be a defined benefit health and welfare plan if its substance is to provide a defined benefit.

b. Defined benefit pension plan—A pension plan that defines an amount of pension benefit to be provided, usually as a function of one or more factors such as age, years of service, or compensation. Any pension plan that is not a defined contribution pension plan is, for purposes of Subtopic 715-30, a defined benefit pension plan.

c. Defined benefit postretirement plan—A plan that defines postretirement benefits in terms of monetary amounts (for example, $100,000 of life insurance) or benefit coverage to be provided (for example, up to $200 per day for hospitalization, or 80 percent of the cost of specified surgical procedures). Any postretirement benefit plan that is not a defined contribution postretirement plan is, for purposes of Subtopic 715-60, a defined benefit postretirement plan. (Specified monetary amounts and benefit coverage are collectively referred to as benefits.)

to the covered plan participant or a direct payment to providers or third-party insurers for the cost of specified services. Such plans may also include benefits that are payable as a lump sum, such as death benefits. The level of benefits may be defined or limited based on factors such as age, years of service, and salary. Contributions may be determined by the plan's actuary or be based on premiums, actual claims paid, hours worked, or other factors determined by the plan sponsor. Even when a plan is funded pursuant to agreements that specify a fixed rate of employer contributions (for example, a collectively bargained multiemployer plan), such a plan may nevertheless be a defined benefit health and welfare plan if its substance is to provide a defined benefit.

b. Defined benefit pension plan—A pension plan that defines an amount of pension benefit to be provided, usually as a function of one or more factors such as age, years of service, or compensation. Any pension plan that is not a defined contribution pension plan is, for purposes of Subtopic 715-30, a defined benefit pension plan.

c. Defined benefit postretirement plan—A plan that defines postretirement benefits in terms of monetary amounts (for example, $100,000 of life insurance) or benefit coverage to be provided (for example, up to $200 per day for hospitalization, or 80 percent of the cost of specified surgical procedures). Any postretirement benefit plan that is not a defined contribution postretirement plan is, for purposes of Subtopic 715-60, a defined benefit postretirement plan. (Specified monetary amounts and benefit coverage are collectively referred to as benefits.)

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**05 Overview and Background**

**05-1** This Subtopic provides guidance on defined benefit pension accounting for an employer that offers **pension benefits** to its employees. This Subtopic focuses on an employer's accounting for a single-employer **defined benefit pension plan**.

**05-2** Many of the provisions in this Subtopic are the same as or are similar to the provisions of Subtopic 715-60. Consequently, the guidance provided in that Subtopic may be useful in understanding and implementing many of the provisions of this Subtopic. However, there are differences between the specific requirements of the two. Subtopics, and therefore the specific guidance in one Subtopic should not be used to override guidance of the other.

**05-3** The guidance in this Subtopic is presented in the following two Subsections:

a. General
b. Settlements, Curtailments, and Certain Termination **Benefits**.

**05-4** The General Subsections address the fundamentals of defined benefit pension accounting. A pension benefit is part of the compensation paid to an employee for services. Generally, the amount of benefit to be paid depends on a number of future events that are incorporated in the **plan's benefit formula**, often including how long the employee and any survivors live, how many years of **service** the employee renders, and the employee's compensation in the years immediately before retirement or termination. Conceptually, compensation cost should be recognized in the period in which the employee renders services. Although the complexity and uncertainty of the pension arrangement may preclude complete achievement of that goal, a fundamental objective of this Subtopic is to approximate more closely the recognition of the

**05 Overview and Background**

**05-1** This Subtopic provides accounting and reporting guidance for other **postretirement benefits**. The guidance in this Subtopic is presented in the following four Subsections:

a. General
b. Medicare Prescription Drug, Improvement, and Modernization Act
c. Settlements, Curtailments, and Certain Termination Benefits
d. Split-Dollar Life Insurance Arrangements.

**05-2** The General Subsections provide guidance on an employer's accounting and reporting for a **defined benefit postretirement benefit plan**, that is, a **single-employer plan** that defines the nonpension **postretirement benefits** to be provided to **retirees**. This Subtopic refers to these **benefits** as postretirement benefits and to these **plans** as postretirement plans. Generally, the amount of those benefits depends on the **benefit formula** (which may include factors such as the number of years of service rendered or the employee's compensation before retirement or termination), the longevity of the retiree and any beneficiaries and covered dependents, and the incidence of events requiring benefit payments (for example, illnesses affecting the amount of health care required).

**05-6** Although this Subtopic applies to all defined benefit postretirement plans other than pensions, **postretirement health care benefits** are likely to be the most significant in terms of cost and prevalence, and certain of the issues that arise in measuring those benefits are unique.

**05-7** Many of the provisions in this Subtopic are the same as or similar to the provisions of Subtopic 715-30. Consequently, the guidance provided in that Subtopic may

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| compensation cost of an employee's pension benefits over that employee's service period.<br><br>**05-6** The core elements of pension accounting include measurement of net periodic pension cost and benefit obligations (see paragraphs 715-30-35-1A through 35-41), assumptions (see paragraphs 715-30-35-42 through 35-49), and measurement of plan assets (see paragraphs 715-30-35-50 through 35-52). | be useful in understanding and implementing many of the provisions of this Subtopic. However, there are differences between the specific requirements of this Subtopic and that Subtopic, and therefore the specific guidance in one Subtopic should not be used to override guidance of the other. |

## 6.2.20 Basic concepts

The obligation to provide benefits under the terms of a DB plan accumulates as employees render the services necessary to earn the benefits. Topic 715 explains *when* and *how* the cost of providing the benefits should be recognized over those employee service periods. This section explores some basic concepts about DB pension and OPEB accounting that are helpful to understanding the subsequent sections in this chapter.

### Question 6.2.10
**When is a DB plan 'funded'?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** DB plans are often referred to as funded or unfunded. This refers to whether the entity has plan assets – usually in a trust – specifically reserved to pay for the retirement benefits it will pay to retirees. For a plan to be considered funded, the plan-related assets must meet the definition of plan assets under Topic 715 and qualify for netting against the benefit obligation (see Question 6.3.10). If there are no assets that meet the definition of plan assets under Topic 715, the plan is considered to be unfunded. When a DB plan is funded, it can be either overfunded or underfunded (see Question 6.2.20). [715-30-25-1, 715-60-35-5]

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## Question 6.2.20
**When is a DB plan over- or underfunded?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Over- and underfunding refers to the fair value of plan assets relative to the benefit obligation of a DB plan. When the benefit obligation exceeds the fair value of plan assets, the DB plan is underfunded and the entity recognizes a net liability for the unfunded portion of the obligation. When the fair value of plan assets exceeds the benefit obligation, the DB plan is overfunded and the entity recognizes a net asset for the overfunded benefit obligation. [715-30-25-1 – 25-2, 715-60-25-1]

## Question 6.2.30
**What does the measurement date signify for plan assets and obligations?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Each DB plan has an annual measurement date, which is the date the DB plan's assets and obligations are measured for the purpose of accounting for each plan in an entity's annual financial statements. Under Topic 715, an entity's fiscal year-end reporting date is the plan's measurement date. If an entity's fiscal year-end does not coincide with a month-end, the entity may measure plan assets and benefit obligations using the month-end that is closest to its fiscal year-end. When an entity uses the closest month-end, it should use the same month-end consistently from year to year and consistently for all its DB plans (if the entity has more than one). [715-30-35-62, 715-30-35-63A, 715-60-35-121, 715-60-35-123A]

For discussion about the measurement timing, including interim measurements related to a significant event, see Question 8.7.60 and section 8.7.

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# 6.3 Plan assets

| Excerpt from ASC 715-30 | Excerpt from ASC 715-60 |
|---|---|
| **20 Glossary** | **20 Glossary** |
| **Actual Return on Plan Assets (Component of Net Periodic Pension Cost) –** For a funded plan, the actual return on plan assets is determined as the difference between the fair value of plan assets at the end of the period and the fair value at the beginning of the period, adjusted for contributions and payments of benefits during the period. | **Actual Return on Plan Assets (Component of Net Periodic Postretirement Benefit Cost) –** The change in the fair value of the plan's assets for a period including the decrease due to expenses incurred during the period (such as income tax expense incurred by the fund, if applicable), adjusted for contributions and benefit payments during the period. For a funded plan, the actual return on plan assets shall be determined based on the fair value of plan assets (see paragraph 715-60-35-107) at the beginning and end of the period, adjusted for contributions and benefit payments. If the fund holding the plan assets is a taxable entity, the actual return on plan assets shall reflect the tax expense or benefit for the period determined in accordance with generally accepted accounting principles (GAAP). Otherwise, no provision for taxes shall be included in the actual return on plan assets. |
| **Asset Group –** An asset group is the unit of accounting for a long-lived asset or assets to be held and used, which represents the lowest level for which identifiable cash flows are largely independent of the cash flows of other groups of assets and liabilities. | |
| **Expected Long-Term Rate of Return on Plan Assets –** An assumption about the rate of return on plan assets reflecting the average rate of earnings expected on existing plan assets and expected contributions to the plan during the period. | **Expected Long-Term Rate of Return on Plan Assets –** An assumption about the rate of return on plan assets reflecting the average rate of earnings expected on existing plan assets and expected contributions to the plan during the period. |
| | **Funding Policy –** The program regarding the amounts and timing of contributions by the employers, plan participants, |

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| | and any other sources (for example, state subsidies or federal grants) to provide the benefits a pension plan or other postretirement benefit plan specifies. |
| **Market-Related Value of Plan Assets –** A balance used to calculate the expected return on plan assets. The market-related value of plan assets is 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. Different ways of calculating market-related value may be used for different classes of assets (for example, an employer might use fair value for bonds and a five-year-moving-average value for equities), but the manner of determining market-related value is required to be applied consistently from year to year for each asset class. For a method to meet the criteria of being systematic and rational, it must reflect only the changes in the fair value of plan assets between various dates. | **Market-Related Value of Plan Assets –** A balance used to calculate the expected return on plan assets. The market-related value of plan assets is 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. Different ways of calculating market-related value may be used for different classes of assets (for example, an employer might use fair value for bonds and a five-year-moving-average value for equities), but the manner of determining market-related value is required to be applied consistently from year to year for each asset class. For a method to meet the criteria of being systematic and rational, it must reflect only the changes in the fair value of plan assets between various dates. |
| **Pension Fund –** The assets of a pension plan held by a funding agency. | |
| **Plan Assets –** Assets—usually stocks, bonds, and other investments—that have been segregated and restricted, usually in a trust, to provide for pension benefits. The amount of plan assets includes amounts contributed by the employer, and by employees for a contributory plan, and amounts earned from investing the contributions, less benefits paid. Plan assets ordinarily cannot be withdrawn by the employer except under certain circumstances when a plan has assets in excess of obligations and the employer has taken certain steps to satisfy existing obligations. Assets not segregated in a trust or otherwise effectively restricted so that they cannot be used by the employer for other purposes are not plan assets even though it may be intended that such assets be used to provide pensions. If a plan has liabilities other than for benefits, those nonbenefit obligations may be considered as reductions of plan | **Plan Assets –** Assets—usually stocks, bonds, and other investments (except certain insurance contracts as noted in paragraph 715-60-35-109)—that have been segregated and restricted (usually in a trust) to be used for a health and welfare plan (which can include active, terminated, and retired employees or their dependents or beneficiaries). The amount of plan assets includes amounts contributed by the employer, and by plan participants for a contributory plan, and amounts earned from investing the contributions, less benefits, income taxes, and other expenses incurred. Plan assets ordinarily cannot be withdrawn by the employer except under certain circumstances when a plan has assets in excess of obligations and the employer has taken certain steps to satisfy existing obligations. Securities of the employer held by the plan are includable in plan assets provided they are transferable. |

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| | |
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| assets. Amounts accrued by the employer but not yet paid to the plan are not plan assets. Securities of the employer held by the plan are includable in plan assets provided they are transferable. | Assets not segregated in a trust, or otherwise effectively restricted, so that they cannot be used by the employer for other purposes are not plan assets, even though the employer may intend that those assets be used to provide health and welfare benefits, which may include postretirement benefits. Those assets shall be accounted for in the same manner as other employer assets of a similar nature and with similar restrictions. If a plan has liabilities other than for benefits, those nonbenefit obligations are considered as reductions of plan assets. Amounts accrued by the employer but not yet paid to the plan are not plan assets. If a trust arrangement explicitly provides that segregated assets are available to satisfy claims of creditors in bankruptcy, such a provision would effectively permit those assets to be used for other purposes at the discretion of the employer. It is not necessary to determine that a trust is bankruptcy-proof for the assets of the trust to qualify as plan assets. However, assets held in a trust that explicitly provides that such assets are available to the general creditors of the employer in the event of the employer's bankruptcy would not qualify as plan assets. |
| **35 Subsequent Measurement**<br>**> Transfer of Excess Pension Assets to a Retiree Health Care Benefits Account**<br>**35-73** The transfer of excess pension assets to a retiree health care account or plan (whether or not the transfer of assets is made pursuant to applicable laws or regulations) shall be recognized as a negative contribution to (withdrawal of funds from) the pension plan and a positive contribution to the retiree health care plan. No gain or loss arises from the transfer of the excess pension assets. | **35 Subsequent Measurement** |

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**>> Expected Long-Term Rate of Return**

**35-47** The **expected long-term rate of return on plan assets** shall reflect the average rate of earnings expected on the funds invested or to be invested to provide for the benefits included in the projected benefit obligation. In estimating that rate, appropriate consideration shall be given to the returns being earned by the plan assets in the **fund** and the rates of return expected to be available for reinvestment. The expected long-term rate of return on plan assets is used (with the market-related value of assets) to compute the expected return on assets. In the context of its use in this paragraph, funds to be invested refers only to the reinvestment of returns on existing plan assets.

**35-48** The expected return on plan assets shall take into consideration the availability of all plan assets for investment throughout the year. Therefore, the amount and timing of pension plan contributions and benefit payments expected to be made during the year shall be considered in determining the expected return on plan assets for that 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 shall include an amount related to the expected return on that contribution only for those two months.

**35-49** However, the expected return on future years' contributions to a pension plan shall not be considered in determining the expected long-term rate of return on plan assets. The expected long-term rate of return on plan assets shall reflect long-term earnings expectations only on existing plan assets and those contributions expected to be received during the current year.

**>>> Expected Long-term Rate of Return on Plan Assets**

**35-84** The expected long-term rate of return on plan assets shall reflect the average rate of earnings expected on the existing assets that qualify as plan assets and contributions to the plan expected to be made during the period. In estimating that rate, appropriate consideration shall be given to the returns being earned on the plan assets currently invested and the rates of return expected to be available for reinvestment.

**35-85** Unlike most pension plans, the return on postretirement benefit plan assets may be subject to income tax because of the lack of tax-exempt vehicles for funding those benefits. At present, even if postretirement benefit plan assets are restricted and segregated within a trust, the income generated by those assets generally is taxable. If the plan has taxable income, the assessed tax will reduce the returns available for payment of benefits or reinvestment. If the trust or other entity holding the plan assets is taxed as a separate entity on the return on plan assets, the expected long-term rate of return shall be determined by giving consideration to anticipated income taxes under enacted tax law. However, if the tax on income generated by plan assets is not a liability of the plan, but of the employer, the expected long-term rate of return shall not anticipate a tax on those earnings, because that tax will be reflected in the employer's accounting for income taxes (see Topic 740).

**35-86** Thus, if the return on plan assets is taxable to the trust or other fund under the plan, the expected long-term rate of return shall be reduced to reflect the related income taxes expected to be paid under existing law.

**35-87** The expected long-term rate of return on plan assets is used with the market-related value of plan assets to compute the expected return on plan assets. (See

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**> Measurement of Plan Assets**

**35-50** For purposes of applying the **plan-asset-related** provisions of paragraph 715-30-25-1 and for purposes of the disclosures required by paragraphs 715-20-50-1 and 715-20-50-5, plan investments, whether equity or debt securities, real estate, or other, shall be measured at their fair value as of the measurement date. The fair value of an investment shall be reduced by brokerage commissions and other costs normally incurred in a sale if those costs are significant (similar to fair value less cost to sell).

**35-51** For purposes of determining the expected return on plan assets and accounting for asset gains and losses pursuant to paragraphs 715-30-35-18 through 35-26, a **market-related asset value** is used.

**35-52** Plan assets used in plan operations (for example, buildings, equipment, furniture and fixtures, and leasehold improvements) shall be measured at cost less accumulated depreciation or amortization for all purposes.

**55 Implementation Guidance and Illustrations**

**>> Plan Assets**

**55-35** The definition of **plan assets** excludes amounts accrued by the employer but not yet paid to the plan if the exclusion is intended to relate to a recognized pension liability. However, if transferable securities issued by the employer are included in plan assets, the measurement of plan assets should also include the interest accrued but not yet received on those securities.

**55-36** An employer may have a nonqualified pension plan (for tax purposes) that is funded with life insurance policies

paragraph 715-60-35-26.) There is no assumption of an expected long-term rate of return on plan assets for plans that are unfunded or that have no assets that qualify as plan assets pursuant to this Subtopic.

**> Measurement of Plan Assets**

**35-106** For recognition guidance on the funded statuses of other postretirement benefit plans, see paragraph 715-60-25-1.

**35-107** For purposes of the disclosures required by paragraph 715-20-50-1 and paragraph 715-20-50-5, plan investments, whether **equity** or **debt securities**, real estate, or other, shall be measured at their fair value as of the measurement date. (See paragraph 715-60-35-120.) The fair value of an investment shall be reduced by brokerage commissions and other costs normally incurred in a sale if those costs are significant (similar to fair value less cost to sell). Plan assets used in plan operations (for example, buildings, equipment, furniture and fixtures, and leasehold improvements) shall be measured at cost less accumulated depreciation or amortization for all purposes.

**35-108** See paragraphs 715-60-55-26 through 55-28 for implementation guidance on plan assets.

**55 Implementation Guidance and Illustrations**

**>> Plan Assets**

**55-26** If a trust arrangement explicitly provides that segregated assets are available to satisfy claims of creditors in bankruptcy, such a provision would effectively permit those assets to be used for other purposes at the discretion of the employer. It is not necessary to determine that a trust is bankruptcy-proof for the assets of the trust to qualify as **plan assets** under this Subtopic. Assets held in a trust that explicitly provides that such assets are available to the general creditors of the employer in the event of the

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owned by the employer. The cash surrender value of life insurance policies, if the employer is the owner or beneficiary, do not qualify as plan assets and the accounting for those policies should be in accordance with Subtopic 325-30.

**55-37** An employer may have several pension plans with similar plan assets and may elect to use a market-related value approach to value those plan assets. While paragraph 715-30-35-69 provides for the separate application of the guidance in this Subtopic to each plan, 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 the objective of enhancing the comparability of reported pension information.

**55-38** The asset valuation method selected for each class of plan assets 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. There is no 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**.

**55-39** 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 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 net gain or loss included in

employer's bankruptcy would not qualify as plan assets under this Subtopic.

**55-27** An employer may not include in plan assets the assets of a rabbi trust. The assets of a rabbi trust do not qualify as plan assets because they are explicitly available to the employer's creditors in the event of bankruptcy.

**55-28** An employer that issues its own debt or equity securities directly to its postretirement benefit trust may include those securities as plan assets under this Subtopic provided the securities are currently transferable. To be transferable the securities held by the postretirement benefit trust must be legally and unconditionally transferable to unrelated third parties at any time, for any reason, and without economic penalties. Thus, the trustee of the postretirement benefit trust must have the unilateral right and ability to legally and unconditionally sell, transfer, or otherwise dispose of the securities. Securities that are not transferable in their present state do not meet the transferability requirement even though they can be converted into securities that are transferable or can otherwise be made transferable through other means, such as through future registration of the securities for trading in a public market. For example, if an employer issues to its postretirement benefit trust nontransferable convertible preferred stock that can be converted into transferable common stock of the employer, the convertible preferred stock would not meet the criterion of currently transferable and, thus, would not be included in plan assets.

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accumulated other comprehensive income that is 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.

**55-40** The definition of market-related value of plan assets contemplates the use of systematic and rational methodology that reflects only the changes in fair value of plan assets between various dates. An example of an unacceptable method for determining the market-related value of plan assets follows. It is not acceptable because it introduces a factor (see layer [b]) that can be unrelated to the change in the fair value of plan assets. This example of an unacceptable 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 5-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 component layers (a) and (b).

This section examines the recognition and measurement criteria for plan assets, and related concepts under Subtopics 715-30 and 715-60. These components are shown in the following diagram.

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| Balance sheet components | | | | | | Income statement components | | |
|---|---|---|---|---|---|---|---|---|
| Over/under funded status, net by plan | Asset | Plan Assets (section 6.3) | | | | Expected return on plan assets (section 7.5) | | Gain/loss (section 7.3.10, chapter 9) |
| | Liability | Pension: PBO OPEB: APBO (section 6.4) | | | | Service cost (section 7.4) | Interest cost (section 7.4) | |
| Equity (AOCI) | Gain/loss (section 7.3.10) | | Prior service cost (section 7.3.20) | Transition obligation/asset (section 7.3.30) | | Amortization (section 7.3) | | |

## 6.3.10 About plan assets

### Question 6.3.10
**What are plan assets?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Plan assets are usually stocks, bonds and other investments that generate cash flows to pay the benefits. As discussed in Question 6.2.10, a 'funded plan' is one that has assets that qualify as plan assets. Plan assets may include amounts contributed by the entity and employees, and amounts earned from investing and reinvesting the contributions. Plan assets are measured net of non-benefit obligations of the plan (e.g. amounts due to service providers) under the plan. [715-30-35-50, 715-30 Glossary, 715-60-35-85, 715-60 Glossary]

Plan assets must be segregated and restricted so the entity cannot use them for other purposes, including to pay creditors in case of bankruptcy. For example, a tax-qualified DB pension plan must have a separate trust, and meet other qualification requirements of the IRC (if based in the US), which allows the plan sponsor to deduct its contributions to the trust within limits for tax purposes while not creating an immediately taxable benefit for its employees. [715-30 Glossary, 715-60 Glossary]

An entity can use other assets to provide benefits, but if they are not segregated in a trust or likewise restricted for use by the trust, they do not qualify as plan assets and do not offset the DB plan obligation on the balance sheet. For

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example, the entity may have assets it earmarks for nonqualified pension benefits (e.g. SERP, deferred compensation), which may be held in a rabbi trust. A rabbi trust is still subject to the entity's creditors and is not included in plan assets. [715-30 Glossary, 715-60-55-27, 715-60 Glossary]

Securities of the entity held by the plan may be included in plan assets if they are transferable. [715-30-55-35, 715-30 Glossary, 715-60-55-26, 55-28]

### Guidance specific to Subtopic 715-60

Unlike most pension plans where the trusts are generally tax-exempt vehicles, OPEB plan assets may be subject to unrelated business income tax (UBIT) in the US even when they are restricted and segregated. If the OPEB plan has taxable income, the plan assets are measured net of income taxes. Further, if an OPEB trust explicitly states that its plan assets can be used to pay general creditors of the entity, they do not qualify as plan assets and do not offset the APBO in the financial statements. [715-60-35-85, 715-60 Glossary]

Because OPEB plans in the scope of Subtopic 715-60 may be subject to income tax, often they do not have plan assets. However, if an OPEB plan does have plan assets, this section addresses questions relevant to all funded DB plans, including those that are funded OPEB plans.

## Example 6.3.10

**Example rollforward of plan assets**

### Background

ABC has a DB pension plan that covers active participants, participants with deferred vested benefits, and participants currently receiving benefits. To calculate its gain/loss on plan assets, ABC Corp. prepares a rollforward of plan assets for its DB pension plan for the year ended December 31, Year 1. ABC updates the rollforward at the December 31, Year 1 measurement date when actual information is available.

Various items caused the balance to change during the year.

- ABC, with assistance from its consulting actuaries, calculated an EROA of $110 million at the beginning of the year. When calculating the EROA, ABC estimated employer contributions of $50 million to the plan trust and benefit payments of $70 million in Year 1.
- Actual contributions were $60 million. No employees contributed to the plan during the year.
- Actual benefit payments during Year 1 were $75 million.
- The actual return on plan assets for Year 1 calculated at the December 31, Year 1 measurement date was $80 million.

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## Analysis

The following rollforward of plan assets is based on journal entries recorded throughout Year 1 and illustrates how ABC calculated the gain/loss on plan assets resulting from differences between its expectations and actual experience.

| **Rollforward of plan assets ($ millions)** | | |
|---|---|---|
| **Plan assets at fair value as of January 1, Year 1** | **$1,375** | **Notes** |
| Expected return on assets | 110 | 1 |
| Actual contributions | 60 | 2 |
| Actual benefits paid | (75) | 3 |
| **Plan assets at end of year before remeasurement** | **$1,470** | **4** |
| **Plan assets at fair value as of December 31, Year 1** | **$1,440** | **5** |
| Gain/(loss) on plan assets | (30) | 6 |

Notes:

1. ABC expected its plan assets to increase $110 million in value over the year from expected investment earnings (EROA). It estimated this amount at the beginning of the year by multiplying the MRV of plan assets as of January 1, Year 1 (adjusted for expected contributions of $50 million and expected benefit payments of $70 million for the year) by the expected long-term rate of return assumption. See JE 1. Section 7.5 discusses EROA and MRV.
2. Actual contributions by ABC during the year were $60 million. See JE 2.
3. Actual benefit payments during the year were $75 million. See JE 3.
4. Before remeasuring plan assets at year-end, ABC's plan assets balance at year-end was $1,470 million, which reflected EROA estimated at the beginning of the year and recorded during Year 1, actual contributions made and actual benefits paid.
5. ABC remeasured its plan assets at December 31, Year 1 to their fair value of $1,440 million.
6. The loss on plan assets of $30 million represents the difference between the balance before remeasurement of $1,470 million and the fair value of plan assets of $1,440 million as of December 31, Year 1. Recognition of the loss depends on the entity's approach and is either expensed immediately or deferred in AOCI and amortized to net income in future periods. See JE 4. Section 7.3.10 and Question 7.3.10 discuss gains and losses on plan assets and different recognition methods.

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ABC records the following journal entries (JE) during Year 1.

| | *Debit* | *Credit* |
|---|---|---|
| **JE 1** | | |
| Plan assets | 110,000,000 | |
| Net periodic pension cost | | 110,000,000 |
| *To recognize expected return on plan assets (EROA) in income statement during Year 1. [Note: in practice, ABC may record 1/12 or $9.2 million each month or choose to record amounts quarterly]* | | |
| **JE 2** | | |
| Plan assets | 60,000,000 | |
| Cash | | 60,000,000 |
| *To recognize increase in plan assets from actual plan contributions in Year 1 upon contribution.* | | |
| **JE 3** | | |
| PBO | 75,000,000 | |
| Plan assets | | 75,000,000 |
| *To recognize benefits paid to retirees from plan assets during Year 1 and related reduction of benefit obligation.* | | |
| **JE 4** | | |
| AOCI | 30,000,000 | |
| Plan assets | | 30,000,000 |
| *To recognize loss on plan assets as of December 31, Year 1. [This assumes ABC defers recognition of gains/losses on plan assets. If ABC recognizes gains/losses immediately, it would debit net periodic pension cost in the income statement instead of AOCI.]* | | |

## 6.3.20 Qualifying as plan assets

As discussed in Question 6.3.10, to meet the requirements of Topic 715, plan assets must be restricted or segregated to provide plan benefits. Section 6.3.20 considers common difficulties in determining whether assets are actually restricted or segregated.

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## Question 6.3.20
**How are plan assets segregated and restricted?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Generally, plan assets are placed in a trust to pay benefits. However, this action by itself does not satisfy the requirement that plan assets be segregated and restricted. Instead, for the plans assets to be segregated and restricted, the terms of the trust or other funding vehicle must restrict the use solely for payments to, or on behalf of, plan participants or their dependents or beneficiaries.

Under the terms of the trust or other funding vehicle, the assets may revert to the entity or be used for other purposes under the plan only if: [715-30 Glossary, 715-60 Glossary]

- the plan assets exceed obligations; and
- the entity took steps to satisfy the pension benefit obligations under the plan.

Plan assets segregated to meet pension obligations must legally meet the criteria to comply with ERISA. However, this will not be the case in all jurisdictions (e.g. for foreign plans) or for all types of plans in the scope of Topic 715 (e.g. funded supplementary executive retirement plans). Question 5.2.20 discusses ERISA requirements. [715-30-55-35, 715-60-55-28]

As indicated in the definition of plan assets under Subtopic 715-60, also relevant to Subtopic 715-30, it is not necessary to determine legally that a trust is bankruptcy-proof for its assets to qualify as plan assets. However, assets held in a trust that explicitly provides that they are available to the general creditors of the entity in the event of the entity's bankruptcy do not qualify as plan assets under Topic 715. [715-60-55-26]

## Question 6.3.30
**Are assets restricted if benefits can be provided to active employees under the plan?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Generally, no. Although Topic 715 allows for the possibility of accumulating plan assets in funding vehicles other than trusts, generally trusts are the only types of entities that accumulate plan assets. If benefits are provided or could be provided under plan terms to active employees and retirees (with limited exceptions) then the

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assets are not effectively restricted for the payment of benefits and do not qualify as plan assets. For example, some DB plans, in certain circumstances, are permitted to provide in-service distributions (e.g. to active employees over age 65) from plan assets, which does not stop the assets from being plan assets for the DB plan for Topic 715 purposes.

To indicate that the assets have been restricted, the entity generally should inform retirees and active plan participants: [715-30-55-35, 715-60-55-26]

— of the terms of the trust or other funding vehicle; and
— that the assets can only be used to provide retirement benefits under the plan.

## Question 6.3.40

**Does the entity's intent or discretion determine whether assets are plan assets?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** No. Determining whether assets qualify as plan assets does not depend solely on the entity's intent. If the entity has the discretion to use the assets for purposes other than providing retirement benefits, those assets do not qualify even though the entity intends to use them for that purpose. An entity should account for those assets in the same manner as its other assets with similar restrictions. If the entity has the sole discretion to amend the terms of the trust or other funding vehicle, without trustee approval, and use trust assets for purposes other than providing retirement benefits, the assets in the trust or other funding vehicle are not effectively restricted and do not qualify as plan assets. However, see also Question 6.3.30, which discusses whether assets used to provide benefits to active employees are restricted. [715-30-55-35, 715-60-55-26]

## Question 6.3.50

**Can shares of the sponsoring entity qualify as plan assets?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Yes. Shares of the sponsor or a subsidiary of the sponsor contributed to a pension plan qualify as plan assets if they are irrevocably transferred by the sponsor and unrestricted by the plan. [715-30-55-35, 715-60-55-28]

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## Question 6.3.60

**How are contributions of subsidiary's shares to fund a trust accounted for?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** If contributions of a subsidiary's shares qualify as plan assets (see Question 6.3.50), we believe the contribution should be accounted for at fair value if the securities qualify as plan assets (i.e. they are irrevocably transferred and unrestricted) and remeasured at each measurement date.[715-30-55-35, 715-60-55-28]

Gains or losses on transferable securities issued by the entity that are included in plan assets are also included in asset gains and losses. [715-30-35-22]

If the sponsor contributes shares of a subsidiary, it applies Topic 810 (consolidation) to account for the reduction of its ownership interest and increase to noncontrolling interest, if any. An entity discloses the structure and effect of this type of transaction in its financial statements. [810-10-40-5, 45-23]

See chapter 7 of KPMG Handbook, Consolidation.

## Question 6.3.70

**Can assets in a 401(h) retiree medical benefit account qualify as plan assets?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Yes, under Subtopic 715-60. Within narrow limits under the tax law, plans can provide OPEB benefits for retirees with assets accumulated in a separate 401(h) account. 401(h) accounts for retiree OPEB benefits qualify as plan assets under Subtopic 715-60, but not Subtopic 715-30. See also Question 6.3.80. [715-30-35-73, 715-60-35-132]

### Guidance specific to Subtopic 715-60

Due to tax law limitations, the ability to accumulate plan assets in a 401(h) account to provide OPEB benefits is limited. [Treas Reg §1.401-14]

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## Question 6.3.80

**Can surplus pension assets be transferred to fund OPEB benefits?**

*This interpretive response applies to Subtopic 715-30 only.*

**Interpretive response:** Yes. Subtopic 715-30 addresses accounting for qualified transfers of excess pension assets to a retiree healthcare benefits account (e.g. a 401(h) account) to provide qualified current health and welfare retirement benefits. Such a transfer is accounted for as a negative contribution to (withdrawal of funds from) the pension plan and a positive contribution to the OPEB plan. No gain or loss results from the transfer of excess pension plan assets. [715-30-35-73]

## Question 6.3.90

**Can assets in a welfare benefit trust qualify as plan assets?**

*This interpretive response applies to Subtopic 715-60 only.*

**Interpretive response:** It depends. Under tax law, certain methods allow entities to obtain current tax benefits for prefunding obligations under OPEB plans. Those methods may not result in accumulating assets that qualify as plan assets under Topic 715. The terms of many existing welfare benefit trusts (e.g. VEBAs) allow the trustee to use trust assets to provide benefits to both active and retired employees. The entity also may:

— retain the right to amend the plan;
— add benefits for active employees; and
— allow the trust assets to be used to provide benefits to active employees without satisfying the OPEB obligations.

In these situations, the assets do not qualify as plan assets under Topic 715 because the entity, at its discretion, can use the assets for purposes other than providing retirement benefits to retirees under the plan. Question 6.3.40 further discusses discretion in using plan assets.

While it is common for an entity to structure a welfare benefit trust to meet the criteria for plan assets, an entity may be hesitant because it does not wish to restrict the use of those assets to providing OPEB benefits. If use of the assets is not restricted to providing OPEB benefits, the assets do not qualify under Topic 715. [715-60-55-26]

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## Question 6.3.100

**If an OPEB trust contemplates a law change that eliminates an OPEB obligation and allows the assets to fund other benefits, do the trust assets qualify as plan assets?**

*This interpretive response applies to Subtopic 715-60 only.*

**Interpretive response:** It depends. Although assets in a trust must be restricted to providing OPEB benefits to qualify as plan assets under Topic 715, an entity can include a clause in the trust agreement that permits use of the funds for other benefit plans if there is a change in law that eliminates the OPEB obligation. VEBA trusts sometimes include this clause, but generally it is not common. [715-60-55-26]

Under Topic 715, an entity cannot withdraw plan assets except under certain circumstances when the plan has excess assets (e.g. in excess of its obligation) and it has taken certain steps to satisfy existing obligations. A change in law that eliminates an entity's obligation for OPEB benefits would qualify as satisfying the obligation. Following this change in law, the plan's remaining assets would be restricted from use for general corporate purposes, although they could be used to fund other benefit obligations. The trust agreement or governing document should contain language to this effect. [715-60 Glossary]

## Question 6.3.110

**Does an entity-owned life insurance policy qualify as a plan asset?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** No. Some entities may consider using entity-owned life insurance to fund DB plan benefits. However, if the entity is the owner or beneficiary of the policies, the CSV of the policies does not qualify as a plan asset under Topic 715; this is because the CSV is not segregated and restricted to providing DB plan benefits and the entity, at its discretion, could use the CSV for other purposes. Entity-owned life insurance policies are accounted for under Subtopic 325-30 (life settlement contracts). [715-30-55-36]

We believe that a life insurance policy should designate the plan as owner and beneficiary for the policy to qualify as a plan asset.

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## 6.3.30 Fair value of plan assets

### Question 6.3.120
**How is the fair value of plan assets measured?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Topic 820 (fair value measurement) is used to measure the fair value of plan assets, subject to certain adjustments and exceptions. [715-30-35-50, 715-30-35-52, 715-60-35-107]

— Brokerage commissions that are to be paid out of plan assets are deducted from the fair value of plan assets, if significant.
— Plan assets used in plan operations (e.g. buildings, equipment, furniture and fixtures, leasehold improvements) are not recorded at fair value and instead are measured at cost less accumulated depreciation or amortization.
— Certain annuity contracts are recorded at contract value.

### Question 6.3.130
**How does an entity present non-benefit obligations in a plan?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** If a plan has obligations other than benefit obligations (e.g. amounts due to service providers), it considers those non-benefit obligations a reduction of plan assets for pension accounting purposes. [715-30-35-50, 715-60-35-107]

## 6.3.40 Not used

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### 6.3.50 Other plan asset considerations

Question 6.3.220

**When is excise tax related to excess plan assets recognized?**

*This interpretive response applies to Subtopic 715-30 only.*

**Background:** An excise tax is independent of taxable income and is due on a specific transaction, regardless of whether there is taxable income for the period in which the transaction occurs. It is not an income tax that an entity accounts for under Topic 740.

**Interpretive response:** An entity recognizes an excise tax as an expense (not classified as income taxes) in the period in which the excess plan assets revert to the entity and the excise tax becomes payable. [715-30-60-5]

We believe the reversion should be considered to occur at the earlier of:

— withdrawal of the excess funds from the plan; and
— the period in which a settlement that will result in recapture of excess assets is recognized.

OPEB trusts under Subtopic 715-60 do not normally have excess plan assets so this issue would generally not apply to OPEB plans.

## 6.4 Benefit obligations

| Excerpt from ASC 715-30 | Excerpt from ASC 715-60 |
|---|---|
| **20 Glossary**<br><br>**Accumulated Benefit Obligation –** The actuarial present value of benefits (whether vested or nonvested) attributed, generally by the pension benefit formula, to employee service rendered before a specified date and based on employee service and compensation (if applicable) before | **20 Glossary**<br><br>**Accumulated Postretirement Benefit Obligation –** The actuarial present value as of a particular date of all future benefits attributed to an employee's service rendered to that date assuming the plan continues in effect and that all assumptions about future events are fulfilled. The |

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| | |
|---|---|
| that date. The accumulated benefit obligation differs from the projected benefit obligation in that it includes no assumption about future compensation levels. For plans with flat-benefit or non-pay-related pension benefit formulas, the accumulated benefit obligation and the projected benefit obligation are the same. | accumulated postretirement benefit obligation generally reflects a ratable allocation of expected future benefits to employee service already rendered in the attribution period. Before an employee's full eligibility date, the accumulated postretirement benefit obligation as of a particular date for an employee is the portion of the expected postretirement benefit obligation attributed to that employee's service rendered to that date; on and after the full eligibility date, the accumulated and expected postretirement benefit obligations for an employee are the same. |
| **Benefits –** The monetary or in-kind benefits or benefit coverage to which participants may be entitled under a pension plan or a health and welfare plan (which can include active, terminated, and retired employees or their dependents or beneficiaries). Examples of benefits may include, but are not limited to, health care benefits, life insurance, legal, educational, and advisory services, pension benefits, disability benefits, death benefits, and benefits due to termination of employment. | **Benefits –** The monetary or in-kind benefits or benefit coverage to which participants may be entitled under a pension plan or a health and welfare plan (which can include active, terminated, and retired employees or their dependents or beneficiaries). Examples of benefits may include, but are not limited to, health care benefits, life insurance, legal, educational, and advisory services, pension benefits, disability benefits, death benefits, and benefits due to termination of employment. |
| **Pension Benefit Formula –** The basis for determining payments to which participants may be entitled under a pension plan. Pension benefit formulas usually refer to the employee's service or compensation or both. Sometimes referred to as a plan's benefit formula or benefit formula. | **Benefit Formula –** The basis for determining benefits to which participants may be entitled under a postretirement benefit plan. A plan's benefit formula specifies the years of service to be rendered, age to be attained while in service, or a combination of both that must be met for an employee to be eligible to receive benefits under the plan. A plan's benefit formula may also define the beginning of the credited service period and the benefits earned for specific periods of service.<br><br>**Expected Postretirement Benefit Obligation –** The actuarial present value as of a particular date of the postretirement benefits expected to be paid by the employer's plan to or for each employee, the employee's beneficiaries, and any covered dependents pursuant to the terms of the plan. |

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**Pension Benefits –** Periodic (usually monthly) payments made pursuant to the terms of the pension plan to a person who has retired from employment or to that person's beneficiary.

**Unfunded Projected Benefit Obligation –** The excess of the projected benefit obligation over plan assets.

**Vested Benefit Obligation –** The actuarial present value of vested benefits.

**Vested Benefits –** Benefits for which the employee's right to receive a present or future pension benefit is no longer contingent on remaining in the service of the employer. (Other conditions, such as inadequacy of the pension fund, may prevent the employee from receiving the vested benefit.) Under graded vesting, the initial vested right may be to receive in the future a stated percentage of a pension based on the number of years of accumulated credited service; thereafter, the percentage may increase with the number of years of service or of age until the right to receive the entire benefit has vested.

**25 Recognition**

**> Recognition of Liabilities and Assets**

**25-1** If the **projected benefit obligation** exceeds the fair value of **plan assets**, the employer shall recognize in its statement of financial position a liability that equals the **unfunded projected benefit obligation**. If the fair value of plan assets exceeds the projected benefit obligation, the employer shall recognize in its statement of financial position an asset that equals the overfunded projected benefit obligation.

**25-2** The employer shall aggregate the statuses of all overfunded plans and recognize that amount as an asset in its statement of financial position. It also shall aggregate the statuses of all underfunded plans and recognize that

**Postretirement Benefits –** All forms of benefits, other than retirement income, provided by an employer to retirees. Those benefits may be defined in terms of specified benefits, such as health care, tuition assistance, or legal services, that are provided to retirees as the need for those benefits arises, such as certain health care benefits, or they may be defined in terms of monetary amounts that become payable on the occurrence of a specified event, such as life insurance benefits.

**25 Recognition**

**> Recognition of Liabilities and Assets**

**25-1** An employer that sponsors one or more single-employer defined benefit postretirement plans other than pensions shall recognize in its statement of financial position the funded statuses of those plans. The employer shall aggregate the statuses of all overfunded plans and recognize that amount as an asset in its statement of financial position. It also shall aggregate the statuses of all underfunded plans and recognize that amount as a liability in its statement of financial position.

**25-2** As indicated in paragraphs 715-60-35-125 through 35-126 remeasurement of both plan assets and the accumulated postretirement benefit obligation may be

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amount as a liability in its statement of financial position.

**25-3** The asset or liability that is recognized pursuant to paragraph 715-30-25-1 may result in a temporary difference, as defined in Subtopic 740-10. The deferred tax effects of any temporary differences shall be recognized in income tax expense or benefit for the year and shall be allocated to various financial statement components, including other comprehensive income, pursuant to Section 740-20-45.

**25-4** If a new determination of the funded status of a plan to be recognized as an asset or a liability in the employer's statement of financial position is made (see paragraphs 715-30-35-62 through 35-69), or when net gains or losses, prior **service** costs or credits, or the net transition asset or obligation existing at the date of initial application of this Subtopic are amortized as components of **net periodic pension cost**, the related balances for those net gains or losses, prior service costs or credits, and transition asset or obligation in accumulated other comprehensive income shall be adjusted as necessary and reported in other comprehensive income.

**25-5** Sometimes, an entity remeasures both plan assets and benefit obligations during the fiscal year. Paragraph 715-30-35-66 provides an example of some events that may require a remeasurement. Upon remeasurement, a business entity shall adjust its statement of financial position in a subsequent interim period to reflect the overfunded or underfunded status of the plan consistent with that measurement date.

**25-6** An employer that sponsors two or more separate **defined benefit pension plans** shall determine net periodic pension cost, liabilities, and assets by separately applying the provisions of this Subtopic to each plan. In particular, unless an employer clearly has a right to use the assets of one plan to pay benefits of another, a liability

necessary. Upon remeasurement, a business entity shall adjust its statement of financial position in a subsequent interim period to reflect the overfunded or underfunded status of the plan consistent with that measurement date.

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required to be recognized pursuant to paragraph 715-30-25-1 for one plan shall not be reduced or eliminated because the employer has recognized an asset for another plan that has assets in excess of its projected benefit obligation.

**35 Subsequent Measurement**

**> Benefit Obligations**

**35-1A** The **projected benefit obligation** as of a date is the **actuarial present value** of all benefits attributed by the **plan's benefit formula** to employee service rendered before that date. The projected benefit obligation is measured using an **assumption** as to future compensation levels if the pension benefit formula is based on those future compensation levels. Plans for which the pension **benefit formula** is based on future compensation are sometimes called pay-related, **final-pay**, final-average-pay, or career-average-pay plans. Plans for which the pension benefit formula is not based on future compensation levels are called non-pay-related or **flat-benefit plans**. The projected benefit obligation is a measure of benefits attributed to service to date assuming that the plan continues in effect and that estimated future events (including compensation increases, **turnover**, and **mortality**) occur.

**35-2** The **accumulated benefit obligation** as of a date is the actuarial present value of benefits attributed by the pension benefit formula to employee service rendered before that date and based on current and past compensation levels. The accumulated benefit obligation differs from the projected benefit obligation in that it includes no assumption about future compensation levels. For plans with flat-benefit or non-pay-related pension benefit formulas, the accumulated benefit obligation and the projected benefit obligation are the same. The accumulated benefit obligation and the **vested benefit**

**35 Subsequent Measurement**

**> Benefit Obligations**

**35-1A** This Subtopic uses two terms to describe certain measures of the obligation to provide **postretirement benefits**: **expected postretirement benefit obligation** and **accumulated postretirement benefit obligation**.

**35-2** Measurement of the expected postretirement benefit obligation is based on the expected amount and timing of future **benefits**, taking into consideration the expected future cost of providing the benefits and the extent to which those costs are shared by the employer, the employee (including consideration of contributions required during the employee's active service period and following retirement, deductibles, coinsurance provisions, and so forth), or others (such as through governmental programs).

**35-3** The accumulated postretirement benefit obligation is the **actuarial present value** of all future benefits attributed to an employee's service rendered to a particular date pursuant to paragraphs 715-60-35-16 through 35-20, 715-60-35-62, and 715-60-35-66, assuming the **plan** continues in effect and all **assumptions** about future events are fulfilled.

**35-4** The accumulated postretirement benefit obligation generally reflects a ratable allocation of expected future benefits to employee service already rendered in the **attribution period**.

**35-5** An employer that sponsors one or more single-employer defined benefit other postretirement plans other than pensions shall measure the funded status for each

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**obligation** provide information about the obligation the employer would have if the plan were discontinued.

**> Measurement of Costs and Obligations**

**35-29** Any method of pension accounting that recognizes cost before the payment of benefits to retirees must deal with two problems stemming from the nature of the defined benefit pension contract. First, estimates or assumptions must be made concerning the future events that will determine the amount and timing of the benefit payments. Second, some approach to attributing the cost of **pension benefits** to individual years of service must be selected. Thus, the assumptions and the attribution of cost to periods of employee service are fundamental to the measurements of net periodic pension cost and pension obligations required by this Subtopic. For example, the service component of net periodic pension cost, the projected benefit obligation, and the accumulated benefit obligation are based on an attribution of pension benefits to periods of employee service and on the use of actuarial assumptions to calculate the actuarial present value of those benefits.

**35-30** Paragraph 715-30-35-42 requires use of explicit assumptions, each of which individually represents the best estimate of a particular future event. This Subtopic also requires use of the terms of the pension plan itself, specifically the plan's benefit formula, as a basis for attributing benefits earned and their cost to periods of employee service.

**35-31** The service cost component of net periodic pension

plan as the difference between the fair value of **plan assets** and the accumulated postretirement benefit obligation as it is defined in this Subtopic.

**35-6** See paragraphs 715-60-55-35 through 55-39 for an illustration of the terms expected postretirement benefit obligation and accumulated postretirement benefit obligation.

**> Measurement of Costs and Obligations**

**35-41** Any method of accounting that recognizes the cost of postretirement benefits over employee service periods (before the payment of benefits to retirees) must deal with two factors that stem from the nature of the arrangement. First, estimates or assumptions shall be made about the future events that will determine the amount and timing of the benefit payments. Second, an attribution approach that assigns benefits and the cost of those benefits to individual years of service shall be selected.

**35-42** Unlike Subtopic 715-30, this Subtopic implicitly considers salary progression in the measurement of the accumulated postretirement benefit obligation of a **pay-related plan**. Because measurement of the expected postretirement benefit obligation includes an assumed salary progression for a pay-related plan, salary progression is, by definition, included in the accumulated benefit obligation for a pay-related **postretirement benefit plan**. Thus, the accumulated postretirement benefit obligation disclosed pursuant to Subtopic 715-20 is defined in terms notionally more comparable to the projected benefit obligation under Subtopic 715-30.

**35-43** For other postretirement plans that provide disability benefits, the determination of disability benefits to be accrued pursuant to this Subtopic is based on the terms of the postretirement benefit plan defining when a disabled employee is entitled to postretirement benefits.

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cost and the projected benefit obligation shall reflect future compensation levels to the extent that the pension benefit formula defines pension benefits wholly or partially as a function of future compensation levels (that is, for a final-pay plan or a career-average-pay plan). Future increases for which a present commitment exists as described in paragraph 715-30-35-34 shall be similarly considered. Assumed compensation levels shall reflect an estimate of the actual future compensation levels of the individual employees involved, including future changes attributed to general price levels, productivity, seniority, promotion, and other factors. All assumptions shall be consistent to the extent that each reflects expectations of the same future economic conditions, such as future rates of inflation. Measuring service cost and the projected benefit obligation based on estimated future compensation levels entails considering indirect effects, such as changes under existing law in social security benefits or benefit limitations that would affect benefits provided by the plan, for example, those currently imposed by Section 415 of the Internal Revenue Code. However, possible amendments of the law shall not be considered in determining those pension measurements. Assumed compensation levels shall be consistent with assumed discount rates to the extent that both incorporate expectations of the same future economic conditions. Paragraphs 715-30-55-20 through 55-22 discuss and provide examples of applying this guidance.

**35-32** The accumulated benefit obligation shall be measured based on employees' history of service and compensation without an estimate of future compensation levels. Excluding estimated future compensation levels also means excluding indirect effects of future changes such as increases in the social security wage base. In measuring the accumulated benefit obligation, projected years of service shall be a factor only in determining

**35-44** For example, an employer may promise to provide postretirement health care coverage to all employees who render 30 or more years of service. The employer may carry active employees who become disabled on active status so a disabled employee continues to accumulate credit toward postretirement benefits. Measurement of the expected postretirement benefit obligation shall include an assumption that some employees who are expected to receive benefits under the postretirement benefit plan will become disabled and cease working before the date at which they otherwise would have been eligible for **postretirement health care benefits**. The measurement of the postretirement benefits expected to be paid to disabled employees would encompass only those benefits expected to be paid during the period following what otherwise would have been their full eligibility date; in this case, the date at which the employee would have completed 30 years of service. That amount is attributed to an employee's service to the date the disability is assumed to occur.

**35-45** Only some employees become and remain disabled. Therefore, in measuring the expected postretirement benefit obligation and in determining the attribution period for plan participants expected to become disabled, the probability and timing of a disabling event is considered in determining whether employees are likely to become disabled and whether they will be entitled to receive postretirement benefits.

**35-46** Note that measurement of an employer's postretirement benefit obligation is based on the current plan participants (a closed group approach) because it better recognizes the benefit obligation over the period in which employees render service in exchange for benefits.

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employees' expected eligibility for particular benefits, such as any of the following:

a. Increased benefits that are granted provided a specified number of years of service are rendered (for example, a pension benefit that is increased from $9 per month to $10 per month for each year of service if 20 or more years of service are rendered)
b. Early retirement benefits
c. Death benefits
d. Disability benefits.

**>> Substantive and Contractual Commitments**

**35-34** 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. In those situations, the substantive commitment shall be the basis for the accounting.

**35-35** Automatic benefit increases specified by the plan (for example, automatic cost-of-living increases) that are expected to occur shall be included in measurements of the projected, accumulated, and vested benefit obligations, and the service cost component required by this Subtopic. Also, retroactive plan amendments shall be included in the computation of the projected and accumulated benefit obligations once they have been contractually agreed to, even if some provisions take effect only in future periods. For example, if a plan amendment grants a higher benefit level for employees retiring after a future date, the higher benefit level shall be included in current-period measurements for employees expected to retire after that date.

**>> Substantive Plan**

**35-48** An objective of this Subtopic is that the accounting reflect the terms of the exchange transaction that takes place between an employer that provides other postretirement benefits and the employees who render services in exchange for those benefits, as those terms are understood by both parties to the transaction.

**35-49** Generally, the extant written plan provides the best evidence of the terms of that exchange transaction. However, in some situations, an employer's cost-sharing policy, as evidenced by past practice or by communication of intended changes to a plan's cost-sharing provisions, or a past practice of regular increases in certain monetary benefits (see paragraphs 715-60-35-51 through 56), may indicate that the substantive plan—the plan as understood by the parties to the exchange transaction—differs from the extant written plan. The substantive plan shall be the basis for the accounting.

**35-50** See paragraph 715-60-55-1 for implementation guidance on a collectively bargained defined benefit postretirement health care plan.

**35-51** Except as provided in paragraphs 715-60-35-52 through 35-55, an employer's cost-sharing policy, as evidenced by the following past practice or

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communication, shall constitute the cost-sharing provisions of the substantive plan if either of the following conditions exist:

a. The employer has a past practice of maintaining a consistent level of cost sharing between the employer and its retirees through changes in deductibles, coinsurance provisions, retiree contributions, or some combination of those changes or consistently increasing or reducing the employer's share of the cost of the covered benefits through changes in retired or active plan participants' contributions toward their retiree health care benefits, deductibles, coinsurance provisions, out-of-pocket limitations, and so forth, in accordance with the employer's established cost-sharing policy Such a past practice would be indicated when the nature of the change and duration of the past practice are sufficient to warrant a presumption that it is understood by the plan participants.
b. The employer has the ability, and has communicated to affected plan participants its intent, to institute different cost-sharing provisions at a specified time or when certain conditions exist (for example, when health care cost increases exceed a certain level).

Otherwise, the extant written plan shall be considered to be the substantive plan.

**35-52** An employer's past practice of maintaining a consistent level of cost sharing with its retirees or consistently increasing or reducing its share of the cost of providing the covered benefits shall not constitute provisions of the substantive plan if accompanied by identifiable offsetting changes in other benefits or compensation or if the employer incurred significant costs, such as work stoppages, to effect that cost-sharing policy.

**35-53** For example, a past practice of increasing retiree contributions annually based on a specified index or

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formula may appear to indicate that the substantive plan includes a determinable indexing of the retirees' annual contributions to the plan. However, if that past practice of increasing retiree contributions is accompanied by identifiable offsetting changes in other benefits or compensation, those offsetting changes would indicate that the substantive plan incorporates only the current cost-sharing provisions. Therefore, future increases or reductions of those cost-sharing provisions shall not be incorporated in measuring the expected postretirement benefit obligation.

**35-54** Similarly, an employer's communication of its intent to institute cost-sharing provisions that differ from the extant written plan or the past cost-sharing practice shall not constitute provisions of the substantive plan if either of the following conditions exists:

a. The plan participants would be unwilling to accept the change without adverse consequences to the employer's operations.
b. Other modifications of the plan, such as the level of benefit coverage, or providing offsetting changes in other benefits, such as pension benefits, would be required to gain plan participants' acceptance of the change to the cost-sharing arrangement.

**35-55** By definition, an employer does not have the unilateral right to change a collectively bargained plan. Therefore, if the postretirement benefits are the subject of collective bargaining, the extant written plan shall be the substantive plan unless the employer can demonstrate its ability to maintain a consistent level of cost sharing or a consistent practice of increasing or reducing its share of the cost of the covered benefits in past negotiations without making offsetting changes in other benefits or compensation of the affected plan participants or by

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incurring other significant costs to maintain that cost-sharing arrangement.

**35-56** A past practice of regular increases in postretirement benefits defined in terms of monetary amounts may indicate that the employer has a present commitment to make future improvements to the plan and that the plan will provide monetary benefits attributable to prior service that are greater than the monetary benefits defined by the extant written plan. In those situations, the substantive commitment to increase those benefits shall be the basis for the accounting. Changes in the benefits, other than benefits defined in terms of monetary amounts, covered by a postretirement health care plan or by other postretirement benefit plans shall not be anticipated.

**35-57** Contributions expected to be received from active employees toward the cost of their postretirement benefits and from retired plan participants are treated similarly for purposes of measuring an employer's expected postretirement benefit obligation. That obligation is measured as the actuarial present value of the benefits expected to be provided under the plan, reduced by the actuarial present value of contributions expected to be received from the plan participants during their remaining active service and postretirement periods. In determining the amount of the contributions expected to be received from those participants toward the cost of their postretirement benefits, consideration is given to any related substantive plan provisions, such as an employer's past practice of consistently increasing or reducing the contribution rates as described in paragraphs 715-60-35-51 through 35-55. An obligation to return contributions received from employees who do not attain eligibility for postretirement benefits and, if applicable, any interest accrued on those contributions shall be recognized as a component of an employer's postretirement benefit obligation.

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**35-58** Automatic benefit changes specified by the plan that are expected to occur shall be included in measurements of the expected and accumulated postretirement benefit obligations and the service cost component of net periodic postretirement benefit cost.

**35-59** For purposes of this Subtopic, a plan that promises to provide retirees a benefit in kind, such as health care benefits, rather than a defined dollar amount of benefit, is considered to be a plan that specifies automatic benefit changes. (The assumed rate of change in the future cost of providing health care benefits, the assumed health care cost trend rate, is discussed in paragraphs 715-60-35-99 through 35-101.) Because automatic benefit changes are not conditional on employees rendering additional years of service, the full eligibility date is not affected by those changes. A benefit in kind includes the direct rendering of services, the payment directly to others who provide the services, or the reimbursement of the retiree's payment for those services.

**35-60** Also, plan amendments shall be included in the computation of the expected and accumulated postretirement benefit obligations once they have been contractually agreed to, even if some provisions take effect only in future periods. For example, if a plan amendment grants a different benefit level for employees retiring after a future date, that increased or reduced benefit level shall be included in current-period measurements for employees expected to retire after that date.

**55 Implementation Guidance and Illustrations**

**>> Substantive Commitment**

**55-16** Paragraph 715-30-35-34 describes circumstances under which a substantive commitment is the basis for accounting beyond the written terms of a pension plan.

**55 Implementation Guidance and Illustrations**

**>> Substantive Plan**

**55-1** A collectively bargained defined benefit postretirement health care **plan** of a single employer may stipulate that **benefits** will be provided for the duration of the collective-bargaining agreement or may imply or

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**55-17** 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.

**55-18** 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 determining the appropriate amortization periods for **prior service cost** as discussed in paragraph 715-30-35-14. An employer's accounting for its pension plan should not 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.

**55-19** An employer may have a substantive commitment to have a formula greater than the pension plan's written formula. There may be a 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. If that difference results from an intended modification of the formula for which there is a substantive commitment, the accounting shall be that prescribed in paragraphs 715-30-35-10 through 35-17 for a retroactive plan amendment. Otherwise, that difference is a gain or loss subject to the accounting specified in paragraphs 715-30-35-18 through 35-27.

explicitly state that benefits are subject to renegotiation upon the expiration of the current collective-bargaining agreement. Past negotiations have resulted in the continuation of the plan, although the plan has been amended at various times. The **accumulated postretirement benefit obligation** should be measured assuming that benefits will be provided beyond the period covered by the current collective-bargaining agreement. Unless the most recently negotiated collective-bargaining agreement explicitly states for the first time that the payment of **postretirement benefits** will be discontinued upon the contract's expiration and that is the expectation of the parties to the agreement, the presumption of an ongoing plan is not overcome by the presence of an expiration date for the present collective-bargaining agreement.

**>> Capped Plans**

**55-2** A defined dollar cap is part of an employer's cost-sharing arrangement under which the employer limits the amount it will spend for retiree benefits by defining the maximum dollar amount for each retiree or the retiree group to be applied by the employer toward the cost of retiree benefits. For example, a plan with a defined dollar cap may stipulate that the employer will pay for all retiree health care costs in a year up to a specified dollar limit. A past practice of regular increases (or decreases) in that defined dollar cap may indicate that the cost-sharing provisions of the **substantive plan** differ from the extant written plan. Future amendments to a written postretirement health care plan that change the amount of a defined dollar cap can be anticipated as part of the substantive plan if the conditions in paragraphs 715-60-35-51 through 35-55 are satisfied.

**55-3** A postretirement health care plan with a defined dollar cap is not considered to be a plan that provides

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benefits defined in terms of monetary amounts as discussed in paragraph 715-60-35-56. Changes in monetary benefits provided by one plan or changes in the amount of a defined dollar cap on cost sharing for a different plan may need to be anticipated as part of determining what the substantive plans are. However, the nature of the promises for the two plans differs. Benefits for the first plan are defined in monetary amounts, for example, a stipulated dollar amount of life insurance coverage, whereas benefits offered under the defined dollar capped plan are not defined in monetary amounts. Although the cap on the employer's contribution is defined in monetary terms, the benefits are the specified eligible medical claims with payment by the employer being no greater than the amount of that cap. Changes in the types of benefits or the types of health care costs covered by a plan cannot be anticipated.

**>>> Expected Postretirement Benefit Obligation and Accumulated Postretirement Benefit Obligation**

**55-35** The following illustrates the notion of the expected postretirement benefit obligation and the relationship between that obligation and the accumulated postretirement benefit obligation at various dates.

**55-36** Entity A's plan provides postretirement health care benefits to all employees who render at least 10 years of service and attain age 55 while in service. A 50-year-old employee, hired January 1, 20X3, at age 30 and eligible for benefits upon attaining age 55, is expected to terminate employment at age 62 and is expected to live to age 77. A discount rate of 8 percent is assumed.

**55-37** At December 31, 20Z2, Entity A estimates the expected amount and timing of benefit payments for that employee as follows.

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| Age | Expected Future Claims | Present Value at Age 50 | 53 | 55 |
|---|---|---|---|---|
| 63 | $ 2,796 | $1,028 | $1,295 | $1,511 |
| 64 | 3,093 | 1,052 | 1,326 | 1,547 |
| 65 | 856 | 270 | 339 | 396 |
| 66 | 947 | 276 | 348 | 406 |
| 67 | 1,051 | 284 | 357 | 417 |
| 68 | 1,161 | 291 | 366 | 427 |
| 69 | 1,282 | 297 | 374 | 436 |
| 70 | 1,425 | 306 | 385 | 449 |
| 71 | 1,577 | 313 | 394 | 460 |
| 72 | 1,744 | 321 | 404 | 471 |
| 73 | 1,934 | 329 | 415 | 484 |
| 74 | 2,137 | 337 | 424 | 495 |
| 75 | 2,367 | 346 | 435 | 508 |
| 76 | 2,620 | 354 | 446 | 520 |
| 77 | 3,899 | 488 | 615 | 717 |
| | $28,889 | $6,292 | $7,923 | $9,244 |

**55-38** The expected and accumulated postretirement benefit obligations at December 31, 20Z2 (age 50) are $6,292 and $5,034 (20/25 of $6,292), respectively. An equal amount of the expected postretirement benefit obligation is attributed to each year of service from the employee's date of hire to the employee's full eligibility date (age 55) (see paragraphs 715-60-35-62 through 35-66). Therefore, when the employee is age 50, the accumulated postretirement benefit obligation is measured as 20/25 of the expected postretirement benefit obligation, as the employee has rendered 20 years of the 25-year credited service period. See paragraphs 715-60-55-40 through 55-56 for additional guidance on the full eligibility date and

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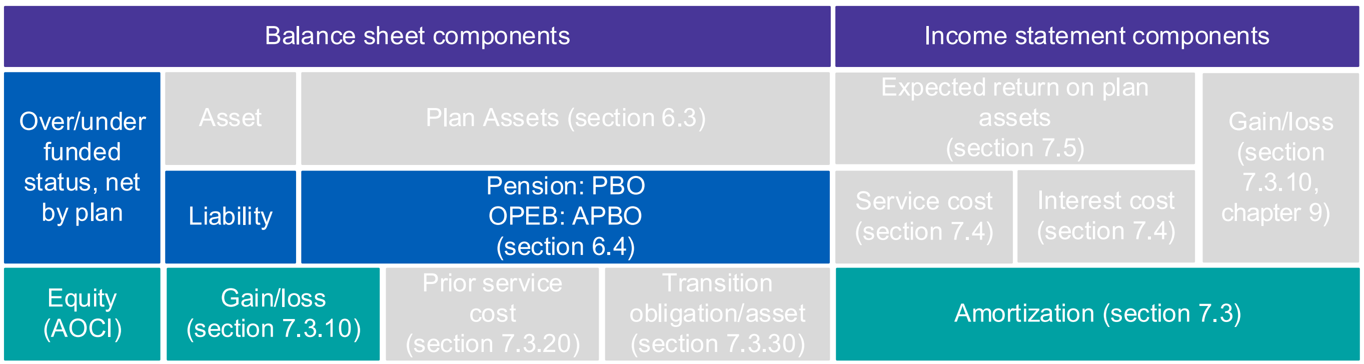
| | |
|---|---|
| | paragraphs 715-60-55-57 through 55-59 for additional guidance on attribution. |

This section examines the recognition and measurement criteria for DB plan benefit obligations under Subtopic 715-30 and Subtopic 715-60. These components are shown in the following diagram. Chapter 8 discusses in more depth the assumptions and approaches used to measure the benefit obligation.




## 6.4.10 About benefit obligations

Under Subtopics 715-30 and 715-60, entities calculate their obligation to provide benefits under each DB plan at each reporting date. In addition, entities may be required to perform certain calculations of the obligation only for disclosure purposes to provide additional information to financial statement users (e.g. the obligation at the reporting date if the plan were discontinued).

The following table explains the features of the various obligations calculated for DB plans.

| Obligation | Features |
|---|---|
| **Subtopic 715-30** | |
| Accumulated benefit obligation (ABO) | — The actuarial present value (as of a specified date) of benefits attributed by a pension benefit formula to employee service provided before that date; based on current and past compensation levels.<br>— Excludes assumptions about future compensation levels. |

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| Obligation | Features |
|---|---|
| **Subtopic 715-30** | |
| | — Used only for disclosure purposes to provide information about the entity's obligation if the plan were discontinued. [715-30-35-2, 715-30 Glossary] |
| Projected benefit obligation (PBO) | — The actuarial present value (as of a specified date) of all benefits attributed by the pension benefit formula to employee service provided before that date.<br>— Includes assumptions about future compensation levels if the pension benefit formula is based on them (pay-related, final-pay, final-average-pay and career-average-pay plans). [715-30 Glossary] |
| Unfunded PBO | The excess of the PBO over plan assets. [715-30 Glossary] |
| **Subtopic 715-60** | |
| Accumulated postretirement benefit obligation (APBO) | — The actuarial present value at a specified date of all future benefits attributed to an employee's service provided to that date.<br>— Assumes the plan continues in effect and that all assumptions about future events are fulfilled.<br>— Generally reflects a ratable allocation of expected future benefits to employee service already rendered in the attribution period.<br>— Before an employee's full eligibility date, the APBO as of a particular date for an employee is the portion of the EPBO attributed to that employee's service rendered to that date;<br>— On and after the full eligibility date, the APBO and EPBO for an employee are the same. [715-60 Glossary] |
| Expected postretirement benefit obligation (EPBO) | The actuarial present value as of a specified date of the OPEB benefits expected to be paid by the entity's plan to or for each employee, the employee's beneficiaries and any covered dependents under the terms of the plan. [715-60 Glossary] |
| Unfunded accumulated benefit obligation | The APBO in excess of the fair value of plan assets. [715-60 Glossary] |

This section focuses on the benefit obligations that are recognized in the balance sheet at each reporting date. Because transition obligations (originally recognized in OCI on adoption of Topic 715) no longer remain relevant to most entities, this Handbook does not address transition obligations in detail, but instead provides a brief overview in section 7.3.30. Chapter 11 discusses disclosure requirements for the PBO and APBO and other benefit obligations calculated only for disclosure purposes (e.g. ABO).

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A history of retroactive plan amendments to increase pension benefits or a past practice of changing a cost-sharing policy under an OPEB plan (e.g. to meet a certain ratio) may provide evidence of a substantive commitment by the entity to the plan participants. This substantive commitment, if mutually understood by both parties, may form the basis for a substantive plan that differs from the extant written plan but forms the new basis of accounting. Topic 715 describes circumstances in which an entity may have a substantive commitment to amend a DB pension plan or to change its cost-sharing policy and how to account for those changes. [715-30-35-16 – 35-19, 715-60-35-56]

The rollforward in Example 6.4.10 illustrates the components of the PBO; however, the APBO for an OPEB plan generally includes the same or similar components.

## Example 6.4.10
## **Example PBO rollforward**

### Background

ABC Corp. has a DB pension plan for its employees and is preparing its year-end rollforward as of December 31, Year 1. ABC considers the following factors.

— Plan participants receive an annual pension payment of (final year salary × 2%) × number of years of service rendered.
— On December 31, Year 1, ABC increased the benefit formula for all plan participants from 2% to 3% of their final pay for each year of service (including years already served at the time of the amendment). The plan amendment immediately increases ABC's actual obligation for active plan participants by 50% ((3% – 2%) / 2%) and represents a prior service cost because the plan participants will receive additional credit for past service. See section 7.3.20 for discussion about plan amendments.

### Analysis

ABC develops this rollforward as of December 31, Year 1.

| PBO rollforward ($ millions) | | Notes |
|---|---|---|
| **Actual PBO at January 1, Year 1** | $2,000 | 1 |
| Service cost | 50 | 2 |
| Interest cost | 100 | 3 |
| Benefits paid (actual) | (80) | 4 |

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| PBO rollforward ($ millions) | | Notes |
|---|---|---|
| Prior service cost due to plan amendment | 300 | 5 |
| PBO at end of year before remeasurement | $2,370 | 6 |
| Actuarial (gain)/loss on pension liability | 20 | 7 |
| **Actual PBO at December 31, Year 1** | **$2,390** | **8** |

Notes:

1. The actuarial present value of benefits earned for the period is often calculated by the entity's actuaries at the beginning of the year. This obligation was calculated based on an annual pension benefit determined using 2% × final year salary.
2. The service cost is recognized throughout the year based on amounts calculated and provided by the actuaries at the beginning of the year. Section 7.4.20 discusses the calculation of service cost.
3. The interest cost is calculated as opening PBO × assumed discount rate. Interest cost is typically provided by the actuary at the beginning of the year. Section 7.4.20 discusses the calculation of interest cost.
4. Benefits paid are the actual amounts paid out to retirees during the year. For a funded plan, benefits are paid out of plan assets and for an unfunded plan (where there are no plan assets), they are paid out of the entity's assets (e.g. cash).
5. The prior service cost represents the increase in the obligation due to the increase in the benefit formula from the plan amendment. Section 7.3.20 discusses prior service cost.
6. The PBO at the end of the year before remeasurement is calculated by taking the actual PBO at January 1, Year 1 and rolling that balance forward to December 31, Year 1 based on estimates made at the beginning of the year, adjusted for actual versus expected benefits paid during the year and the effects of the plan amendment.
7. The actuarial (gain)/loss on pension liability represents the difference between the actual PBO at December 31, Year 1 (item 8) and the PBO at year-end before remeasurement (item 6). This actuarial gain/loss can only be determined at the measurement date, when the actuarial valuation, including the calculation of the actual PBO, has been prepared.
8. The actual PBO at December 31, Year 1 reflects the plan amendment, actual benefits paid, and any changes as of year-end in the assumptions used at the beginning of year (e.g. discount rate, mortality, salary).

**Note:** If the plan amendment had occurred earlier in the year and represented a significant event requiring remeasurement, service cost and interest cost for the balance of the year would reflect the remeasurement. Section 7.4.20 discusses the calculation of service cost and interest cost; section 8.7 discusses interim remeasurement for a significant event.

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## Question 6.4.10
**Does the estimated benefit obligation include only current plan participants?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Yes. While only explicitly stated in Subtopic 715-60, under both Subtopics projections of benefit payments are calculated on a closed-group basis. The calculation includes only current plan participants because it better recognizes the benefit obligation over the period in which employees render service in exchange for benefits. [715-60-35-46]

## Question 6.4.20
**What is the EPBO and how is it calculated?**

*This interpretive response applies to Subtopic 715-60 only.*

**Interpretive response:** The EPBO represents the actuarial present value of the total OPEB benefits expected to be paid to retirees and their beneficiaries based on the plan formula. The EPBO is then attributed to past service and current service to compute the APBO and service cost, respectively. In general, an equal amount of the EPBO for an employee is attributed to each year of service in the attribution period (a benefit-years-of-service approach). Chapter 8 discusses attribution.

An entity measures its EPBO using explicit assumptions as described in Question 8.2.40 and generally does not anticipate future changes in plan benefits when calculating the EPBO. Significant assumptions include the annual gross claims cost, healthcare cost trend rates, Medicare reimbursements, discount rates, turnover, retirement age dependency status, and life expectancy. The entity measures the EPBO based on its estimate of the plan's future experience, considering only current plan participants – i.e. a closed-group approach (see Question 6.4.10). If the level of OPEB benefits depends on compensation (a pay-related plan), future compensation increases are also included in the calculation of the EPBO. [715-60-35-2]

Under certain conditions, a substantive plan anticipates future changes in cost-sharing provisions (e.g. retiree contributions).

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## Question 6.4.30
**What is the APBO and how is it calculated?**

*This interpretive response applies to Subtopic 715-60 only.*

**Interpretive response:** The APBO is the portion of the EPBO that employees have earned through service provided as of a specified date. If all employees have reached their full eligibility date, the APBO is the same as the EPBO. If, for example, employees must work for 20 years to reach full eligibility and all employees have worked 15 years, the APBO would be 75% of the EPBO (15/20).

## Example 6.4.20
**Using a plan's benefit formula to calculate the APBO**

### Background

ABC Corp. purchases a single premium company-owned life insurance policy to provide funds for an executive deferred compensation agreement. The deferred compensation agreement provides for a primary and secondary benefit.

- The covered executives are entitled to receive deferred compensation based on the excess earnings of the insurance policy.
- The compensation agreement provides for a base earnings amount on the initial investment in the policy, computed using a defined index.
- All earnings over the base amount (the excess earnings) accrue to the benefit of the executives, during employment and their retirement years.
- The executives receive the deferred compensation payments for both the primary and secondary benefits during retirement years.
- Earnings on the policy that accumulate for the executives' benefit before retirement are paid in 10 equal installments upon retirement and represent the primary benefit.
- Earnings that accrue for the executives' benefit after retirement represent the secondary benefit.

### Analysis

ABC estimates the APBO using the plan's benefit formula. ABC includes both primary and secondary benefits in the measurement and uses the best estimates available each period for the expected performance of the insurance policy.

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### Question 6.4.40
**Is an obligation under community-rated or experience-rated postretirement healthcare plans recognized?**

*This interpretive response applies to Subtopic 715-60 only.*

**Interpretive response:** It depends. An entity has no OPEB obligation under its contributory healthcare plan that provides coverage to both active employees and retirees if:

— the retirees pay 100% of their premiums; and
— it is community-rated.

Under a community-rated plan, premiums are determined based on healthcare costs incurred across a given geographic area, and do not vary between participating entities. If an entity's healthcare plan is community-rated, its premiums are unaffected when retirees are included in the covered group. The entity records no OPEB obligation if the retirees pay 100% of the premiums.

However, under an experience-rated plan, premiums vary between entities depending on actual healthcare costs incurred by the covered group. The entity measures its OPEB obligation as the portion of future retiree healthcare costs not recovered through retiree premiums, Medicare or other reimbursements. [715-60-55-6]

## 6.4.20 Obligation arising from a business combination

| Excerpt from ASC 715-30 | Excerpt from ASC 715-60 |
|---|---|
| **60 Relationships**<br><br>**> Business Combinations**<br><br>**60-6** For the required pension related accounting for issues arising in connection with a business combination, including plans to terminate certain employees, the measurement of projected benefit obligations and the assignment of the purchase price to individual assets acquired and liabilities assumed, see Subtopic 805-20. | **60 Relationships**<br><br>**> Business Combinations**<br><br>**60-1** For guidance on the accounting when an employer is acquired in a business combination and that employer sponsors a single-employer **defined benefit postretirement plan**, see paragraph 805-20-25-25. |

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| | |
|---|---|
| | **60-2** For guidance on plans to terminate certain employees if a business combination is probable, see paragraphs 805-20-55-50 through 55-51. |

## Excerpt from 805-20

**25 Recognition**

**>> Employee Benefits**

**25-22** The acquirer shall recognize a liability (or asset, if any) related to the acquiree's employee benefit arrangements in accordance with other GAAP. For example, employee benefits in the scope of the guidance identified in paragraphs 805-20-25-23 through 25-26 would be recognized in accordance with that guidance and as specified in those paragraphs.

**>>> Pension and Postretirement Benefits Other than Pensions**

**25-23** Guidance on defined benefit pension plans is presented in Subtopic 715-30. If an acquiree sponsors a single-employer defined benefit pension plan, the acquirer shall recognize as part of the business combination an asset or a liability representing the funded status of the plan (see paragraph 715-30-25-1). Paragraph 805-20-30-15 provides guidance on determining that funded status. If an acquiree participates in a multiemployer plan, and it is probable as of the acquisition date that the acquirer will withdraw from that plan, the acquirer shall recognize as part of the business combination a withdrawal liability in accordance with Subtopic 450-20.

**25-24** The Settlements, Curtailments, and Certain Termination Benefits Subsections of Sections 715-30-25 and 715-30-35 establish the recognition guidance related to accounting for settlements and curtailments of defined benefit pension plans and certain termination benefits.

**25-25** Guidance on defined benefit other postretirement plans is presented in Subtopic 715-60. If an acquiree sponsors a single-employer defined benefit postretirement plan, the acquirer shall recognize as part of the business combination an asset or a liability representing the funded status of the plan (see paragraph 715-60-25-1). Paragraph 805-20-30-15 provides guidance on determining that funded status. If an acquiree participates in a multiemployer plan and it is probable as of the acquisition date that the acquirer will withdraw from that plan, the acquirer shall recognize as part of the business combination a withdrawal liability in accordance with Subtopic 450-20.

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**30 Initial Measurement**

**>>> Pension and Postretirement Benefits Other Than Pensions**

**30-15** Guidance on defined benefit pension plans is presented in Subtopic 715-30. Guidance on defined benefit other postretirement plans is presented in Subtopic 715-60. Paragraphs 805-20-25-23 and 805-20-25-25 require an acquirer to recognize as part of a business combination an asset or a liability representing the funded status of a single-employer defined benefit pension or postretirement plan. In determining that funded status, the acquirer shall exclude the effects of expected plan amendments, terminations, or curtailments that at the acquisition date it has no obligation to make. The projected benefit obligation assumed shall reflect any other necessary changes in assumptions based on the acquirer's assessment of relevant future events.

**30-16** The Settlements, Curtailments, and Certain Termination Benefits Subsection of Section 715-30-35 establishes the measurement guidance related to accounting for settlements and curtailments of defined benefit pension plans and certain termination benefits.

An acquiring entity may assume all or some of the pension and OPEB liabilities of the acquiree in a business combination. An acquirer recognizes and measures a pension or OPEB asset or liability assumed in a business combination based on the funded status of the plan as determined under Topic 715. [715-30-25-1, 715-60-25-1, 805-20-25-22]

## Question 6.4.50

**How is a benefit obligation arising from a business combination measured?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** The acquirer recognizes an asset or liability representing the funded or unfunded status (see Question 6.2.20) of the plan. In determining the funded status, the acquirer excludes the effects of expected plan amendments, terminations or curtailments that at the acquisition date it has no obligation to make. In some circumstances, as part of negotiations, the acquirer may not assume all pension and OPEB obligations of the acquiree. [715-30-60-6, 715-60-60-1, 805-20-25-25, 30-15]

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## Example 6.4.30
### Indemnifying a buyer for future pension obligations in a business combination

**Background**

ABC Corp. sold its 100% interest in Target to a third-party buyer. The following facts are relevant.

- Target accounted for its pension obligations under Subtopic 715-30.
- ABC indemnified Buyer for Target's pension obligations at the acquisition date.
- The pension plan had been frozen to new participants in a prior year.
- Target was (and remains) the legal sponsor of the plan.

**Analysis**

ABC considers the following factors to determine whether Topic 715 applies to the indemnification agreement.

| ABC considers | ABC does not consider whether |
|---|---|
| Nature of the obligation | The plan is funded |
| Terms or conditions that define the amount of benefits to be paid | Benefits are payable at intervals or as a single amount |
| | Benefits are required by law or custom |
| | Benefits are provided under a plan the entity has elected to sponsor |

Based on these considerations, ABC applies Subtopic 715-30 to account for the indemnification agreement; this is because it has indemnified Buyer for all future contributions to the pension plan. This includes the ability to defer actuarial gains and losses in AOCI, subject to amortization when outside the corridor, assuming it is ABC's policy to do so (see Question 7.3.30).

When ABC sold Target and indemnified Buyer for future pension contributions, the obligation to fund the pension was unchanged for ABC. Therefore, the definition of settlement under Topic 715 has not been met; this is because ABC is not relieved of the primary responsibility for the PBO or the related significant risks. Section 9.3 discusses settlements.

In addition, ABC's obligation is not in the scope of Topic 450 (contingencies) or Topic 460 (guarantees). Topic 450 states that employment-related costs, including deferred compensation contracts, are excluded from its scope. Because we believe Target's obligation should be accounted for under Topic 715, it is by definition outside the scope of Topic 450.

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Topic 460 states that it does not apply to a guarantee or an indemnification that is excluded from the scope of Topic 450.

**Note:** In practice, is not uncommon for sellers of businesses to retain the pension obligations of sold businesses, particularly when the underlying pension plans have been frozen.

## 6.5 Presentation of plan assets and benefit obligations

### Excerpt from ASC 715-20

**05 Overview and Background**

**05-1** This Subtopic provides guidance on the disclosure and other accounting and reporting requirements related to single-employer defined benefit pension and other postretirement benefit plans.

**05-2** This Subtopic addresses:

a. The content and organization of annual disclosures about defined benefit pension plans and other postretirement benefits
b. Disclosures required for interim-period financial reports.
c. Presentation matters about defined benefit pension and other postretirement benefit plans.

**05-3** An employer that sponsors one or more defined benefit pension or other postretirement benefit plans is required to provide the information called for in Section 715-20-50 separately for pension plans and other postretirement benefit plans.

**45 Other Presentation Matters**

**> Entities That Do Not Report Other Comprehensive Income, Other Than Not-for-Profit**

**45-1** An employer other than a not-for-profit employer that does not report other comprehensive income pursuant to Topic 220 shall apply the provisions of Sections 958-715-25, 958-715-35, 958-715-45, and 958-715-50 in an analogous manner that is appropriate for its method of reporting financial performance and financial position.

**> Classification**

**45-2** An employer that sponsors one or more defined benefit pension plans or one or more defined benefit other postretirement plans shall provide separately for pension plans and other postretirement benefit plans the funded

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status of the plans and the amounts recognized in the statement of financial position, showing separately the assets and current and noncurrent liabilities recognized.

**45-3** An employer that presents a classified statement of financial position shall classify the liability for an underfunded plan as a current liability, a noncurrent liability, or a combination of both. The current portion (determined on a plan-by-plan basis) is the amount by which the actuarial present value of benefits included in the benefit obligation payable in the next 12 months, or operating cycle if longer, exceeds the fair value of plan assets. The asset for an overfunded plan shall be classified as a noncurrent asset in a classified statement of financial position. The amount classified as a current liability is limited to the amount of the plan's unfunded status recognized in the employer's statement of financial position.

## Question 6.5.10

### How is the funded status presented in the financial statements?

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** An entity that sponsors one or more DB plans must separately provide the funded status for the pension plans and the funded status of the OPEB plans (and the amounts recognized on the balance sheet). The entity aggregates overfunded pension plans separately from underfunded pension plans for presentation purposes. The same is done for OPEB plans. Therefore, depending on the funded status of the DB plans, an entity may have both an asset and liability presented for its DB plans. [715-30-25-1 – 25-2, 715-60-25-1]

An entity that presents a classified balance sheet (separated between current and noncurrent) classifies the liability for an underfunded DB plan as a current liability, a noncurrent liability or a combination of both. The current portion of a DB plan liability (determined on a plan-by-plan basis) is the amount by which the DB plan obligation that is payable within the next 12 months (or operating cycle if longer) exceeds plan assets. [715-20-45-3]

The asset for an overfunded plan is classified as noncurrent on a classified balance sheet. [715-20-45-3]

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## Question 6.5.20

### Is the net benefit obligation classified as current or noncurrent?

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** The current portion of net obligations, which is determined on a plan-by-plan basis, is the amount by which the benefit obligation payable in the next 12 months (or operating cycle if longer) exceeds the fair value of plan assets. This generally results in entities with funded plans classifying the obligation as noncurrent. However, for unfunded plans or significantly underfunded plans, the liability may be partially current and partially noncurrent. [715-20-45-3]

The benefit obligation payable in the next 12 months is the actuarial present value of those benefits included in the benefit obligation. Some interpret this as the discounted value of benefits expected to be paid in the next 12 months. Others believe the guidance supports using undiscounted benefit payments expected to be paid in the next 12 months. In our experience, both views are applied in practice and we believe that either is acceptable if it is consistently applied to all plans. [715-20-45-3, FAS 158.BC48]

The current portion of the net obligation cannot be based on the amount of expected contributions to the plan. Contributions are viewed as essentially intercompany transactions that do not affect classification of the benefit obligation. [715-20-45-3]

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# 7. DB pensions and OPEB plans: Costs

## Detailed contents

**Item significantly updated in this edition #**
**Item moved from another chapter without significant change ●**



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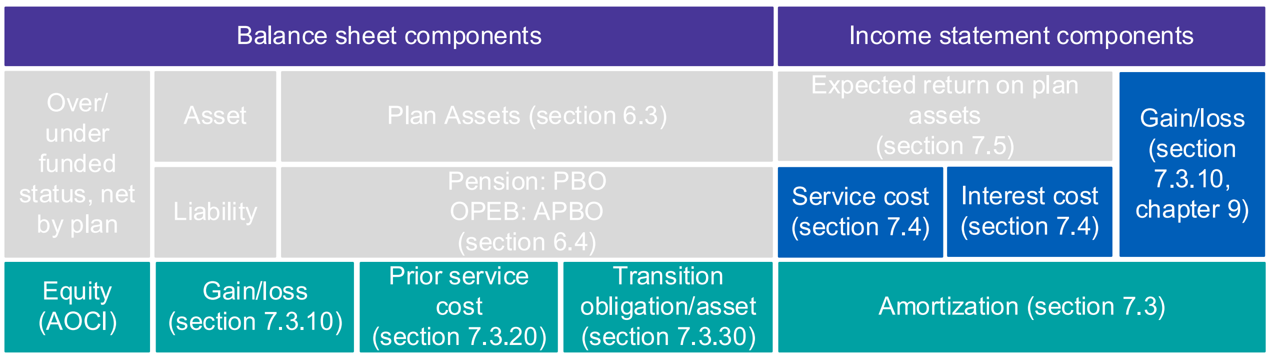
## 7.1 How the standard works

Accounting for the plan assets and obligations of DB plans gives rise to a number of costs each period. Some components of net periodic benefit cost, such as interest cost, are recognized immediately in the income statement. Others, such as prior service cost and gains and losses, may or must be deferred in AOCI and amortized into income. Uniquely, service cost can be capitalized as part of an asset such as inventory or recognized immediately as an expense. As such, the term net periodic benefit 'cost' is used instead of 'expense'. Presentation also differs for service cost compared to the other components of net periodic benefit cost.

Chapter 7 examines the accounting for each component of net periodic benefit cost, illustrated in the diagram below.




Chapter 7 also considers when past practice – such as a history of regular plan amendments or regular changes to an entity's cost-sharing policy for its DB OPEB plan – may provide evidence of a substantive commitment that is mutually understood by the entity and plan participants. A substantive commitment may indicate that a substantive plan exists that differs from the extant written plan and forms the new basis of accounting.

### Organization of chapters on DB pension and OPEB plans under Topic 715

This Handbook divides the accounting for DB plans into several in-depth chapters:

— Chapter 6 examines the accounting requirements for plan assets and obligations.
— This chapter examines costs of DB plans.
— Chapter 8 explains actuarial assumptions used to measure these financial statement components and attribution.
— Chapter 9 discusses settlements, curtailments and certain termination benefits.
— Chapter 10 discusses special topics, including multiemployer plans.
— Chapter 11 reviews disclosure and reporting requirements.

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## 7.2 Overview

| Excerpt from ASC 715-30 | Excerpt from ASC 715-60 |
|---|---|
| **20 Glossary** | **20 Glossary** |
| | **Gross Eligible Charges –** The cost of providing the postretirement health care benefits covered by the plan to a plan participant, before adjusting for expected reimbursements from Medicare and other providers of health care benefits and for the effects of the cost-sharing provisions of the plan. |
| **Net Periodic Pension Cost –** The amount recognized in an employer's financial statements as the cost of a pension plan for a period. Components of net periodic pension cost are service cost, interest cost, actual return on plan assets, gain or loss, amortization of prior service cost or credit, and amortization of the transition asset or obligation existing at the date of initial application of Subtopic 715-30. The term net periodic pension cost is used instead of net pension expense because the service cost component recognized in a period may be capitalized as part of an asset such as inventory. | **Net Periodic Postretirement Benefit Cost –** The amount recognized in an employer's financial statements as the cost of a postretirement benefit plan for a period. Components of net periodic postretirement benefit cost include service cost, interest cost, actual return on plan assets, gain or loss, amortization of prior service cost or credit, and amortization of the transition obligation or asset. |
| **35 Subsequent Measurement** | **35 Subsequent Measurement** |
| **> Components of Net Periodic Pension Cost** | **> Components of Net Periodic Postretirement Benefit Cost** |
| **35-3 Net periodic pension cost** has often been viewed as a single homogeneous amount, but in fact it is made up of several components that reflect different aspects of the employer's financial arrangements as well as the cost of benefits earned by employees. The cost of a benefit can be determined without regard to how the employer decides to finance the plan. | **35-7** As with other forms of deferred compensation, the cost of providing postretirement benefits shall be attributed to the periods of employee service rendered in exchange for those future benefits pursuant to the terms of the plan. That cost notionally represents the change in the **unfunded accumulated postretirement benefit obligation** for the period, ignoring employer contributions |

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**35-4** All of the following components shall be included in the net pension cost recognized for a period by an employer sponsoring a **defined benefit pension plan**:

a. **Service cost**
b. **Interest cost**
c. **Actual return on plan assets**, if any
d. **Amortization** of any **prior service cost** or credit included in accumulated other comprehensive income
e. **Gain or loss** (including the effects of changes in assumptions), which includes, to the extent recognized (see paragraph 715-30-35-26), amortization of the net gain or loss included in accumulated other comprehensive income
f. Amortization of any net transition asset or obligation existing at the date of initial application of this Subtopic and remaining in accumulated other comprehensive income.

**35-5** Note that both the **return on plan assets** and interest cost components are in substance financial items rather than employee compensation costs. An employer may have net periodic pension cost that is a net credit (that is, net periodic pension income) as noted in paragraph 715-30-55-3.

to the plan, plan settlements, and payments made by the employer directly to **retirees**. However, changes in that unfunded obligation that arise from experience gains and losses and the effects of changes in assumptions may be recognized as a component of **net periodic postretirement benefit cost** on a delayed basis. In addition, the effects of a plan initiation or amendment generally are recognized on a delayed basis.

**35-8** Thus, any change in the accumulated postretirement benefit obligation or the plan assets (other than contributions and benefit payments) either is initially recognized in other comprehensive income or is included in net periodic postretirement benefit cost. Contributions to a funded plan by the employer decrease the recognized postretirement benefit liability or increase the recognized postretirement benefit asset.

**35-9** Net periodic postretirement benefit cost comprises several components that reflect different aspects of the employer's financial arrangements. All of the following components shall be included in the net periodic postretirement benefit cost recognized by an employer sponsoring a **defined benefit postretirement plan**:

a. **Service cost** (see the following paragraph).
b. **Interest cost** (see paragraph 715-60-35-11). The interest cost component of postretirement benefit cost shall not be considered interest for purposes of applying Subtopic 835-20.
c. **Actual return on plan assets**, if any (see paragraphs 715-60-35-23 through 35-36)
d. **Amortization** of any **prior service cost** or credit included in accumulated other comprehensive income to the extent required by paragraphs 715-60-35-13 through 35-20.
e. **Gain or loss** (including the effects of changes in assumptions) to the extent recognized, which includes

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amortization of the net gain or loss included in accumulated other comprehensive income (see paragraphs 715-60-35-23 through 35-36).

f. Amortization of any obligation or asset existing at the date of initial application of this Subtopic, hereinafter referred to as the **transition obligation** or **transition asset** remaining in accumulated other comprehensive income (see paragraphs 715-60-35-38 through 35-40).

**55 Implementation Guidance and Illustrations**

**>> Net Periodic Pension Cost**

**55-3** Paragraph 715-30-35-4 provides that **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 a transition asset remaining in accumulated other comprehensive income that exceeds the other net periodic pension cost components.

**55-4** An employer sponsoring a pension plan that is overfunded may have net periodic pension cost that is a net credit (that is, net periodic pension income) and the employer may make no contribution to the pension plan because it cannot currently deduct that amount for tax purposes. In this situation, the difference between net periodic pension income and the tax-deductible amount is a temporary difference as discussed in paragraphs 740-10-25-18 through 25-20. 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

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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.

**55-5** The overall temporary difference discussed in the preceding paragraph 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 decline in interest rates, additional pension benefits earned for future years of **service**, or 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.

**55-6** An employer may withdraw excess plan assets (cash) from a pension plan, not be required to settle a pension benefit obligation as part of an asset reversion transaction, and, as provided for in paragraph 715-30-55-145, no net **gain or loss** included in accumulated other comprehensive income would be immediately recognized in earnings. However, the withdrawal of excess plan assets shall be recorded as a negative contribution. That is, the employer shall record a debit to cash and a credit to the net pension asset or liability, as appropriate.

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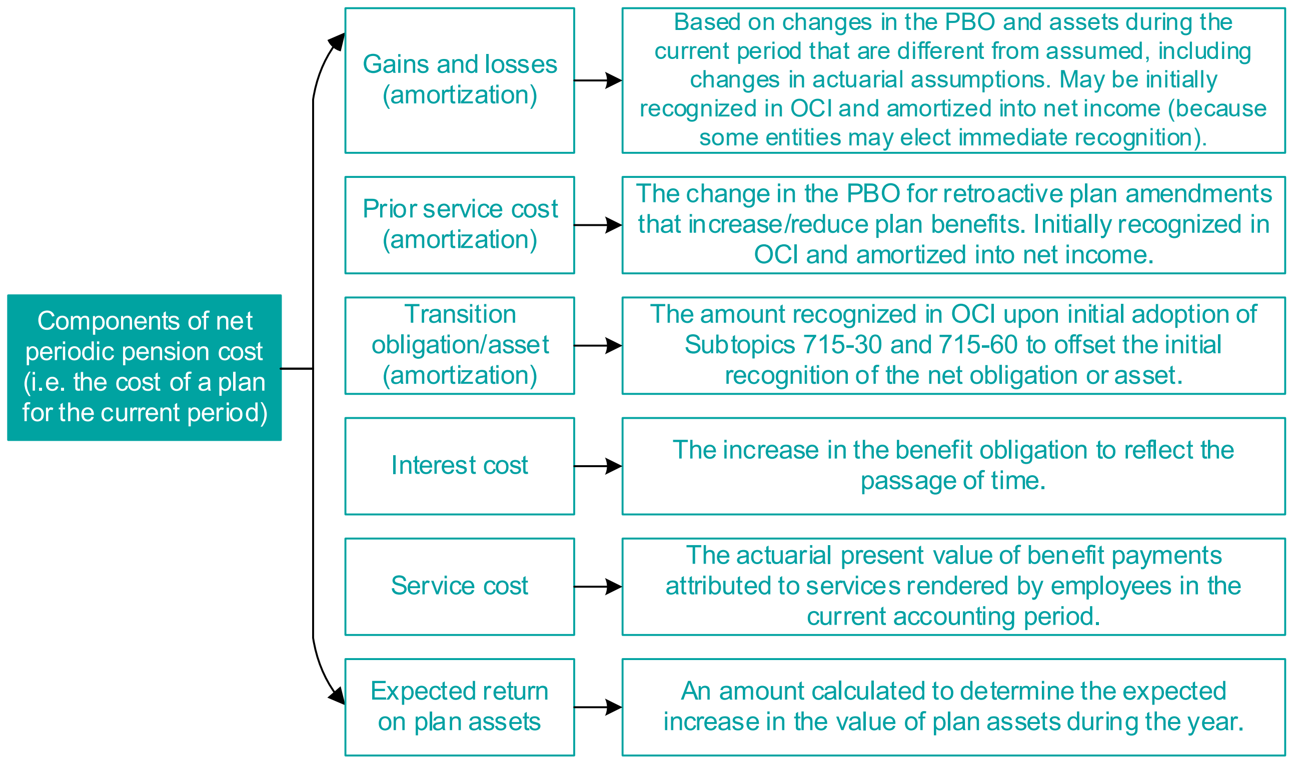
Net periodic benefit cost is generally calculated at the beginning of the year using information available at that time. Entities make demographic (e.g. turnover) and economic (e.g. discount rate) assumptions about changes to the benefit obligations and plan assets at the beginning of the year – including expected changes such as contributions, benefit payments and changes to plan asset investment strategy – to calculate the related net periodic benefit cost.

The following diagram depicts the components that this chapter discusses. The components are of a pension plan, but the schematic for OPEB plans is similar.




Topic 715 describes the components of net periodic benefit cost to include "actual" return on plan assets rather than "expected" return on plan assets. However, many entities elect to defer recognizing gains and losses from plan assets in OCI. Under this policy election, as depicted above, entities recognize EROA as a component of net periodic benefit

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cost and recognize the difference between the actual return on plan assets and EROA in OCI as part of gains and losses. Chapter 7 guidance reflects this common practice and refers to the net periodic benefit cost component related to periodic changes in plan assets as EROA. See section 7.5 for a detailed discussion of EROA.

Transition obligation/asset amortization is included in the diagram, but is relevant only when initially adopting Subtopics 715-30 and 715-60. See section 7.3.30.

## Question 7.2.10#

### How are each of the components of net periodic benefit cost recognized?

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Because initial recognition requirements differ across the components of net periodic benefit cost, the following table provides an overview of the initial and subsequent recognition guidance discussed throughout chapter 7.

| Component of net periodic benefit cost | Initial recognition | | | Subsequent recognition | Chapter 7 reference |
|---|---|---|---|---|---|
| | Capitalize | OCI | Income statement | | |
| Gain/loss | Not permitted | Permitted | Permitted | Amortize out of AOCI | Question 7.3.10 |
| Prior service cost | Not permitted | Required | Not permitted | Amortize out of AOCI | Question 7.3.130 |
| Transition obligation | Not permitted | Required | Not permitted | Amortize out of AOCI | Section 7.3.30 |
| Interest cost | Not permitted | Not permitted | Required | N/A | Question 7.4.10 |
| Service cost | Required, if applicable | Not permitted | Required, if applicable | Depreciate/ amortize with asset, if capitalized | Question 7.4.20 |

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| Component of net periodic benefit cost | Initial recognition | | | Subsequent recognition | Chapter 7 reference |
|---|---|---|---|---|---|
| | Capitalize | OCI | Income statement | | |
| Expected return on plan assets | Not permitted | Permitted | Permitted | N/A | Question 7.5.30 |

For a full picture of accounting for these costs, see also:

- section 6.4.10, which addresses how entities estimate their benefit obligation; and
- chapter 8, which examines actuarial assumptions and attribution methods entities for calculating the components of net periodic benefit cost.

## Question 7.2.20

**Should non-SEC registrants consider SEC guidance related to calculating the components of net periodic benefit cost?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Yes. Although SEC staff observations discussed apply to SEC registrants, they also are considered for relevance by nonpublic entities. Chapter 7 includes relevant discussions with, and indications from, standard setters and regulators, including the FASB and SEC staffs. For example, many questions in section 7.4 reference remarks made by the SEC at the 2015 AICPA National Conference on Current SEC and PCAOB Developments about changes to key discount rate assumptions and selecting market interest information about methods used to calculate interest cost and service cost.

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# 7.3 Amortization of amounts deferred in AOCI

## 7.3.10 Gains and losses

| Excerpt from ASC 715-30 | Excerpt from ASC 715-60 |
|---|---|
| **20 Glossary**<br><br>**Gain or Loss –** A change in the value of either the benefit obligation (projected benefit obligation for pension plans or accumulated postretirement benefit obligation for other postretirement benefit plans) or the plan assets resulting from experience different from that assumed or from a change in an actuarial assumption, or the consequence of a decision to temporarily deviate from the other postretirement benefit substantive plan. Gains or losses that are not recognized in net periodic pension cost or net periodic postretirement benefit cost when they arise are recognized in other comprehensive income. Those gains or losses are subsequently recognized as a component of net periodic pension cost or net periodic postretirement benefit cost based on the recognition and amortization provisions of Subtopic 715-30 or Subtopic 715-60.<br><br>**35 Subsequent Measurement**<br><br>**>> Gains and Losses**<br><br>**35-18** As established in the definition of the term, a gain or loss results from a change in the value of either the projected benefit obligation or the **plan assets** resulting from experience different from that assumed or from a change in an actuarial assumption. This Subtopic generally does not distinguish between gains and losses that result from experience different from that assumed or from changes in assumptions. Gains and losses include amounts | **20 Glossary**<br><br>**Gain or Loss –** A change in the value of either the benefit obligation (projected benefit obligation for pension plans or accumulated postretirement benefit obligation for other postretirement benefit plans) or the plan assets resulting from experience different from that assumed or from a change in an actuarial assumption, or the consequence of a decision to temporarily deviate from the other postretirement benefit substantive plan. Gains or losses that are not recognized in net periodic pension cost or net periodic postretirement benefit cost when they arise are recognized in other comprehensive income. Those gains or losses are subsequently recognized as a component of net periodic pension cost or net periodic postretirement benefit cost based on the recognition and amortization provisions of Subtopic 715-30 or Subtopic 715-60.<br><br>**35 Subsequent Measurement**<br><br>**>> Gains and Losses**<br><br>**35-23** This Subtopic generally does not distinguish between gains and losses that result from experience different than assumed or from changes in assumptions. Gains and losses include amounts that have been realized, for example, by the sale of a security, as well as amounts that are unrealized.<br><br>**35-24** Because gains and losses may reflect refinements in estimates as well as real changes in economic values and |

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that have been realized, for example by sale of a security, as well as amounts that are unrealized.

**35-19** Because gains and losses may reflect refinements in estimates as well as real changes in economic values and because some gains in one period may be offset by losses in another or vice versa, this Subtopic does not require recognition of gains and losses as components of net pension cost of the period in which they arise.

**35-20** However, immediate recognition of gains and losses as a component of net periodic pension cost is permitted if that method is applied consistently, and is applied to all gains and losses on both plan assets and obligations.

**35-21** Gains and losses that are not recognized immediately as a component of net periodic pension cost shall be recognized as increases or decreases in other comprehensive income as they arise. Accounting for **plan terminations** and **curtailments** and other circumstances in which recognition of gains and losses as a component of net periodic pension cost might not be delayed is addressed in the Settlements, Curtailments, and Certain Termination Benefits Subsection of this Section.

**35-22** Asset gains and losses are differences between the actual return on plan assets during a period and the **expected return on plan assets** for that period. Asset gains and losses include both changes reflected in the **market-related value of plan assets** and changes not yet reflected in the market-related value (that is, the difference between the fair value of assets and the market-related value). Gains or losses on transferable securities issued by the employer and included in plan assets are also included in asset gains and losses. Asset gains and losses not yet reflected in market-related value are not required to be amortized under paragraphs 715-30-35-24 through 35-25.

**35-23** In other words, the expected return on plan assets

because some gains in one period may be offset by losses in another or vice versa, this Subtopic does not require recognition of gains and losses as components of net postretirement benefit cost in the period in which they arise, except as described in paragraphs 715-60-35-34 through 35-35.

**35-25** Gains and losses that are not recognized immediately as a component of net periodic postretirement benefit cost shall be recognized as increases or decreases in other comprehensive income as they arise. (Gain and loss recognition in accounting for settlements and curtailments is addressed in paragraphs 715-60-35-149 through 35-171.)

**35-26** The expected return on plan assets  shall be determined based on the expected long-term rate of return on plan assets (see paragraphs 715-60-35-84 through 35-87) and the market-related value of plan assets. If the fund holding plan assets is a taxable entity, the expected long-term rate of return on plan assets is net of estimated income taxes.

**35-27** Plan asset gains and losses are differences between the actual return on plan assets during a period and the expected return on plan assets for that period. Plan asset gains and losses include both of the following:

a. Changes reflected in the market-related value of plan assets
b. Changes not yet reflected in the market-related value of plan assets (that is, the difference between the fair value and the market-related value of plan assets).

**35-28** Plan asset gains and losses not yet reflected in market-related value are not required to be amortized under the following paragraph and paragraphs 715-60-35-31 through 35-32.

**35-29** As a minimum, amortization of a net gain or loss

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generally will be different from the actual return on plan assets for the year. This Subtopic provides for recognition of that difference (a net gain or loss) in other comprehensive income in the period it arises. The amount recognized in other comprehensive income is also a component of net periodic pension cost for the current period. Thus, the amount recognized in other comprehensive income and the actual return on plan assets, when aggregated, equal the expected return on plan assets. The amount recognized in accumulated other comprehensive income affects future net periodic pension cost through subsequent amortization, if any, of the net gain or loss.

**35-24** As a minimum, amortization of a net gain or loss included in accumulated other comprehensive income (excluding asset gains and losses not yet reflected in market-related value) shall be included as a component of net pension cost for a year if, as of the beginning of the year, that net gain or loss exceeds 10 percent of the greater of the projected benefit obligation or the market-related value of plan assets. If amortization is required, the minimum amortization shall be that excess divided by the average remaining service period of active employees expected to receive benefits under the plan. The amortization must always reduce the beginning-of-the-year balance. Amortization of a net gain results in a decrease in net periodic pension cost; amortization of a net **loss** results in an increase in net periodic pension cost. If all or almost all of a plan's participants are inactive, the average remaining life expectancy of the inactive participants shall be used instead of average remaining service.

**35-25** Any systematic method of amortizing gains or losses may be used in lieu of the minimum specified in the preceding paragraph provided that all of the following conditions are met:

included in accumulated other comprehensive income (excluding plan asset gains and losses not yet reflected in market-related value) shall be included as a component of net periodic postretirement benefit cost for a year if, as of the beginning of the year, that net gain or loss exceeds 10 percent of the greater of the accumulated postretirement benefit obligation or the market-related value of plan assets. If amortization is required, the minimum amortization shall be that excess divided by the average remaining service period of active plan participants. If all or almost all of a plan's participants are inactive, the average remaining life expectancy of the inactive participants shall be used instead of the average remaining service period.

**35-30** The amortization shall reduce the beginning-of-the-year balance included in accumulated other comprehensive income. Amortization of a net gain included in accumulated other comprehensive income results in a decrease in net periodic postretirement benefit cost; amortization of a net loss included in accumulated other comprehensive income results in an increase in net periodic postretirement benefit cost.

**35-31** Any systematic method of amortizing gains and losses included in accumulated other comprehensive income may be used in place of the minimum amortization specified in paragraph 715-60-35-29 provided that all of the following conditions are met:

a. The minimum amortization is recognized in any period in which it is greater (reduces the net gain or loss balance by more) than the amount that would be recognized under the method used.
b. The method is applied consistently.
c. The method is applied similarly to both gains and losses.

**35-32** If an entity uses a method of consistently recognizing gains and losses immediately, any gain that

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a. The minimum is used in any period in which the minimum amortization is greater (reduces the net balance included in accumulated other comprehensive income by more).
b. The method is applied consistently.
c. The method is applied similarly to both gains and losses.

**35-26** The **gain or loss component of net periodic pension cost** shall consist of both of the following:

a. The difference between the actual return on plan assets and the expected return on plan assets
b. Amortization of the net gain or loss included in accumulated other comprehensive income.

**35-27** Consequently, as stated in the definition of the term, the gain or loss component is the net effect of delayed recognition of gains and losses in determining net periodic pension cost (the net change in the gain or loss) in accumulated other comprehensive income except that it does not include changes in the projected benefit obligation occurring during the period and deferred for later recognition in net periodic pension cost.

**35-28** See Example 2 (paragraph 715-30-55-101) for an illustration of this guidance on gains and losses.

does not offset a loss previously recognized in income pursuant to this paragraph shall first offset any transition obligation remaining in accumulated other comprehensive income; any loss that does not offset a gain previously recognized in income pursuant to this paragraph shall first offset any transition asset remaining in accumulated other comprehensive income.

**35-33** In applying the provisions of paragraphs 715-60-35-29 through 35-32 for the recognition of gains and losses as a component of net periodic postretirement benefit cost, it is not appropriate for an employer to elect annually a new method of amortization of gains and losses included in accumulated other comprehensive income. Rather, an employer shall select an amortization method and apply it consistently from period to period as long as the resulting amortization equals or exceeds the minimum amortization specified by paragraph 715-60-35-29. Any change in the method selected would be subject to Topic 250.

**35-34** In some situations, an employer may forgive a retrospective adjustment of the current or past years' **cost-sharing provisions** of the plan as they relate to benefit costs already incurred by retirees or may otherwise deviate from the provisions of the substantive plan to increase or decrease the employer's share of the benefit costs incurred in the current or past periods. The effect of a decision to temporarily deviate from the substantive plan shall be immediately recognized as a loss or gain.

**35-35** For example, the terms of a substantive postretirement health care plan may provide that any shortfall resulting from current year benefit payments in excess of the employer's stated share of **incurred claims cost** and retiree contributions for that year is to be recovered from increased retiree contributions in the subsequent year. The employer may subsequently determine that increasing retiree contributions for the

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shortfall in the prior year would be onerous and decides to bear the cost of the shortfall for that year. The employer's decision to bear the shortfall represents a change in intent and the resulting loss shall be recognized immediately. Future decisions by the employer to continue to bear the shortfall suggest an amendment of the substantive plan that shall be accounted for as described in paragraphs 715-60-35-12 through 35-22.

**35-36** The gain or loss component of net periodic postretirement benefit cost shall consist of all of the following:

a. The difference between the actual return on plan assets and the expected return on plan assets
b. Any gain or loss immediately recognized or the amortization of the net gain or loss included in accumulated other comprehensive income
c. Any amount immediately recognized as a gain or loss pursuant to paragraphs 715-60-35-34 through 35-35.

**35-37** See paragraphs 715-60-55-22 through 55-25 for implementation guidance on gains and losses.

**55 Implementation Guidance and Illustrations**

**>> Gains and Losses**

**55-22** An employer sponsors a contributory postretirement health care plan that has an annual limitation on the dollar amount of the employer's share of the cost of benefits (a defined dollar capped plan). The cap on the employer's share of annual costs and the retirees' contribution rates are increased 5 percent annually. Any amount by which incurred claims costs exceed the combined employer and retiree contributions is initially borne by the employer but is passed back to retirees in the subsequent year through supplemental retiree contributions for that year. In 20X1, incurred claims costs exceed the combined employer and retiree contributions requiring a supplemental retiree

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contribution in 20X2. The employer decides in 20X2 to absorb the excess that arose in 20X1 rather than pass it on to the retirees. The employer should recognize as a component of net periodic postretirement benefit cost the loss due to that temporary deviation from the substantive plan. The employer should recognize the loss as a component of net periodic postretirement benefit cost in 20X2 when it makes the decision to deviate from the substantive plan.

**55-23** An employer previously projected that health care costs under a defined dollar capped plan would exceed the cap in 20X1 but actual claims in that year do not exceed the cap. The resulting gain should not be recognized immediately as a component of net periodic postretirement benefit cost in 20X1 in accordance with paragraphs 715-60-35-34 through 35-35.

**55-24** The change in the accumulated postretirement benefit obligation due to experience different from that assumed results in a **gain or loss** that should be recognized in accumulated other comprehensive income in accordance with paragraphs 715-60-35-23 through 35-25. Paragraphs 715-60-35-34 through 35-35 addresses the recognition of a temporary deviation from provisions of the substantive plan that increases or decreases the employer's share of the benefit costs incurred in the current or past periods. A situation that would result in a gain or loss that should be recognized immediately as a component of net periodic postretirement benefit cost is one in which an employer has a past practice of changing the cap to reduce its share of expenses such that that practice constitutes the cost-sharing provision of the substantive plan. If, as a result of perceived economic adversity affecting the retiree population, the employer decides in 20X1 and for that year alone not to change the cap to further reduce its share of expenses in 20X1 as had been anticipated in the substantive plan, that action would

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| | |
|---|---|
| | give rise to a loss that would be required to be recognized immediately as a component of net periodic postretirement benefit cost in 20X1.<br><br>**55-25** A gain that would be recognized immediately as a component of net periodic postretirement benefit cost in accordance with paragraphs 715-60-35-34 through 35-35 would occur if participants voluntarily agreed to bear a one-time higher share of costs for a past or current period. For example, if retirees agreed to make a contribution to the plan in one year that is larger than the contribution amount called for by the plan and future contributions would comply with the existing terms of the plan, the employer would recognize immediately as a component of net periodic postretirement benefit cost a one-time gain for the excess of the new retiree contribution amount over the old retiree contribution amount. |

Under Topic 715, gains and losses arise from changes to the benefit obligation or the plan assets from:

— differences between actual results (i.e. experience) and expectations; and
— changes to assumptions.

Topic 715 does not distinguish between gains and losses arising from experience (e.g. a change to the fair value of plan assets) or changes in assumptions; changes related to actuarial assumptions are also referred to as actuarial gains and losses. The term 'gains and losses' in this Handbook refers to any gain or loss recognized under Topic 715 regardless of how it arose. [715-30-35-18, 715-30 Glossary, 715-60-35-23, 715-60 Glossary]

Accounting policy decisions dictate how and when to recognize gains and losses under Subtopics 715-30 and 715-60.

This section discusses common questions related to policy decisions when accounting for gains and losses, amortization methods and how to account for a change in policy (i.e. a change in accounting principle). These components considered in section 7.3 are highlighted in the following diagram. Chapter 8 discusses assumptions under Topic 715.

Gains and losses are initially recognized in OCI to the extent they are not recognized in net periodic benefit cost when they arise. At a minimum, entities amortize out of AOCI into net periodic benefit cost the amount of gains and losses in excess of the 'corridor' amount. The corridor amount is 10% of the greater of the benefit obligation and the MRV of plan assets. Entities may choose to recognize gains and losses immediately in the income statement or may adopt a policy of

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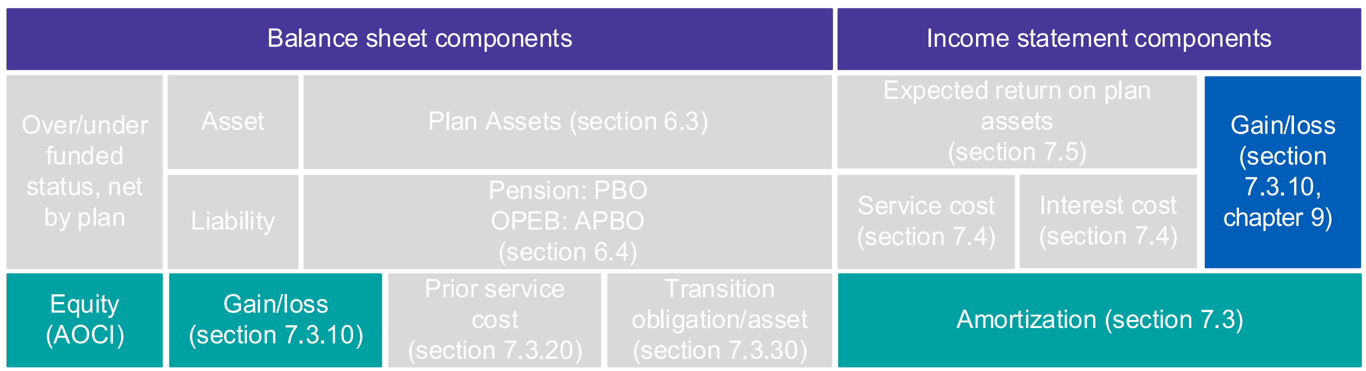
amortizing more than the minimum annual amount determined using the corridor approach, but not less than this amount. An entity is permitted to recognize gains and losses in net periodic benefit cost using any systematic and rational method that results in faster recognition than using the corridor method. [715-30-35-21, 715-30-35-24 – 35-25, 715-60-35-25, 715-60-35-29, 715-60-35-31]

For entities using an amortization approach, the net cumulative (unamortized) gain or loss at the beginning of the period in excess of the corridor is amortized into net periodic benefit cost on a straight-line basis over the expected average remaining service period of the active employees participating in the plan or, if all or almost all participants are inactive, over the remaining life expectancy of inactive participants.

The following diagram below illustrates the financial statement components of gains and losses discussed in section 7.3.10. [715-30-35-24, 715-60-35-29]




## Question 7.3.10

### How do gains and losses arise and how are they recognized?

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Gains and losses represent the change in value of the benefit obligation or plan assets resulting from:

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- experience different from that assumed – e.g. actual return on plan assets different from the assumed return; or
- changes in assumptions – e.g. changes in the discount rate.

Depending on an entity's accounting policy, these gains and losses are either recognized: [715-30 Glossary, 715-60 Glossary]

- immediately in net periodic benefit cost; or
- in OCI and then amortized out of AOCI in future periods as a component of net periodic benefit cost.

See Question 7.2.10 for an overview of recognition requirements.

## Question 7.3.20

**What is the accounting for immediately recognized gains and losses?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:**

### Classification of immediately recognized gain or loss

Under Topic 715, immediately recognized gains and losses are a component of net periodic benefit cost. An entity does not need to track an AOCI amount and monitor the corridor when the policy is to immediately recognize *all* gains and losses. [715-30-35-20, 715-20-45-3A]

Section 7.6 discusses the presentation of net periodic benefit cost.

### Tracking AOCI for gains and losses inside the corridor

When an entity has a policy to immediately recognize only gains or losses outside the corridor, the amounts inside the corridor are still recognized in AOCI. Therefore, the entity should monitor its corridor each period. The amount subject to amortization within net periodic benefit cost will depend on the difference between the cumulative amount in AOCI and the corridor amount.

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## Question 7.3.30

**If an entity elects to defer gains and losses in AOCI, how does it amortize them?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Topic 715 supports a policy of immediately recognizing gains and losses provided the policy is applied consistently. Topic 715 also permits an entity to delay recognizing gains and losses by deferring them in AOCI and amortizing them into net periodic benefit cost in future periods using a minimum amortization method. [715-30-35-24, 715-30-35-29]

The 10% corridor approach is the minimal method of amortizing gains and losses from AOCI into net income. It is called the corridor approach because an entity does not amortize into net periodic benefit cost gains and losses within a 10% corridor – they remain in AOCI. [715-30-35-24, 715-60-35-29]

The corridor is 10% of the greater of the benefit obligation and the MRV of plan assets at the beginning of the period; see Question 7.5.10 regarding MRV. The corridor is calculated and applied separately for each plan. Each year, an entity determines whether the gain or loss exceeds the corridor amount and, if so, includes a portion of that excess – the excess amount divided by the average remaining service period or the average remaining life expectancy – in net periodic benefit cost. See Question 7.3.140 for discussion about determining the amortization period. Example 7.3.10 provides a simple illustration of the corridor method calculation. [715-30-35-24]

## Example 7.3.10

**Immediate recognition of gains and losses outside of the corridor**

### Background

ABC Corp. has one DB pension plan and a policy to immediately recognize gains and losses outside the 10% corridor.

The following additional facts about ABC are relevant.

— Year 1 loss, $1,500.
— Year 2 gain, $300.
— Year 3 loss, $500.
— For simplicity, the corridor amount (calculated as 10% of the greater of the PBO or the MRV of plan assets) is $1,000 for each year.

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### Analysis

At each fiscal year-end, ABC immediately recognizes gains or losses outside the $1,000 corridor as a component of net periodic pension cost.

| Year | AOCI, beginning balance | Gain/(loss) | Excess > corridor recognized in net pension cost | AOCI, ending balance |
|---|---|---|---|---|
| 1 | - | ($1,500) | $500 | ($1,000) |
| 2 | ($1,000) | $300 | - | ($700) |
| 3 | ($700) | ($500) | $200 | ($1,000) |

## Question 7.3.40#

**How does an entity determine whether an employee is active or inactive?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** To determine the minimum amortization period for gains and losses and the period over which to recognize prior service cost, an entity determines whether the participants are active or inactive employees. Such amounts are amortized over the average remaining service period of active employees, unless all or almost all of a plan's participants are inactive, in which case the average remaining life expectancy of the inactive participants is used instead of the average remaining service period. [715-30-35-11,715-30-35-24]

Subtopic 715-30 does not define either an active or inactive participant. Subtopic 715-60 defines a plan participant as a current or former employee who has rendered service in the credited service period and is expected to receive benefits under the OPEB plan. It further defines an active plan participant as an active employee who has rendered service in the credited service period and is expected to receive benefits under the OPEB plan. This could be interpreted as limiting the population of active participants to only those that continue to accrue benefits under the plan. [715-60 Glossary]

Another view is that the active versus inactive determination should be based on the participants' employment status, regardless of whether the employees continue to accrue benefits under the plan.

Practice is mixed with respect to when an employee is considered *inactive*, and we believe entities are able to make a policy election. However, we would generally expect the same policy to be applied to all DB plans.

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**Policy 1**

One policy approach is to consider employees inactive who have either terminated employment or who continue to provide employment services, but no longer earn additional benefits under the plan. This approach makes the active versus inactive assessment in relation to the participants' ability to accrue additional defined benefits under the plan. It is consistent with the definition of active plan participant in the Glossary of Subtopic 715-60.

**Policy 2**

Another policy approach is to consider employees as active who continue to provide services, without regard to whether future services entitle the employee to receive additional defined benefits. This approach makes the active versus inactive assessment in relation to whether the participant is currently employed by the entity.

## Example 7.3.20

**Impact of policy to define inactive participants**

ABC Corp. has a DB pension plan. Key facts as of January 1, Year 1:

— ABC has unrecognized actuarial losses in AOCI that exceed 10% of the greater of the MRV of plan assets or the PBO.
— ABC has unrecognized prior services cost from earlier plan amendments in AOCI.
— Benefit payments under the plan are calculated as the average of the highest five years annual earnings, including compensation levels in years after the plan amendment described below (i.e. maintain the final salary element of the benefits formula).

ABC alters the terms of the plan to:

— prevent new employees from becoming eligible for defined benefits; and
— eliminate the ability of existing plan participants to earn additional defined benefits for future service.

There is no change to the benefit calculation. The amendment is classified as a soft freeze.

ABC has chosen to treat these employees as inactive because they can no longer earn defined benefits for future services, consistent with Policy 1 described in Question 7.3.40, and thus changes its amortization period for amounts in AOCI to the remaining life expectancy of the inactive participants (a much longer period than the average remaining service period of active participants). We note, however, that if ABC chose to treat them as active (i.e. apply Policy 2 in Question 7.3.40), over time as plan participants approach retirement age, the average remaining service period (and thus the amortization period) will continue to decrease until such time that *all or almost all* of the participants have retired or

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otherwise terminated employment, at which time the amortization period switches to the remaining life expectancy. ABC's management may want to consider this discontinuity in evaluating which policy to select.

## Question 7.3.50

**Is the corridor method the only acceptable method of amortizing gains and losses?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** No. While the corridor method is the minimal method of amortizing gains and losses, an entity is permitted to recognize gains and losses in net periodic benefit cost using any systematic and rational method that results in recognition faster than the corridor method. Question 7.3.60 discusses the timing of recognition. [715-30-35 – 25, 715-60-35-31]

## Question 7.3.60#

**Can an entity change its policy for recognizing gains and losses or determining MRV plan assets?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Background:** In our experience, most entities amortize gains and losses outside the 10% corridor. Most entities also use a calculated value for MRV instead of using the fair value of plan assets to calculate the EROA and to determine the corridor. [715-30-35-22, 35-24, 35-51, 715-60-35-29]

**Interpretive response**: Yes, if the change is preferable. Entities with a delayed recognition policy may consider changing to a policy that results in gains and losses being recognized sooner, as shown in the following table. Changing to an accelerated recognition policy is considered preferable to a delayed policy. Also, a policy to use current fair value of plan assets as MRV would result in recognizing net periodic benefit cost that is more commensurate with the changes in the fair value of plan assets. Once changed, entities cannot change back again if such a change is not preferable (see Question 7.3.70). Examples of potential policy changes are reflected in the table below. [715-30-35-20, 35-25, 715-60-35-31]

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| Original policy | New policy |
|---|---|
| Amortize gains and losses that are outside the corridor into net periodic benefit cost:<br>— over the remaining working life of active plan participants; or<br>— using some other systematic and rational method that results in faster amortization. | Recognize either of the following in net periodic benefit cost on the measurement date:<br>— all net gains or losses; or<br>— the amounts that are outside the corridor. |
| Calculate the MRV of plan assets using a technique that smoothes changes in the fair value of plan assets over a period of up to five years. | Use the current fair value of plan assets as MRV or use a smoothing period shorter than what was used previously in calculating MRV. Also refer to Question 7.5.10 |

See section 7.5 for a discussion of the use of MRV for purposes of determining EROA and its impact on the amortization of gains and losses.

## Question 7.3.70#

### How is a change in method of recognizing gains and losses or MRV accounted for?

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** If an entity is considering a policy change for recognizing gains and losses or MRV as described in Question 7.3.60, this is a change in accounting policy that requires consideration of the Topic 250 requirements for such changes. Under Topic 250, a voluntary change in accounting policy needs to be preferable to the entity's existing policy, and the entity also discloses the reasons for the change. In addition, for SEC registrants, there is a requirement to file with the SEC a preferability letter from its independent accountant for material accounting policy changes. [250-10-45-2, 250-10-S99-4, 715-30-35-20, 715-60-35-25]

As required by Topic 250, an entity generally reflects these policy changes retrospectively in financial statements for all periods presented. This retrospective application of the new policy could have a significant effect on the amounts of previously reported net periodic benefit cost and AOCI. For example, a policy to immediately recognize net gains or losses (or all gains or losses outside the corridor) would result in recognizing significant gains or losses in any period in which the plan assets and liabilities are remeasured (generally Q4 each year) if there has been a significant change in the fair value of plan assets or the benefit obligation. In addition, there would be no component of net periodic benefit cost relating to amortization of deferred gains and losses. [250-10-45-5, 715-30-35-20, 715-60-35-25]

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Neither of these policy changes would affect the reported funded status of an entity's net benefit liability because that amount is always the difference between the benefit obligation and the fair value of plan assets.

Accounting policy changes are explained in-depth in chapter 3 of KPMG Handbook, Accounting changes and error corrections.

## Question 7.3.80

**Is immediately recognizing gains and losses a preferable policy?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Yes. In general, earlier recognition in the income statement of changes in the funded status of the plan is an accounting policy that is preferable to delayed recognition. The FASB noted when it originally issued Subtopic 715-30 that it would be appropriate and preferable to recognize a benefit liability or asset with no delay in recognizing gains and losses. We believe this statement provides relevant evidence of preferability. [250-10-45-2, 715-30-35-20, FAS 87.B107]

In addition, an entity may change from using a calculated value to using fair value as MRV – either is explicitly permitted by definition – because using current fair value as MRV would result in recognizing net periodic benefit cost that is more commensurate with changes in fair value of plan assets. See also Question 7.3.70 and Example 7.3.30. [715-30 Glossary, 715-60 Glossary]

## Example 7.3.30●

**Changing the method for determining MRV of plan assets for a particular year**

### Background

To determine the MRV of its plan assets, ABC Corp. uses a calculated value that recognizes changes in fair value in a systematic and rational manner over five years, the maximum permitted under Topic 715. In the current year, after remeasuring its plan assets and obligations, ABC determines that the calculated value is significantly higher than the fair value of plan assets. ABC determines that using the calculated value to measure the EROA will likely result in recognizing a significant loss because the EROA (determined using the calculated value) will likely exceed the actual return on plan assets.

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To avoid recognizing a significant loss in the current year, ABC proposes to use the fair value of plan assets (not the calculated value) as MRV to determine EROA for the current year. ABC would also use the fair value of plan assets to determine EROA for purposes of measuring net periodic pension cost in the subsequent year. After that, if the calculated value no longer significantly deviates from the fair value of plan assets, ABC proposes to revert to using the calculated value to determine the MRV of plan assets.

**Analysis**

As discussed in Question 7.3.70, an entity may change from using a calculated value to fair value for calculating MRV, because current fair value for calculating MRV is more commensurate with the change in fair value of plan assets during a particular year. However, while ABC could support an accounting policy change to using fair value when calculating MRV, ABC cannot change its method for determining MRV for a particular year only. The definition of MRV requires the manner of determining MRV to be consistent from year to year.

## Question 7.3.90

**When supporting preferability, must an entity change its policies for MRV and recognizing gains and losses at the same time?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive policy:** No. An entity is not required to change both its policy on recognizing gains and losses and its MRV policy at the same time to support preferability. These are separate accounting policies and therefore each change is evaluated for preferability on its own merits. While we believe that in most cases it would be appropriate to change both policies at the same time, some entities may elect to change only one or the other. If both policies are changed at the same time, the reasoning for both policies to change could be closely related and a single preferability letter could be issued for SEC registrants. [715-30-35-20, 35-25, 715-60-35-31]

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## Question 7.3.100

### Must an entity have a consistent policy for recognizing gains and losses for all pension plans?

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Generally, yes. We expect an entity to apply its accounting policy for gains or losses consistently to all its pension plans in the scope of Subtopic 715-30. Similarly, we expect a consistent policy for all OPEB plans in the scope of Subtopic 715-60. We would generally expect this approach even though the plans may cover different employee groups in the same or different geographic jurisdictions, segments, or other basis, or if they employ different funding strategies. [715-30-35-20, 715-60-35-3]

However, there may be circumstances in which a plan (or group of plans) has unique characteristics compared to other plans sponsored by the same entity. In this case, it may be acceptable for these plans to retain or adopt different accounting policies.

While it would be acceptable, we do not believe it is necessary to adopt the same policies for gains and losses for OPEB plans in the scope of Subtopic 715-60 as those adopted for pension plans in the scope of Subtopic 715-30. [715-30-35-20, 715-60-35-3]

## Question 7.3.110

### What are some practical considerations of a policy change to recognize gains and losses immediately?

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** In addition to the discussion in Questions 7.3.10 to 7.3.90, below are some of the practical considerations before changing an accounting policy to immediately recognize gains and losses. [715-30-35-20, 715-60-35-25]

#### Future periods

##### *Volatility in earnings*

A policy of immediately recognizing all or a portion of actuarial gains and losses typically results in greater volatility to an entity's reported financial results. In most cases, this volatility is reported in Q4 when the annual remeasurement of a plan is prepared. However, the policy could also affect other interim periods when a significant event triggers a requirement to obtain a plan remeasurement in an interim period. [715-30-35-20]

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Some entities consider changing their investment strategy for plan assets to mitigate the volatility. To do so, they may allocate plan assets in greater concentrations to bonds and other debt securities for which fair value is sensitive to interest rates and have cash flows that somewhat match the expected cash flows for benefit payments. They expect that changes in the fair value of those plan assets will correlate with changes in the benefit obligation that occur as a result of changes in discount rates. [715-30-35-20, 715-60-35-25]

### *Effect on debt covenants*

Changes in accounting policies could affect compliance with financial covenants in debt agreements or other contracts. For example, recognition of expenses earlier or increased volatility may affect an entity's ability to meet a debt covenant. In addition, some debt agreements measure compliance with financial covenants using accounting principles in effect at the time of the agreement. This could require an entity to prepare separate actuarial calculations to prepare pro forma financial statements (i.e. for lenders) in future periods as if the recognition of gains and losses policies had not been changed. [715-30-35-20, 715-60-35-25]

### *Share-based payment vesting conditions*

Some entities implement share-based payment arrangements that include performance conditions using an earnings measure to determine whether the awards vest. The increased volatility from a policy of immediate recognition of gains and losses could make it more difficult to assess whether achievement of the condition in a future period is probable. In addition, modifications of the defined performance condition, as a result of the revised gains and losses policy, may result in additional compensation expense, raise corporate governance concerns or result in adverse tax consequences. [715-30-35-20, 715-60-35-25]

### Retrospective application

In theory, to calculate the result on retained earnings at the beginning of the earliest period presented, an entity would begin with its adoption of Subtopic 715-30 as of January 1, 1987 (for calendar-year public companies) and roll forward the effects of the new policy for each year since. If it is impracticable to apply the new accounting principle retrospectively to all prior periods, an entity applies it prospectively as of the beginning of the earliest period that it is practicable to do so. [250-10-45-9, 715-30-35-20, 715-60-35-25]

The following circumstances might contribute to a conclusion that retrospective application since January 1, 1987 (for calendar-year public companies) is impracticable. [250-10-45-9, 715-30-35-20, 715-60-35-25]

— An entity had significant settlements and curtailments in various periods. The deferred gains and losses calculated when measuring the effects of the settlements or curtailments were material, and the records to determine how those amounts were calculated for the entity to recalculate them under the new accounting policy no longer exist. The effect of these remeasurements might be difficult to determine because settlements and curtailments often do not occur at typical period-end closing dates.

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— An entity merged with another in a business combination accounted for as a pooling of interests after it adopted Subtopic 715-30. This could present challenges if the transactions involved entities with pension plans and the combined entity no longer has access to relevant books and records of one of the combining entities.

See KPMG Handbook, Accounting changes and error corrections, for in-depth discussion about accounting for a change in accounting principle.

## Question 7.3.120

**Is market volatility an appropriate reason to change from one acceptable amortization method to another?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** No. Changes in market volatility do not qualify as a basis for establishing preferability for a change in amortization method. Further, proposed changes that result in slower recognition of gains and losses into net periodic benefit cost generally are not preferable. See Question 7.3.80. [715-30-35-25]

## 7.3.20 Prior service cost

| Excerpt from ASC 715-30 | Excerpt from ASC 715-60 |
|---|---|
| **20 Glossary** | **20 Glossary** |
| **Prior Service Cost –** The cost of retroactive benefits granted in a plan amendment. Retroactive benefits are benefits granted in a plan amendment (or initiation) that are attributed by the benefit formula to employee services rendered in periods before the amendment. | **Prior Service Cost –** The cost of retroactive benefits granted in a plan amendment. Retroactive benefits are benefits granted in a plan amendment (or initiation) that are attributed by the benefit formula to employee services rendered in periods before the amendment. |
| **35 Subsequent Measurement** | **35 Subsequent Measurement** |
| **>> Prior Service Costs** | **>> Prior Service Costs** |

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**35-10 Plan amendments** (including initiation of a plan) often include provisions that grant increased benefits based on services rendered in prior periods. Because plan amendments are granted with the expectation that the employer will realize economic benefits in future periods, this Subtopic does not require the cost of providing such retroactive benefits (that is, prior service cost) to be included in net periodic pension cost entirely in the year of the amendment, absent the conditions addressed in paragraph 715-30-35-16, but provides for recognition during the future service periods of those employees active at the date of the amendment who are expected to receive benefits under the plan.

**35-11** A plan amendment that retroactively increases benefits (including benefits that are granted to retirees) increases the projected benefit obligation. The cost of the benefit improvement shall be recognized as a charge to other comprehensive income at the date of the amendment. Except as specified in paragraphs 715-30-35-13 through 35-16, that prior service cost shall be amortized as a component of net periodic pension cost 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. Other comprehensive income is adjusted each period as prior service cost is amortized.

**35-12** See Example 1 (paragraph 715-30-55-93) for an illustration of this guidance to amortize prior service cost.

**35-13** To reduce the complexity and detail of the computations required, consistent use of an alternative approach that more rapidly amortizes the cost of

**35-12** In measuring an employer's expected and accumulated postretirement benefit obligations, changes in in-kind benefits covered by a postretirement health care plan or by other postretirement benefit plans shall not be anticipated. However, if the employer amends the benefits to be provided by the plan, the effect of the amendment is recognized immediately in measuring the employer's expected and accumulated postretirement benefit obligations, even if the effective date of the change in benefits is delayed until a specified date in the future.

**35-13 Plan amendments** (including initiation of a plan) may include provisions that attribute the increase or reduction in benefits to employee service rendered in prior periods or only to employee service to be rendered in future periods.

**35-14** For purposes of measuring the accumulated postretirement benefit obligation, the effect of a **plan amendment** on a plan participant's expected postretirement benefit obligation shall be attributed to each year of service in that plan participant's attribution period, including years of service already rendered by that **plan participant**, in accordance with the attribution of the expected postretirement benefit obligation to years of service as discussed in paragraphs 715-60-35-62 and 715-60-35-66. If a plan is initiated that grants benefits solely in exchange for employee service after the date of the plan initiation or a future date, no portion of the expected postretirement benefit obligation is attributed to prior service periods because, in that case, the **credited service period** for the current employees who are expected to receive benefits under the plan begins at the date of the plan initiation or the future date.

**35-15** Plan amendments that improve benefits are granted with the expectation that the employer will realize economic benefits in future periods. Consequently, except

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retroactive amendments is acceptable. For example, a straight-line amortization of the cost over the average remaining service period of employees expected to receive benefits under the plan is acceptable.

**35-14** 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.

**35-15** Once a schedule of amortization of prior service cost from a specific retroactive plan amendment has been established, that schedule generally should not be revised. The initial schedule shall be revised only if a **curtailment** occurs (see paragraph 715-30-35-92) or if events indicate that 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 the future economic benefits have been impaired. The schedule shall not be revised because of ordinary variances in expected service lives of employees, nor shall the schedule be revised so that the prior service cost is recognized in net periodic pension cost more slowly.

**35-16** Prior service cost is recognized immediately in other comprehensive income, unless, 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 (see paragraph 715-30-35-14). as discussed in paragraph 715-60-35-19 this Subtopic does not permit the cost of benefit improvements (that is, prior service cost) to be included in net periodic postretirement benefit cost entirely in the year of the amendment. Rather, paragraphs 715-60-35-16 through 35-17 requires that prior service cost arising from a plan initiation or plan amendment shall be recognized initially in other comprehensive income with subsequent amortization in net periodic postretirement benefit cost, at a minimum, by assigning an equal amount of the prior service cost to each remaining year of service to the **full eligibility date** of each plan participant active at the date of the plan initiation or amendment. (See paragraphs 715-60-35-20 through 35-22 for plan amendments that reduce benefits.)

**35-16** A plan amendment that retroactively increases benefits (including benefits that are granted to fully eligible plan participants) increases the accumulated postretirement benefit obligation. The cost of the benefit improvement shall be recognized as a charge to other comprehensive income at the date of the amendment.

**35-17** Except as stated in this paragraph and in paragraphs 715-60-35-18 through 35-19, prior service cost shall be amortized as a component of net periodic postretirement benefit cost by assigning an equal amount to each remaining year of service to the full eligibility date of each plan participant active at the date of the amendment who was not yet fully eligible for benefits at that date. To determine total remaining service years before full eligibility, consideration is given to the remaining number of years of service to the full eligibility date of each plan participant or group of plan participants active at the date of the plan amendment who is not yet fully eligible for benefits. In determining the amortization period, future years of service of active employees who are not plan participants are excluded. Thus, the portion of prior service cost to be recognized in net periodic postretirement benefit

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However, this Subtopic does not permit an accounting policy to recognize immediately as a component of net periodic pension cost the cost of all plan amendments that grant increased benefits for services rendered in prior periods. Adopting an accounting policy to recognize prior service cost immediately in net periodic pension cost would preclude making that assessment for future plan amendments as they occur.

**35-17** A plan amendment that retroactively reduces, rather than increases, benefits decreases the projected benefit obligation. The reduction in benefits shall be recognized as a credit (prior service credit) to other comprehensive income that shall be used first to reduce any remaining prior service cost included in accumulated other comprehensive income. Any remaining prior service credit shall be amortized as a component of net periodic pension cost on the same basis as the cost of a benefit increase.

cost in each of those future years is weighted based on the number of those plan participants expected to render service in each of those future years. If all or almost all of a plan's participants are fully eligible for benefits, the prior service cost shall be amortized based on the remaining life expectancy of those plan participants rather than on the remaining years of service to the full eligibility dates of the **active plan participants**. Other comprehensive income is adjusted as a result of amortizing prior service cost.

**35-18** To reduce the complexity and detail of the computations required, consistent use of an alternative approach that more rapidly amortizes the prior service cost recognized in accumulated other comprehensive income is permitted. For example, a straight-line amortization of the cost over the average remaining years of service to **full eligibility for benefits** of the active plan participants is acceptable.

**35-19** 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 that grants increased benefits is shorter than the remaining years of service to full eligibility for benefits of the active plan participants. Identification of those situations requires an assessment of the individual circumstances of the particular plan. 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.

**35-20** A plan amendment that retroactively reduces, rather than increases, benefits decreases the accumulated postretirement benefit obligation. The reduction in benefits shall be recognized as a corresponding credit (prior service credit) to other comprehensive income that shall be used first to reduce any remaining prior service cost included in

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accumulated other comprehensive income, then to reduce any transition obligation remaining in accumulated other comprehensive income. The excess, if any, shall be amortized as a component of net periodic postretirement benefit cost on the same basis as specified in paragraphs 715-60-35-16 through 35-17 for prior service cost. Immediate recognition of the excess is not permitted. However, as with a plan amendment that increases benefits, the effect of a negative plan amendment (an amendment that decreases benefits) is reflected immediately in the measurement of the accumulated postretirement benefit obligation.

**35-21** The effects of a plan amendment, whether positive or negative, shall be considered at the date the amendment is adopted only if it is communicated to plan participants at that time or within a reasonable period of time thereafter; that is, within the time period that would ordinarily be required to prepare information about the amendment and disseminate it to employees and retirees.

**35-22** See paragraphs 715-60-55-19 through 55-21 and 715-60-55-140 through 55-160 for implementation guidance on plan amendments.

Entities amend their plans for many reasons, and sometimes plan amendments retroactively increase (or decrease) plan benefits. Prior service cost refers to the cost of incremental benefits resulting from new or amended DB pension and OPEB plan provisions that relate to prior service periods. As shown in the diagram below, prior service cost is initially recognized in OCI and then amortized out of AOCI into net periodic benefit cost over the period the entity derives economic benefit from the plan amendments.

Complexities around the accounting for prior service cost include:

- determining whether and for how long a retroactive plan amendment gives rise to future economic benefits;
- recognizing benefits for inactive employees and whether they should be amortized; and
- whether external changes (e.g. a change in law, lawsuit resolution) that increase retroactive benefits are plan amendments.

This section examines common questions and complexities around the accounting for prior service cost.

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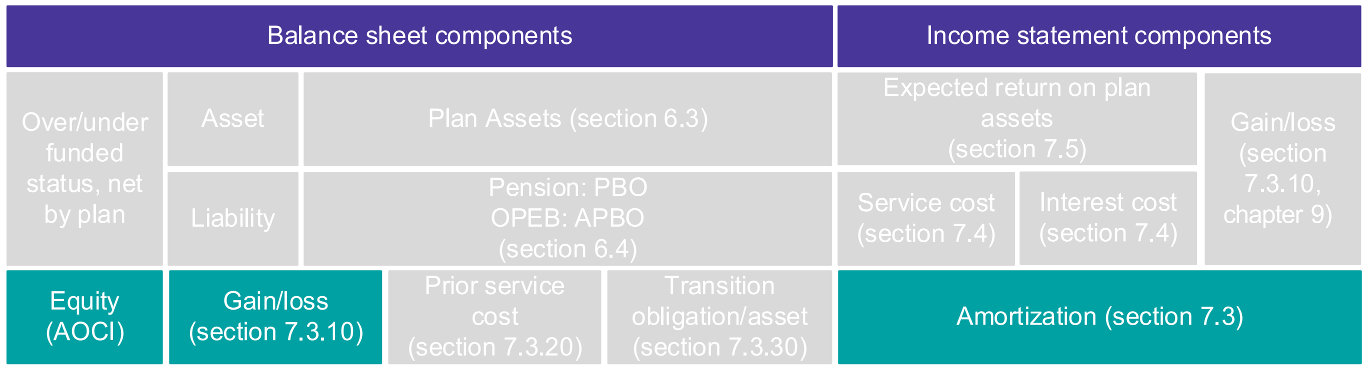


## Question 7.3.130

### How does prior service cost arise and how is it accounted for?

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** An entity may amend a plan or initiate a new plan that gives rise to prior service cost. A plan amendment or new plan that retroactively increases benefits (including those granted to retirees) increases the benefit obligation. The cost of the benefit improvement is initially recognized in OCI. The prior service cost is subsequently amortized out of AOCI as a component of net periodic benefit cost based on the remaining service period of the active participants for pension benefits or remaining service until the full eligibility date for OPEB benefits. If, however, all or almost all of the participants are inactive (pension) or fully eligible (OPEB) at the date of the plan amendment, the prior service cost is amortized over the remaining life expectancy of inactive participants. [715-30-35-11, 715-30 Glossary, 715-60-35-14, 35-17, 715-60 Glossary]

An amendment can also reduce benefits resulting in negative prior service cost, or 'prior service credit'. Such a negative plan amendment reduces the benefit obligation. The reduction first reduces any existing prior service cost included in AOCI with the excess amortized to net periodic benefit cost in the same fashion as prior service cost. Chapter 9 discusses negative plan amendments.

An entity remeasures the benefit obligation as of the plan amendment date if it is deemed a 'significant' event (see Question 8.7.50). [715-30-35-11, 715-60-35-16]

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## Question 7.3.140

### What are key considerations when determining the amortization period for prior service cost?

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Under Topic 715, an entity amortizes the incremental benefits related to a plan amendment as a component of net periodic benefit cost by assigning the prior service cost to future periods. There are two key considerations when determining the amortization period.

### What participants are eligible to receive the retroactive benefits?

An entity first determines which participants are expected to receive benefits under the amendment. For DB pension plans, an entity then determines which of those participants are active or inactive employees. The retroactive benefits are amortized over a different period depending on this designation.

For OPEB plans, the entity determines which participants are fully eligible to receive the retroactive benefits at the date of the plan amendment. Participants who are fully eligible to receive the retroactive OPEB benefits would have no future service requirement and therefore an amortization period different from those who are not fully eligible at the date of the plan amendment. [715-60-35-17]

Subtopic 715-30 does not define 'active' or 'inactive' and, in our experience, practice is mixed with respect to when a participant is considered inactive (see Question 7.3.40). [715-30-35-11]

### Over what period?

| Participant status | Amortization period |
|---|---|
| **Subtopic 715-30** | |
| Active | Amortize ratably over each future period of service of each active employee expected to receive benefits under the plan. [715-30-35-11] |
| Inactive | If all or almost all participants are inactive, amortize the cost over the remaining life expectancy of those participants. [715-30-35-11] |

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| Participant status | Amortization period |
|---|---|
| **Subtopic 715-60** | |
| Not yet fully eligible | Amortize ratably over each remaining year of service to the full eligibility date of the active plan participants who were not fully eligible for benefits at the date of amendment. [715-60-35-17] |
| Fully eligible | If all or almost all participants are fully eligible to receive benefits, amortize the cost over the remaining life expectancy of those participants. [715-60-35-17] |

## Question 7.3.150
**Can an entity simplify the way it amortizes prior service cost?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Yes. The computations to calculate prior service cost amortization can be complex and detailed. As a practical expedient, an entity may adopt a policy to straight-line amortize over the average remaining service period of employees expected to receive benefits under the amended pension plan (or the average remaining years of service to full eligibility for an OPEB plan) if that approach would result in accelerated amortization. [715-30-35-13, 715-30-55-100, 715-60-35-18]

See Subtopic 715-30's Example 1 Case B for an example of straight-line amortization to assign prior service cost.

## Question 7.3.160
**Can an entity revise its amortization schedule for prior service cost?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** It depends. Once an entity establishes an amortization schedule for prior service cost from a specific retroactive plan amendment, it revises the schedule only if: [715-30-35-11, 715-30-35-17, 715-30-35-68, 715-60-35-17, 715-60-35-125]

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- a negative plan amendment or curtailment occurs;
- events indicate that the period over which the entity expects to realize future economic benefits from the retroactive plan amendment that created the prior service cost is shorter than originally estimated; or
- future economic benefits are otherwise impaired.

Revising the schedule to recognize the prior service cost more slowly is not permitted.

## 7.3.30 Transition obligation/asset

### Excerpt from ASC 715-60

**20 Glossary**

**Transition Asset –** The amount, as of the date Subtopic 715-60 was initially applied, of the fair value of plan assets plus any recognized accrued postretirement benefit cost or less any recognized prepaid postretirement benefit cost in excess of the accumulated postretirement benefit obligation.

**Transition Obligation –** The amount, as of the date Subtopic 715-60 was initially applied, of the accumulated postretirement benefit obligation in excess of the fair value of plan assets plus any recognized accrued postretirement benefit cost or less any recognized prepaid postretirement benefit cost.

**35 Subsequent Measurement**

**>> Transition Obligation or Asset**

**35-38** Amortization of the transition obligation or asset shall be adjusted prospectively to recognize the effects of all of the following:

a. A negative plan amendment pursuant to paragraph 715-60-35-20
b. A constraint on immediate recognition of a net gain or loss pursuant to paragraphs 715-60-35-31 through 35-32
c. **Settlement** accounting pursuant to paragraphs 715-60-35-150 through 35-155
d. Plan curtailment accounting pursuant to paragraphs 715-60-35-161 through 35-171
e. A constraint on delayed amortization of the transition obligation pursuant to the following paragraph.

**35-39** The amortization of the transition obligation shall be accelerated if the cumulative benefit payments after the date the employer first applied the provisions of this Subtopic to all plan participants exceed the cumulative postretirement benefit cost accrued after the transition date. In that situation, an additional amount of the transition obligation remaining in accumulated other comprehensive income shall be recognized as a component of net periodic

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postretirement benefit cost equal to the excess cumulative benefit payments. For purposes of applying this provision, cumulative benefit payments shall be reduced by any plan assets or any recognized accrued postretirement benefit obligation at the date the employer first applied the provisions of this Subtopic. Payments made pursuant to a settlement, as discussed in paragraphs 715-60-35-150 through 35-159, shall be included in the determination of cumulative benefit payments made after the transition date. If a settlement occurs in the middle of the year, the additional transition obligation to be recognized in income, if any, pursuant to the constraint in this paragraph is determined based on projected amounts for the full year.

**35-40** If at the measurement date for the beginning of an employer's fiscal year it is expected that additional recognition in net periodic postretirement benefit cost of any transition obligation remaining in accumulated other comprehensive income will be required pursuant to the preceding paragraph, amortization of the transition obligation for interim reporting purposes (see Topic 270) shall be based on the amount expected to be amortized for the year, except for the effects of applying the preceding paragraph for any settlement required to be accounted for pursuant to paragraphs 715-60-35-150 through 35-159. Those effects shall be recognized in net periodic postretirement benefit cost when the related settlement is recognized in income. The effects of changes during the year in the initial assessment of whether additional recognition in net periodic postretirement benefit cost of the transition obligation remaining in accumulated other comprehensive income for the year shall be recognized in net periodic postretirement benefit cost over the remainder of the year. The amount of the transition obligation remaining in accumulated other comprehensive income to be recognized in net periodic postretirement benefit cost for a year shall be finally determined at the measurement date for the end of the year based on the constraints on delayed recognition in net periodic postretirement benefit cost discussed in the preceding paragraph; any difference between the amortization of the transition obligation recognized in net periodic postretirement benefit cost during interim periods and the amount required to be recognized in net periodic postretirement benefit cost for the year shall be recognized in net periodic postretirement benefit cost immediately.

**55 Implementation Guidance and Illustrations**

**>> Illustration of Terms**

**>>> Expected Postretirement Benefit Obligation and Accumulated Postretirement Benefit Obligation**

**55-39** Assuming no changes in health care costs or other circumstances, the accumulated postretirement benefit obligation at December 31, 20Z5 (age 53), is $7,289 (23/25 of $7,923). At the end of the employee's 25th year of service and thereafter, the expected postretirement benefit obligation and the accumulated postretirement benefit obligation are equal. In this Example, at December 31, 20Z7, when the employee is 55 and fully eligible for benefits, the accumulated and expected postretirement benefit obligations are $9,244. At the end of the 26th year of service (December 31, 20Z8) when the employee is 56, those obligations are $9,984 ($9,244 plus interest at 8 percent for 1 year).

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Although Subtopics 715-30 and 715-60 refer to the transition obligation and asset, it is unlikely that this remains relevant to most entities so long after the standards were adopted (1985 and 1990, respectively). On adoption of the guidance in both Subtopics 715-30 and 715-60, entities were required to recognize a net unrecognized obligation or asset related to the impact of transition. To minimize the cost of adoption, entities amortized the net transition obligation or asset over a subsequent period. [FAS 87.77, FAS 87.254 – 206, FAS 106.110]

## 7.4 Interest cost and service cost

### Excerpt from ASC 715-30

**20 Glossary**

**Interest Cost (Component of Net Periodic Pension Cost) –** The amount recognized in a period determined as the increase in the projected benefit obligation due to the passage of time.

**Service Cost (Component of Net Periodic Pension Cost) –** A component of net periodic pension cost recognized in a period determined as the actuarial present value of benefits attributed by the pension benefit formula to services rendered by employees during that period.

The service cost component is a portion of the projected benefit obligation and is unaffected by the funded status of the plan.

**35 Subsequent Measurement**

**>> Service Cost**

**35-6** The service cost component of net periodic pension cost is the actuarial present value of benefits attributed by the plan's benefit formula to services rendered by employees during the period. The service cost component is conceptually the same for an unfunded plan, a plan with

### Excerpt from ASC 715-60

**20 Glossary**

**Interest Cost (Component of Net Periodic Postretirement Benefit Cost) –** The increase in the accumulated postretirement benefit obligation to recognize the effects of the passage of time.

**Service Cost (Component of Net Periodic Postretirement Benefit Cost) –** The actuarial present value of benefits attributed to services rendered by employees during the period (the portion of the expected postretirement benefit obligation attributed to service in the period). The service cost component is the same for an unfunded plan, a plan with minimal funding, and a well-funded plan.

**35 Subsequent Measurement**

**>> Service Cost**

**35-10** The measurement of the service cost component requires identification of the **substantive plan** and the use of assumptions and an **attribution** method, which are discussed in paragraphs 715-60-35-48 through 35-105.

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| | |
|---|---|
| minimal funding, and a well-funded plan.<br><br>**35-7** The measurement of the service cost component requires use of an **attribution** method and assumptions. That measurement is discussed in paragraphs 715-30-35-29 through 35-46.<br><br>**35-7A** The service cost component shall be the only component of net periodic pension cost eligible to be capitalized as part of the cost of inventory or other assets. | **35-10A** The service cost component shall be the only component of net periodic postretirement benefit cost eligible to be capitalized as part of the cost of inventory or other assets. |
| **>> Interest Cost**<br><br>**35-8** The interest cost component of net periodic pension cost is interest on the projected benefit obligation, which is a discounted amount. Measuring the projected benefit obligation as a present value requires accrual of an interest cost at rates equal to the assumed **discount rates**.<br><br>**35-9** The interest cost component of net periodic pension cost shall not be considered interest for purposes of applying Subtopic 835-20. | **>> Interest Cost**<br><br>**35-11** Interest cost is the interest on the accumulated postretirement benefit obligation, which is a discounted amount. Measuring the accumulated postretirement benefit obligation as a present value requires accrual of an interest cost at rates equal to the assumed **discount rates**. |

## 7.4.10 Overview

Section 7.4 addresses two components of net periodic benefit cost: interest cost and service cost. Unlike the amounts discussed in section 7.3, an entity does not have the ability to defer recognizing interest and service cost in AOCI. Both of these components are recognized in net periodic benefit cost immediately, except that service cost is eligible to be capitalized as part of an asset such as inventory.

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## Question 7.4.10

**What is interest cost and how is it calculated?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Interest cost refers to the increase in the benefit obligation due to the passage of time and therefore represents the unwinding of the discount. Interest cost is calculated at the beginning of the year, traditionally by multiplying the opening balance of the benefit obligation by the discount rate – often with the assistance of an actuary.

Interest cost for the period is immediately recognized in the income statement as a component of net periodic benefit cost. This interest cost cannot be capitalized as part of the cost of an asset under cost Subtopic 835-20 (interest capitalization). This is because it reflects the effects of the passage of time rather than the borrowing cost of accumulated expenditures incurred for the qualifying asset. Question 7.4.30 provides more guidance about approaches used to calculate interest cost. [715-30-35-8, 715-30 Glossary, 715-60-35-11, 715-60 Glossary, ASU 2017-07.BC25]

## Question 7.4.20

**What is service cost and how is it calculated?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Service cost is the actuarial present value of the benefits attributed to services provided by participants during the period. It is recognized throughout the year based on amounts – often calculated with the assistance of actuaries – at the beginning of the year. It may be recognized in the income statement as a component of net periodic benefit cost (expense) or capitalized as part of an asset such as inventory or self-constructed long-lived assets, and recognized in future periods as the asset is consumed or depreciated.

## 7.4.20 Calculating interest cost and service cost

This section focuses on common issues around calculating interest cost and service cost, and accounting for changes to the methodologies for those calculations.

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## Question 7.4.30

### What are the alternative approaches to calculating service cost and interest cost?

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** There are a few ways in which to calculate the service and interest cost for DB plans.

### Traditional approach

Section 8.3 discusses discount rate assumptions, and Question 8.3.20 explores how an entity uses a yield curve approach to derive a single weighted-average discount rate to measure its benefit obligation and to derive a single weighted-average discount rate for disclosure purposes. Similarly, as described in Question 8.3.30, an entity using a bond matching approach to measure its benefit obligation will also disclose an equivalent single weighted-average discount rate. The single weighted-average discount rate is used to calculate service cost and interest cost in the succeeding period. This is known as the traditional approach.

The calculations are as follows:

— **Service cost.** The entity uses the single weighted-average discount rate to discount the incremental future cash flows associated with benefits projected to be earned during the following period.
— **Interest cost.** The entity multiplies the beginning of period benefit obligation (reduced by weighting projected benefit payments during the period) by the single weighted-average discount rate.

This traditional approach is viewed as a reasonable approximation in the computations of benefit costs under the discount rate guidance in Subtopics 715-30 and 715-60. [715-30-35-44, 715-60-35-79 – 35-82]

When there is a low interest rate environment, the unusually steep upward-sloping yield curve exacerbates the tendency of the traditional approach to overstate the service and interest cost components of net periodic benefit cost. As a result, in low-interest rate environments, some entities have reevaluated the use of the traditional approach's single weighted-average discount rate for all components of the calculation, seeking to refine the calculation of service cost and/or interest cost to yield more representationally faithful results. For example, the single weighted-average discount rate derived from calculating the benefit obligation reflects the duration of all expected benefit payments, including both near-term payments to current retirees and long-term payments to future retirees.

Conversely, service cost is associated with benefits earned by active participants, which, on balance, will be payable farther out in the future. In a typical interest rate environment with an upward-sloping yield curve, those longer duration obligations would carry a higher interest rate than near-term payments. This suggests that the additional benefit

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payments earned for current service should be discounted at a higher interest rate than the average rate used for the overall plan. [715-30-35-44, 715-60-35-79 – 35-82]

While the traditional approach of calculating service cost and interest cost uses a single aggregate computation with a constant discount rate, more refined calculations that better reflect the fact that the benefit obligation comprises multiple sets of cash flows of varying durations with varying implicit interest rates also may be supported.

The traditional approach effectively treats the benefit obligation as a single obligation carrying a constant effective interest rate (like a bond or mortgage). However, when a yield curve approach is used to determine the benefit obligation, that obligation is the sum of multiple present values of future benefit payments to be paid across many time periods, with each year's payments discounted using a different rate. Therefore, it may be reasonable in these circumstances that an entity could use multiple calculations of interest cost for different components of the overall benefit obligation.

### Alternative spot rate approach

Alternative approaches to determining service cost and interest cost use multiple individual or weighted-average discount rates relative to projected future benefit payments associated with various subsets of the plan's obligation, also referred to as the alternative spot rate approach. The SEC staff has indicated that it will not object to this approach when the entity uses a yield curve approach to determine its benefit obligation. An entity that adopts this approach will determine interest cost using a rate different from the single weighted-average rate under the traditional approach. Use of the alternative spot rate approach to compute service or interest cost has no effect on the measurement of the benefit obligation. [2015 AICPA Conf]

The Codification defines interest cost, but under Topic 715 there is no explicit requirement about how it is calculated. The guidance also accepts the use of a properly weighted-average discount rate for aggregate computations such as interest cost, although it neither defines this phrase nor provides specific guidance for calculating the weighted average (or interest cost). [715-30-35-8, 715-30 Glossary, 715-60-35-11, 715-60 Glossary]

To calculate interest cost, the alternative spot rate approach uses the same information used to determine the benefit obligation differently from the traditional approach. The actuarially projected benefit payment cash flows for each future period over the life of the plan are discounted back to the measurement date using the spot interest rate associated with each respective period in the high-quality corporate bond yield curve. The sum of the discounted amounts is the benefit obligation. Interest cost for the subsequent annual period under the alternative spot rate approach is determined by multiplying the individual spot rates from the same yield curve by each year's present value of future projected benefit payments. The sum of those products is the interest cost for the period.

The alternative spot rate approach will yield a result different from the traditional approach and, depending on a plan's specific circumstances, that difference could be material. The different weighting techniques in the two approaches cause the varying outcomes. Under the traditional approach, each future period's cash flow is weighted for all of the

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future periods until that cash flow is extinguished. Under the alternative spot rate approach, each future period's cash flow is weighted for only one year. As a result, if the yield curve is upward sloping, the interest cost for typical benefit payment arrangements would be higher under the traditional approach.

Determining service cost under the alternative spot rate approach involves estimating the present value of benefits expected to be earned by participants in the subsequent year using the individual spot rates from the same yield curve used to determine the benefit obligation at the most recent measurement date.

## Question 7.4.40

### Can an entity that uses a bond matching model to calculate its benefit obligation adopt the alternative spot rate approach?

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Generally, no. Question 8.3.30 provides an overview of the bond matching approach to calculating the benefit obligation. Similar to the traditional approach discussed in Question 7.4.30, the discount rate derived from the bond matching approach is used in the succeeding period for measuring service and interest cost.

The bond matching model focuses on the fit of the cash flows associated with both principal and interest payments from the selected bonds to the estimated benefit payments. The selected bonds do not necessarily have maturities in *each* future year. Therefore, there is no fully developed yield curve for each year's benefit payments that could be readily used to generate an interest cost that is equivalent to the alternative spot rate approach.

The SEC staff has commented that it would object to one approach that has been proposed to adapt a bond matching model to the alternative spot rate approach. Under this approach, an entity uses market information relating to the bonds in its hypothetical portfolio to derive a bond-model specific curve. It uses the same statistical regression techniques that are commonly used to derive yield curves from broader populations of bonds. The entity then applies indicated spot rates for individual bonds to the plan's estimated benefit payments. [2015 AICPA Conf]

The SEC staff's primary objection was that the approaches to determining the obligation and interest expense would not be sufficiently related. The alternative spot rate approach uses the same yield curve to determine interest cost as it uses to determine the benefit obligation. An entity that uses a bond model determines the benefit obligation by reference to the fair value of the bonds. But under the proposed bond matching model, interest cost is determined using a derived yield curve that disaggregates yields on individual cash flows within a bond that are not directly observable by reference to the spot rates on other bonds. [2015 AICPA Conf]

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## Question 7.4.50

**Can an entity that currently uses a bond matching model switch to a yield curve approach to calculate its benefit obligation and simultaneously adopt the spot rate approach?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Generally, no. The SEC staff has noted that under Topic 715 an entity evaluates the basis for its current selection of the market information used to measure the benefit obligation, and it should change its methodology only if (and to the extent that) the alternative market information results in better information to use in measuring the benefit obligation. [715-30-35-8, 715-60-35-11, 2015 AICPA Conf]

The particular methodology used should align with the requirement to select the best rate(s) for which the obligation could be effectively settled, which is generally not made on the basis of materiality. An entity may only change its methodology to determine the benefit obligation when facts or circumstances change. The entity may also, as part of the analysis, need to consider its prior arguments for changing from a yield curve to a bond matching model, if the entity historically has made this change. The SEC staff indicated that a desire to adopt the alternative spot rate approach for interest cost would not, on its own, justify changing the basis for selecting a different source of market information for measuring the benefit obligation. [715-30-35-8, 715-60-35-11, 2015 AICPA Conf]

# 7.5. Expected return on plan assets

| Excerpt from ASC 715-30 | Excerpt from ASC 715-60 |
|---|---|
| **20 Glossary**<br><br>**Expected Return on Plan Assets –** An amount calculated as a basis for determining the extent of delayed recognition of the effects of changes in the fair value of plan assets. 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. | **20 Glossary**<br><br>**Expected Return on Plan Assets –** An amount calculated as a basis for determining the extent of delayed recognition of the effects of changes in the fair value of plan assets. 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. |

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Question 7.5.30 explains that to recognize the expected increase in the value of plan assets throughout the year, an entity develops an EROA by applying an expected long-term rate of return to the market-related value (MRV) of plan assets. Topic 715 uses MRV as the basis for its asset valuation for the purpose of calculating EROA. Section 7.5 further discusses calculating the EROA by understanding MRV and the expected long-term rate of return on plan assets.

## Question 7.5.10

**What is MRV and how is it used?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Based on an entity's policy election, MRV is either: [715-30 Glossary, 715-60 Glossary]

— the fair value of plan assets; or
— a calculated value of plan assets that delays recognition of changes in fair value in a systematic and rational manner over no more than five years.

The use of an MRV of plan assets affects the determination of net periodic benefit cost in two ways.

— The MRV of plan assets is the basis on which the EROA is computed. MRV is multiplied by the expected long-term rate of return on plan assets to determine the EROA component of net periodic benefit cost for the following year. EROA uses an MRV methodology because it allows entities to use a calculated value to reduce the volatility of (i.e. smooth) net periodic benefit cost by delaying recognition of changes in the fair value of plan assets.

— It impacts the amortization of gains and loss. To the extent that gains or losses based on the fair value of plan assets are not yet reflected in the MRV of plan assets, such amounts are excluded from the net gain or loss included in AOCI that is subject to amortization beginning in the following year. Entities are required to amortize, at a minimum, gains and losses in AOCI that exceed a 'corridor', calculated as the greater of 10% of the PBO (or APBO) or the MRV of plan assets at the beginning of the year. Section 7.3 discusses the corridor approach to amortizing gains and losses. [715-30-35-22, 715-30-55-37 – 55-39, 715-30 Glossary, 715-60-35-26 – 35-29, 715-60 Glossary, FAS 87.BC179, FAS 106.BC294]

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## Question 7.5.20
**What is EROA?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Under Topic 715, an entity reports in its financial statements the performance or financial condition of its plans at the reporting date. The EROA is calculated at the beginning of the period and represents the expected performance of the plan assets to be recognized for the reporting period. It is calculated by multiplying an expected long-term rate of return on plan assets assumption by the MRV of plan assets and considers the availability of all plan assets for investment throughout the year, including the amount and timing of contributions and benefit payments expected to be made during the year. The expected long-term rate of return on plan assets is the average rate of earnings expected on plan assets, including the rates of return on the plan assets and funds available to be reinvested. Question 7.5.10 discusses MRV.

Example 6.3.10 illustrates a rollforward of plan assets, including EROA. [715-30-35-47 – 35-49, 715-60-35-26, 715-60-35-84 – 35-87, 715-60 Glossary, 715-30 Glossary]

### Guidance specific to Subtopic 715-60

If the fund holding the plan assets is a taxable entity, the entity (sponsor) calculates the expected long-term rate of return on plan assets net of estimated income taxes. [715-60-35-26]

## Question 7.5.30
**What is the difference between expected return and actual return on plan assets?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Plan assets are measured at each measurement date, which is typically at year-end (see Question 6.2.30). However, to enable it to recognize anticipated changes to the value of plan assets throughout the year (not just at the measurement date), an entity develops an EROA at the beginning of the year and recognizes it ratably over the year.

To estimate EROA, the entity applies the rate at which it expects the plan assets will increase in value (estimated long-term rate of return) to the MRV of the plan assets. Additionally, because EROA includes consideration of the availability

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of all plan assets for investment throughout the year, EROA factors in expected increases and decreases in plan assets due to expected contributions and benefit payments, respectively. [715-30-35-22, 715-60-35-26]

At the year-end measurement date, the entity compares its expected plan assets for the year to the actual plan assets and the difference (gain or loss) is recognized in AOCI or in the income statement, depending on the entity's recognition policy. Section 6.3.30 discusses the valuation of plan assets. [715-30-35-22, 715-60-35-26]

## Question 7.5.40

**Can an entity have a different MRV policy for each class of asset?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Generally, yes. Subtopic 715-30 permits an entity to designate classes of plan assets and to adopt a separate MRV policy (i.e. fair value or calculated value) for each asset class – e.g. domestic equity securities, emerging market equity securities, corporate bonds, alternative investments. However, the MRV policies generally need to be applied consistently year-to-year and the same policy should be applied across different pension plans for similar plan asset classes unless a plan's inherent facts and circumstances justify a different policy. In our experience, it is unusual for facts and circumstances to justify such a policy difference. [715-30-55-37 – 55-38]

### Guidance specific to Subtopic 715-60

OPEB plans in the scope of Subtopic 715-60 are not normally funded, and therefore this issue normally does not arise for those plans. However, if an OPEB plan is funded, it would be acceptable (but not required) to have the same MRV policy for similar plan asset classes as for the pension plans. [715-60-35-106]

## Question 7.5.50

**What is the effect of an expected change in allocating plan assets on the expected long-term rate of return on plan assets?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Because the definition of expected long-term rate of return on plan assets focuses on funds invested *or to be invested*, we believe the expected change in allocating those funds may be considered. We believe this view is consistent with other considerations in Topic 715, which indicates that the EROA should consider expected

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plan contributions to be made before the next measurement date. Like expected plan contributions, the effect of an expected change in the allocation of plan assets on the expected long-term rate of return on plan assets reflects the expected timing of the change. [715-30-35-47 – 35-48, 715-60-35-84]

However, because there is some ambiguity in the guidance about whether the expected allocation is required to be considered, there is diversity in practice.

## Question 7.5.60

**How are planned changes in asset allocations incorporated into the expected long-term rate of return on plan assets?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** If an entity is considering a change in asset allocations, it articulates the planned changes in its allocation and the timeframe over which it expects to implement them. However, the entity does not consider planned changes in the asset allocation that it does not expect to occur during the next fiscal year. [715-30-35-48, 715-60-35-84]

While the expected return is a long-term assumption, we do not believe the focus should be on the expected long-term allocation of plan assets. Instead, the focus should be on the long-term expected return on the amount and allocation of funds expected to exist in the next fiscal year. Therefore, to the extent that expected changes in the allocation of plan assets are anticipated to occur, the effect on the average rate of return should be considered for the portion of the year in which that changed allocation will be in place. For example, if an entity plans to change its allocation of plan assets two months after the current measurement date, it should determine the expected long-term rate of return assuming the current allocation for the first two months of its fiscal year and the modified allocation for the last ten months of its fiscal year.

## Example 7.5.10

**Considering whether anticipated change in plan asset allocation is appropriate in a DB plan**

### Scenario 1: Specific plan to change asset allocation

At the measurement date of ABC Corp.'s DB plan in Year 1, ABC has finalized plans to reallocate its plan assets with full implementation expected by September 30, Year 2. The current and planned revised allocations are as follows.

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| | Current allocation | Planned allocation |
|---|---|---|
| Corporate equity securities | 50% | 70% |
| Corporate debt securities | 25% | 20% |
| US Government securities | 25% | 10% |

ABC's changes to the planned allocation and the timing of those changes are specific. In addition, ABC expects to implement the changes during the next fiscal year. Accordingly, ABC considers those changes in developing its assumption for the expected long-term rate of return on plan assets for Year 2, taking into account the timing of when it expects to begin implementing the changes to its allocation.

**Scenario 2: No specific plan to change the asset allocation**

At the measurement date of ABC Corp.'s DB plan in Year 1, the plan's assets are allocated the same as in Scenario 1. In addition, the long-term targeted allocations are 50–70% in corporate equity securities; 20–30% in corporate debt securities and 20–25% in US Government securities. ABC is not planning significant changes in its actual allocation and no changes in the ranges of targeted allocations. However, ABC does anticipate some migration toward more investments in equity securities.

In developing its assumption of the expected long-term rate of return on plan assets for Year 2, ABC uses the actual asset allocation as of the Year 1 reporting date. This is because in Scenario 2 there is no specific plan to change the overall allocation, nor is there a timeframe over which ABC will migrate toward a greater concentration in equity instruments.

## Question 7.5.70

### How is a discretionary DB plan contribution that exceeds the initial expectation accounted for?

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** As illustrated in Example 6.3.10, to develop the expected plan assets at year-end, an entity considers EROA and the  plan assets at the beginning of the year adjusted for expected contributions and benefit payments for the year. This estimate is based on the facts and circumstances that existed as of the beginning of the year following the measurement date (e.g. January 1 for a December 31 measurement date). [715-30-35-48, 715-60-35-84]

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We do not believe it is acceptable to incorporate a discretionary plan contribution that exceeds the initial expectation in the current year net periodic benefit cost at the time the discretionary contribution occurs. This is consistent with guidance about the timing of measurement for plan assets in Topic 715. [715-30-35-66, 715-30-35-68, 715-60-35-84]

However, an entity can adopt a policy whereby discretionary contributions that meet pre-determined criteria are considered significant events that trigger a remeasurement. Section 8.7 and Question 8.7.20 discuss significant events and when an entity may need to remeasure plan assets and obligation for such events (i.e. in addition to the measurement date). An entity applies the policy consistently given similar facts and circumstances. If the discretionary contribution is a significant event based on the policy, the entity remeasures the plan assets and benefit obligation, and incorporates the higher contribution in the net periodic benefit cost for the balance of the year. [715-30-35-48, 35-66, 35-68, 715-60-35-84]

## 7.6 Presentation of net periodic benefit cost#

### Excerpt from ASC 715-20

**45 Other Presentation Matters**

**> Classification**

**45-3A** An employer shall report in the income statement:

a. The service cost component of **net periodic pension cost** and **net periodic postretirement benefit cost** in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period (except for the amount being capitalized, if appropriate, in connection with the production or construction of an asset such as inventory or property, plant, and equipment)
b. The other components as defined in paragraphs 715-30-35-4 and 715-60-35-9 separately from the service cost component and outside a subtotal of income from operations, if one is presented. If a separate line item or items are used to present the other components, that line item or items shall be described appropriately.

For the purpose of applying the guidance in this paragraph, a gain or loss from a settlement or curtailment or the cost of certain termination benefits accounted for under this Topic shall be reported in the same way as the other components in (b).

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Income statement presentation guidance for DB pension and OPEB plans in the scope of Topic 715 resides primarily in Subtopic 715-20, which requires that only the service cost component of net periodic benefit cost be presented within operating income, if such a subtotal is presented by the entity. Section 7.6 addresses some related presentation and capitalization questions. Section 6.5 discusses presenting the funded status of DB plans on the balance sheet. The following represents the components of net periodic benefit cost and other defined benefit plan costs that are presented in or outside operating income, if an entity presents such a subtotal.

| Income statement component | Presentation |
|---|---|
| Service cost | **Operating income** |
| Interest cost, expected return on plan assets, gain/loss or amortization of such amounts out of AOCI, amortization of prior service cost, amortization of transition asset/obligation, gain/loss from settlements and curtailments, and costs of Topic 715 termination benefits. | **Outside operating income** |

## Question 7.6.10#

**How is the service cost component of net periodic benefit cost presented?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Entities that sponsor DB plans present the service cost component of net periodic benefit cost in the income statement line item(s) where they report compensation cost. Entities present all other components of net periodic benefit cost outside operating income, if this subtotal is presented. Additionally, service cost is the only component that is eligible to be capitalized as part of the cost of inventory or other assets. Question 7.6.50 discusses industry-specific considerations when capitalizing service costs. [715-20-35-3A]

### Classifying interest on service cost

Because service cost is the actuarial present value of the benefits attributed to services provided by participants during the period, there is an associated interest component that accretes to the end-of-year measurement date. In our experience, most entities classify interest on service cost as service cost, while some include it as interest cost.

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— An entity that includes interest on service cost in service cost considers service cost to be an end-of-the-year amount; this is because interest through the end of the year is already reflected in service cost.

— An entity that includes interest on service cost in interest cost considers service cost to be a beginning-of-the-year amount (similar to the PBO measured at the same point); this is because interest to the end of the year is included in interest cost.

## Question 7.6.20

**How are administrative costs related to a DB plan classified?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** In our experience, there is diversity as to how entities classify administrative costs on DB plans, including those that are frozen. This is in part because some entities pay administrative fees directly from corporate assets and others pay them from plan assets. [715-20-45-3A]

Examples of administrative costs that may arise include:

— Pension Benefit Guaranty Corporation (PBGC) premiums;
— audit fees related to the plan's financial statements;
— actuarial fees; and
— recordkeeper fees (e.g. to a third-party administrator).

We believe the following classifications may be acceptable.

| Classification | Potential justification |
|---|---|
| General corporate expense within SG&A | The administrative costs do not meet the definition of a component of net periodic benefit cost. [715-30 Glossary, 715-60 Glossary] |
| Reduction of EROA | The administrative costs are paid from plan assets. By reducing the EROA, the entity reflects only the net earnings that are available to pay benefits. |
| Service cost | Some or all administrative costs relate to the cost of making benefits available to plan participants. The entity estimates this amount and combines it with service cost for presentation purposes.<br>An entity with a frozen plan may decide to exclude administrative costs from service cost because there is no service provided by employees in the current period. |

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## Question 7.6.30
**How does a subsidiary present net periodic benefit cost in its separate financial statements?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** A subsidiary may participate in its parent-sponsored DB plan. Generally, we believe a subsidiary that follows multiemployer accounting for its separate financial statements should not apply the income statement presentation requirements in Subtopic 715-20. However, we believe a subsidiary that follows an allocation approach using information provided by its parent should apply the income statement presentation and capitalization guidance of Subtopic 715-20 in its separate financial statements. Question 7.6.30 discusses presenting pension costs in a subsidiary's separate financial statements. [715-20-45-3A, 715-30-55-64]

## Question 7.6.40
**How does an entity present net periodic benefit cost in the statement of operations for a not-for-profit healthcare entity?**

### Excerpt from ASC 958-715

**45 Other Presentation Matters**

**45-1** A not-for-profit entity (NFP) shall recognize as a separate line item or items, outside an intermediate measure of operations, if one is presented, or a performance indicator as required by paragraph 954-220-45-5 for NFP business-oriented health care entities, within changes in net assets without donor restrictions, apart from expenses, the net gain or loss, the prior service costs or credits, and the transition asset or obligation that would be recognized in other comprehensive income pursuant to the following Sections:

a. Section 715-30-35
b. Section 715-60-35.

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**45-2** An NFP shall reclassify a portion of the net gain or loss, the prior service costs or credits, and the transition asset or obligation previously recognized in accordance with paragraph 958-715-45-1 as follows:

a. To net periodic pension cost, pursuant to the recognition and amortization provisions of paragraphs 715-30-35-3 through 35-28
b. To net periodic postretirement benefit cost, pursuant to the recognition and amortization provisions of paragraphs 715-60-35-7 through 35-40.

The contra adjustment or adjustments to the initially recognized net gain or loss, the prior service costs or credits, and the transition asset or obligation shall be reported in the same line item or items, outside an intermediate measure of operations, if one is presented, or a performance indicator as required by paragraph 954-220-45-5 for NFP business-oriented health care entities, within changes in net assets without donor restrictions, apart from expenses, as the initially recognized amounts as identified in paragraph 958-715-45-1.

**45-3** An NFP shall report in the statement of activities:

a. The service cost component of net periodic pension cost and net periodic postretirement benefit cost in the same line item(s) as other compensation costs arising from services rendered by the pertinent employees during the period (except for the amount being capitalized, if appropriate, in connection with production or construction of an asset)
b. The other components as defined in paragraphs 715-30-35-4 and 715-60-35-9 separately from the service cost component and outside an intermediate measure of operations, if one is presented, within changes in net assets without donor restrictions. If a separate line item or items are used to present the other components, that line item or items shall be appropriately described and different from the separate line item or items used to present the net gain or loss, the prior service costs or credits, and the transition asset or obligation that would be recognized in other comprehensive income in accordance with Sections 715-30-35 and 715-60-35.

The service cost component and the other components of net periodic pension cost and net periodic postretirement benefit cost shall be reported by **functional expense classification** in accordance with paragraphs 958-720-45-2 and 958-720-45-15.

**Interpretive response:** Subtopic 958-715 requires entities to report all elements of net periodic benefit cost within the performance indicator for not-for-profit business-oriented healthcare entities. Based on this, a question arises about whether to present the non-service cost components of net periodic benefit cost outside of the performance indicator for such an entity. This metric is generally the excess of revenues over expenses, which is analogous to income from continuing operations of a for-profit entity.

The FASB has indicated that the income statement (statement of operations for a not-for-profit) guidance in Subtopic 715-20 is not intended to change the requirement to report all elements of net periodic benefit cost within the

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performance indicator under Topic 958. Therefore, we believe not-for-profit healthcare entities should present the non-service cost components of net periodic benefit cost outside of an intermediate measure of operations (such as operating income), if presented, but still include such costs in the performance indicator. [715-20-45-3A, 958-715-45-1]

## Question 7.6.50

**What are industry considerations when capitalizing net periodic benefit cost?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Under Topic 715, only the service cost component is eligible for capitalization. The assets within which entities capitalize service cost may vary by industry. In our experience, many entities (e.g. in manufacturing and telecommunications) capitalize service cost in inventory and/or self-constructed assets. Financial services entities often include service cost in capitalized deferred acquisition costs or loan origination costs, which are accounted for under Subtopic 310-20 (nonrefundable fees). [310-20-25-2, 310-20-25-7, 715-30-35-7A, 715-60-35-10A]

While rate-regulated companies are precluded from capitalizing the non-service cost components of net periodic benefit cost in property, plant and equipment, they may capitalize the other components in regulatory assets because they are an allowable cost under Topic 980 (regulated operations). [980-340-25-1]

See Questions 7.6.10, and 7.6.30 to 7.6.40 for further discussion.

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# 8. DB Pension and OPEB plans: Assumptions and attribution

## Detailed contents

**Item significantly updated in this edition #**
**Item moved from another chapter without significant change ●**



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## 8.6 Attribution methods

### Question

8.6.10 How is the attribution period for recognizing the obligation and related service cost determined?

### Examples

8.6.10 Attribution period matches service period

8.6.20 Traditional unit credit method

8.6.30 Projected unit credit method

## 8.7 Timing of measurement

### Questions

8.7.10 What are the methods to roll forward an obligation to the measurement date?

8.7.20 Are entities ever required to remeasure plan assets and benefit obligations during the year?

8.7.30 How is a significant event that occurs between a measurement date and a fiscal year-end accounted for?

8.7.40 Are voluntary remeasurements permitted?

8.7.50 When is a plan amendment significant?

8.7.60 Does a significant change in the fair value of plan assets or other changes in estimates require a remeasurement?

8.7.70 On what date does an entity remeasure its plan assets and obligation for a plan amendment?

8.7.80 How does an entity account for changes in an estimate after the measurement date?

8.7.90 Does an equity method investee or subsidiary measure plan assets and obligations using the investor/parent's measurement date?

### Examples

8.7.10 Remeasurement for a plan amendment

8.7.20 Change in estimate

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## 8.1 How the standard works

Subtopics 715-30 and 715-60 outline the requirements to account for the components of DB plans – both pension and OPEB plans. A basic principle under both Subtopics is that the obligation for and cost of benefit payments to be made sometime in the future must be recognized in the accounting periods in which the employees provide services that entitle them to the benefit payments after retirement (employee service periods).

The Subtopics do not dictate the approaches an entity must use to determine its obligation for and costs of future benefit payments. Instead, they clarify that any approach an entity uses to recognize the cost of future benefit payments over employee service periods must address two factors.

— **Estimation.** How to estimate or assume information about future events that will dictate the timing and amount of the benefit payments; and
— **Attribution.** How to attribute the benefits and the related cost over the employee service periods.

Much of the estimation process requires determining the actuarial present value of the future benefit payments. There are several components of a pension or OPEB plan that are determined in whole or part by this actuarial present value. The following diagram depicts these components in a pension plan, and the schematic for OPEB plans is similar.

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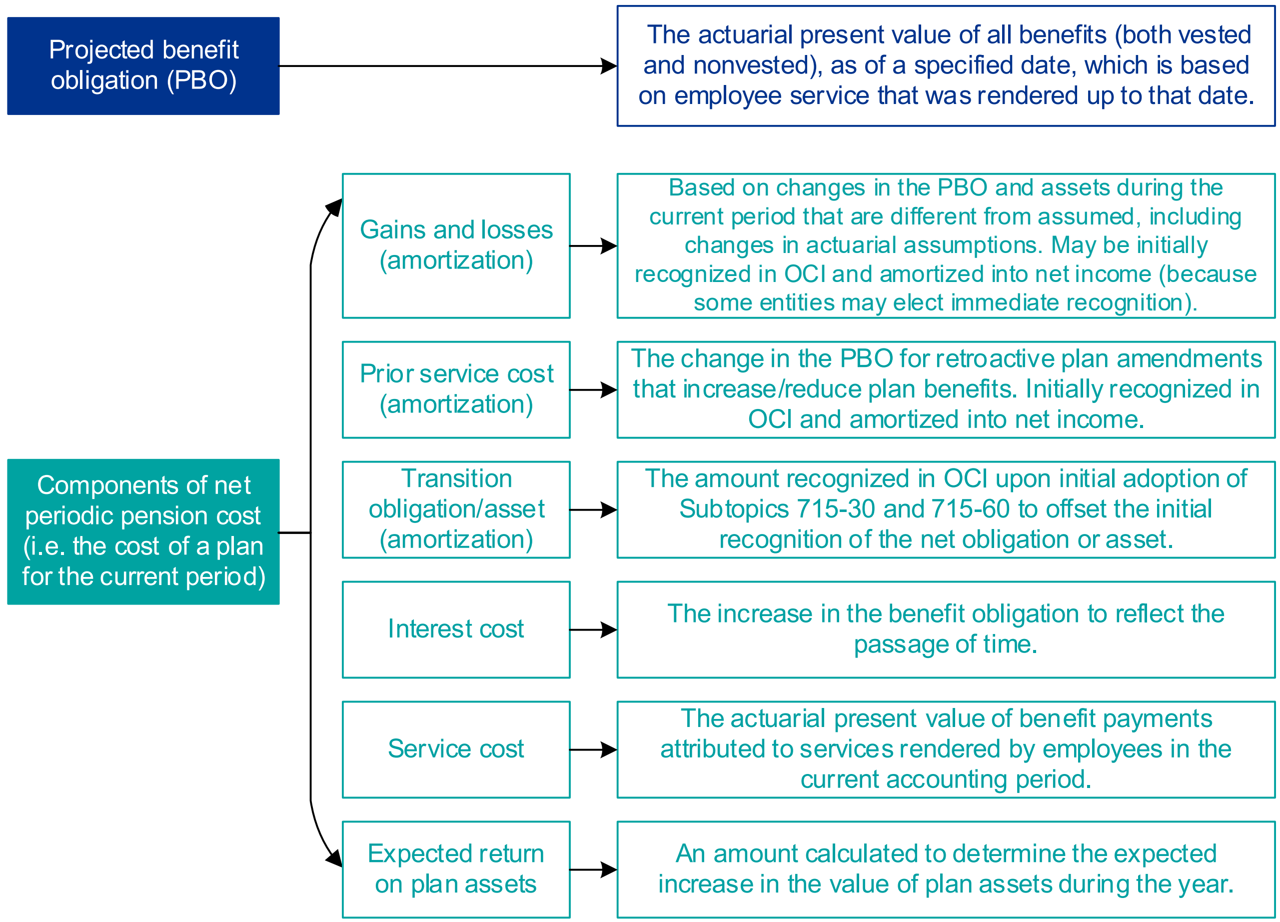


Topic 715 describes the components of net periodic benefit cost to include 'actual' return on plan assets rather than 'expected' return on assets. However, many entities elect to defer recognizing gains and losses from plan assets in OCI. Under this policy election, as depicted above, entities recognize EROA as a component of net periodic benefit cost and recognize the difference between the actual return on plan assets and EROA in OCI as part of gains and losses.

The actuarial present value of future benefit payments relies principally on three key categories of assumptions.

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| Key assumptions in determining actuarial present value of future benefit payments | | |
|---|---|---|
| **Assumptions about** | **Subtopic 715-30** | **Subtopic 715-60** |
| **Time value of money (discount rates)** (see section 8.3) | Rates at which the benefits could effectively be settled. [715-30-35-43] | Rates that reflect the time value of money to determine the present value of future cash outflows currently expected that will satisfy the benefit obligation. [715-60-35-79] |
| **Probability of payment** | Retirement age | Retirement age [715-60-35-73] |
| | Turnover [715-30-35-1A] | Turnover [715-60-35-73] |
| | Mortality (see section 8.4) [715-30-35-1A] | Mortality [715-60-35-73] |
| **Amount of payment** | Compensation increases [715-30-35-1A] | Compensation increases [715-60-35-73] |
| | | Dependency status [715-60-35-73] |
| | | Healthcare cost trend rate [see section 8.2.20] |

Estimating the expected growth in plan assets for the subsequent year also requires assumptions. This chapter discusses how to estimate the expected long-term rate of return on plan assets, which is a key metric in estimating the expected growth.

| Key assumptions entities use under Subtopics 715-30 and 715-60 | |
|---|---|
| **Expected long-term rate of return** (see section 8.5) | Average rate of earnings expected on the existing plan assets and contributions to the plan expected to be made during the period. [715-30-35-47, 715-60-35-84] |

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# 8.2 General guidance about plan assumptions

## 8.2.10 Overview

| Excerpt from ASC 715-30 | Excerpt from ASC 715-60 |
|---|---|
| **35 Subsequent Measurement** | **35 Subsequent Measurement** |
| **> Use of Reasonable Approximations** | **> Use of Reasonable Approximations** |
| **35-1** This Subtopic is intended to specify accounting objectives and results rather than specific computational means of obtaining those results. If estimates, averages, or computational shortcuts can reduce the cost of applying this Subtopic, their use is appropriate, provided the results are reasonably expected not to be materially different from the results of a detailed application. | **35-1** This Subtopic is intended to specify accounting objectives and results rather than computational means of obtaining those results. If estimates, averages, or computational shortcuts can reduce the cost of applying this Subtopic, their use is appropriate, provided the results are reasonably expected not to be materially different from the results of a detailed application. |
| **> Measurement of Costs and Obligations** | |
| **35-29** Any method of pension accounting that recognizes cost before the payment of benefits to retirees must deal with two problems stemming from the nature of the defined benefit pension contract. First, estimates or assumptions must be made concerning the future events that will determine the amount and timing of the benefit payments. Second, some approach to attributing the cost of **pension benefits** to individual years of service must be selected. Thus, the assumptions and the attribution of cost to periods of employee service are fundamental to the measurements of net periodic pension cost and pension obligations required by this Subtopic. For example, the service component of net periodic pension cost, the projected benefit obligation, and the accumulated benefit obligation are based on an attribution of pension benefits to periods of employee service and on the use of actuarial assumptions to calculate the actuarial present value of | |

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those benefits.

**35-30** Paragraph 715-30-35-42 requires use of explicit assumptions, each of which individually represents the best estimate of a particular future event. This Subtopic also requires use of the terms of the pension plan itself, specifically the plan's benefit formula, as a basis for attributing benefits earned and their cost to periods of employee service.

**>> Plan Provisions Affecting Measurement of Vested Benefits**

**35-40** Under some defined benefit pension plans (typically foreign plans), the actuarial present value of benefits to which an employee is entitled if the employee terminates immediately may exceed the actuarial present value of benefits to which the employee is entitled at the expected date of separation based on service to date. For example, at one point in time, the provisions of one country's severance pay statute required that, in most cases, the benefit an employee had accrued for service to date was payable immediately upon separation. The undiscounted value of that benefit payable currently would exceed the actuarial present value of that benefit if payment was estimated to occur at the employee's expected termination date. Another example arises in another country where legislation required that deferred vested benefits of terminated employees be statutorily revalued from date of separation to normal retirement age. If the vested benefit obligation was determined assuming employee termination at the measurement date, that vested benefit obligation could exceed the accumulated benefit obligation if that obligation was measured giving consideration to a statutory revaluation only after the employee's expected date of termination.

**35-41** The vested benefit obligation in the situations addressed in the preceding paragraph may be determined

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as either the actuarial present value of the vested benefits to which the employee is entitled if the employee separates immediately or the actuarial present value of the vested benefits to which the employee is currently entitled but based on the employee's expected date of separation or retirement. Either approach is acceptable for situations not otherwise addressed by this Subtopic in which the facts and circumstances are analogous to those in the preceding paragraph.

**> Assumptions**

**35-42** This Subtopic requires an **explicit approach to assumptions**. That is, each significant assumption used shall reflect the best estimate solely with respect to that individual assumption. All assumptions shall presume that the plan will continue in effect in the absence of evidence that it will not continue. Actuarial assumptions reflect the time value of money (discount rate) and the probability of payment (assumptions as to mortality, turnover, early retirement, and so forth).

**>> Assumptions**

**35-71** Measuring the net periodic postretirement benefit cost and accumulated postretirement benefit obligation based on best estimates is superior to implying, by a failure to accrue, that no cost or obligation exists before the payment of benefits. This Subtopic requires the use of **explicit** assumptions each of which individually represents the best estimate of a particular future event, to measure the expected postretirement benefit obligation. A portion of that expected postretirement benefit obligation is attributed to each period of an employee's service associated with earning the postretirement benefits, and that amount is accrued as service cost for that period.

**35-72** The service cost component of postretirement benefit cost, any prior service cost, and the accumulated postretirement benefit obligation are measured using actuarial assumptions and present value techniques to calculate the actuarial present value of the expected future benefits attributed to periods of employee service. Each assumption used shall reflect the best estimate solely with respect to that individual assumption. All assumptions shall presume that the plan will continue in effect in the absence of evidence that it will not continue.

**35-73** Principal actuarial assumptions include, but are not limited to, all of the following:

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a. The time value of money (discount rates)
b. Participation rates (for **contributory plans**)
c. Retirement age
d. Salary progression (for pay-related plans)
e. The probability of payment (turnover, **dependency status**, mortality, and so forth)
f. Factors affecting the amount and timing of future benefit payments, which for postretirement health care benefits consider past and present **per capital claims cost by age**, health care cost trend rates, and **Medicare reimbursement rates**, and so forth.

**35-74** This Subtopic also requires use of an assumption about the long-term rate of return on plan assets and a market-related value of plan assets to calculate the expected return on plan assets.

**35-75** All assumptions shall be consistent to the extent that each reflects expectations about the same future economic conditions, such as future rates of inflation. Measuring service cost and the expected and accumulated postretirement benefit obligations based on estimated future compensation levels entails considering any indirect effects, such as benefit limitations, that would affect benefits provided by the plan. For example, a plan may define the maximum benefit to be provided under the plan (a fixed cap). In measuring the expected postretirement benefit obligation under that plan, the projected benefit payments would be limited to that cap. For a plan that automatically adjusts the maximum benefit to be provided under the plan for the effects of inflation (an adjustable cap), the expected postretirement benefit obligation would be measured based on adjustments to that cap consistent with the assumed inflation rate reflected in other inflation-related assumptions.

**35-76** For example, assumed discount rates include an inflationary element that reflects the expected general rate

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of inflation. Assumed compensation levels include consideration of future changes attributable to general price levels. Similarly, assumed health care cost trend rates include an element that reflects expected general rates of inflation for the economy overall and an element that reflects price changes of health care costs in particular. To the extent that those assumptions consider similar inflationary effects, the assumptions about those effects shall be consistent.

**35-77** Many of the assumptions used in postretirement benefit measurements are similar to assumptions used in pension measurements, but the sensitivity of the measures to changes in the assumptions may be more significant. For example, the turnover assumption may have a more significant effect for postretirement benefits than for pension benefits because, in many cases, eligibility for postretirement benefits is an all-or-nothing proposition, while most pension plans provide reduced benefits for relatively short periods of service. The dependency status assumption also may have a more significant effect on postretirement benefit measurements than on pension measurements. Plan provisions that entitle an employee's spouse and other dependents to health care and other welfare benefits may substantially increase an employer's cost and obligation for postretirement benefits.

**35-78** Postretirement benefit measurements are more sensitive to assumptions about retirement ages and the probability of retiring at each age than are pension measurements. For example, employer-provided postretirement health care benefits are significantly more expensive before Medicare coverage begins than after. Many pension arrangements provide for an actuarially reduced pension benefit for employees retiring before the normal retirement age; however, for an employee retiring early, there typically is no reduction in the postretirement benefit levels, and those benefits will be paid over a longer

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period of time and at a higher annual cost to the employer than if the employee retired at the normal retirement age. Similarly, postretirement benefit measurements are more sensitive than pension measurements to the life expectancy assumption. In particular, health care benefits are sensitive to that assumption because health care costs generally increase with age.

**>>> Compensation Levels**

**35-88** The service cost component of net periodic postretirement benefit cost and the expected and accumulated postretirement benefit obligations shall reflect future compensation levels to the extent the postretirement benefit formula defines the benefits wholly or partially as a function of future compensation levels. For such pay-related plans, assumed compensation levels shall reflect the best estimate of the actual future compensation levels of the individual employees involved, including future changes attributed to general price levels, productivity, seniority, promotion, and other factors.

**35-89** For pay-related plans, salary progression is included in measuring the expected postretirement benefit obligation. For example, a postretirement health care plan may define the deductible amount or copayment, or a postretirement life insurance plan may define the amount of death benefit, based on the employee's average or final level of annual compensation.

**> Timing of Measurement**

**35-125** Measurements of net periodic postretirement benefit cost for both interim and annual financial statements generally shall be based on the assumptions at the beginning of the year (assumptions used for the previous year-end measurements of plan assets and obligations) unless more recent measurements of both

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plan assets and the accumulated postretirement benefit obligation are available.

**55 Implementation Guidance and Illustrations**

**>> Assumptions**

**55-20** Paragraph 715-30-35-31 provides guidance on how the service cost component of net periodic pension cost shall reflect estimates of future compensation levels. It is not 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. Rather, that paragraph requires consistency based on the incorporation of expectations of the same future economic conditions. That paragraph 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 entities 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.

**55-21** Changes under existing law in benefit limitations, for example, such as those imposed by Section 415 of the U.S. Internal Revenue Code, that would affect benefits provided by a pension plan should be anticipated in measuring the service cost component of net periodic pension cost and the projected benefit obligation. If the existing law provides for indexing or has a schedule of

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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).

**55-22** Provisions of a law, for example, Section 415 of the U.S. Internal Revenue Code, may be incorporated by reference into a pension plan's formula thereby limiting certain participants' accumulated benefits. In such cases, the determination of the pension plan's accumulated benefit obligation should not reflect the current limitation of the law if the pension plan's formula requires automatic increases in accumulated benefits as each change in the limitation under existing law occurs and future service is not a prerequisite for participants to receive those increases. The determination of the pension plan's accumulated benefit obligation 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 715-30-35-35. However, if employees would not automatically receive those pension benefit increases should they retire or terminate their service, then that paragraph would proscribe anticipating those increases and, therefore, the current limitation would be used in determining the accumulated benefit obligation in that situation.

In general, Topic 715 requires an entity to measure plan assets and the benefit obligation at least annually as of the date of the entity's fiscal year-end (the measurement date). The benefit obligation (e.g. the PBO in a pension plan or the APBO in a postretirement benefit plan) is the actuarial present value of future benefits owed for past services. The actuarial assumptions used to determine the benefit obligation at the measurement date are subsequently used to determine the net periodic benefit cost for both interim and annual financial statements in the following fiscal year. [715-30 Glossary]

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## Question 8.2.10

**What are some of the key assumptions when determining the actuarial present value of future benefits?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** To determine the actuarial present value of future benefits attributable to prior service, an entity estimates the timing and amount of future benefit payment cash flows (i.e. the future payments and related benefit costs). Determining future benefit payment cash flows involves making assumptions about the probability, timing, and amount of payment. The entity must then determine the present value of these cash flows using a discount rate assumption (i.e. an assumed discount rate). [715-30-35-42 – 35-43, 715-60-35-71 – 35-73, 715-60-35-75 – 35-79]

There are three common approaches to determining the discount rate that are discussed in section 8.3.

— Bond matching approach
— Yield curve analysis
— A published index.

The probability and timing of payment entails making assumptions that include:

— when the plan participants will retire (retirement age assumption);
— whether and how long plan participants will live after retirement (mortality assumption) (see section 8.4); and
— whether plan participants will leave the entity before they retire (turnover assumption).

The amount of payment entails making assumptions that include:

— quantifying compensation increases for plan participants (compensation increase assumption); and
— determining whether plan participants' dependents are entitled to receive benefits under the plan (dependency status assumption).

While an entity uses the actuarial present value of future benefits to calculate its benefit obligation, along with the service and interest cost components of net periodic benefit cost, Topic 715 does not dictate the approaches to developing these assumptions; therefore, considerable judgment is required to select the appropriate approaches. This chapter identifies the more common approaches and discusses application issues. [715-30-35-42 – 35-43, 715-60-35-71 – 35-73, 715-60-35-75 – 35-79]

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## Question 8.2.20

**Are assumptions established independent of each other?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Yes. Topic 715 requires using explicit actuarial assumptions, an approach under which each significant assumption used reflects the best estimate of a particular future event. In other words, each significant assumption is evaluated separately. [715-30-35-42, 715-30 Glossary, 715-60-35-71]

Interrelationships between assumptions highlight the need for an entity to use its best estimate of each parameter and not base an assumption on specific relationships between the assumptions. For example, inflation may be a building block for multiple economic assumptions (e.g. expected long-term rate of return on plan assets, salary increases, healthcare cost trend rates). Therefore, an entity uses a consistent best estimate of inflation when developing its economic actuarial assumptions. In addition, an entity considers disclosing significant differences between assumed general inflation and entity-specific inflation estimates. [715-30-55-20]

### Incremental guidance for Subtopic 715-60

Subtopic 715-60 states that many of the assumptions used in OPEB measurements are like those used in pension measurements. However, OPEB measurements may be more sensitive to changes than pension measurements. For example, benefit eligibility may be all-or-nothing under an OPEB plan, while most pension plans provide reduced benefits for relatively short periods of service. Therefore, the turnover assumption may be considered differently by an entity when applying it to an OPEB plan versus a pension plan. [715-60-35-71, 715-60-35-77, 715-60 Glossary]

## Question 8.2.30

**Can assumptions and estimates be revised?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Yes. A DB plan is a long-term arrangement, but an entity must evaluate the components of a plan each period and best estimates of obligations and costs in that period. Therefore, an entity revises assumptions and estimates for its obligations and return on plan assets when changes affect the plan's circumstances and participants. Revisions that can affect assumptions related to the obligation and the EROA may result from: [715-60-25-2]

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— market events – e.g. an unanticipated decline in the value of plan assets;
— economic factors – e.g. increases in inflation resulting in higher interest rates and higher than anticipated healthcare costs;
— demographic factors – e.g. revised estimates of employee mortality and turnover; and/or
— modifications to the plan formula or other plan amendments.

Revisions to assumptions, estimates and plan amendments can result in changes to future estimates of net periodic benefit cost and the plan's funded status. [715-30-25-4, 715-60-25-2]

The SEC staff expects registrants to comprehensively reassess their plan assumptions on an ongoing basis to determine whether the assumptions (and therefore the accounting) are relevant, reasonable and reliable. [2004 AICPA Conf]

However, barring a change in circumstances, an entity generally continues to apply its current approaches (see Question 8.3.70).

**Incremental guidance for Subtopic 715-60**

Plans may mitigate OPEB cost volatility using various delayed income statement recognition provisions permitted or required under Topic 715. Though an entity may smooth the effects of these factors for determining net periodic benefit cost, the effect of changes in plan benefits and assumptions is reflected immediately in the funded status of the plan with a corresponding amount recorded in AOCI. [715-60-25-2]

## 8.2.20 Healthcare plans

### Excerpt from ASC 715-60

**20 Glossary**

**Postretirement Health Care Benefits –** A form of postretirement benefit provided by an employer to retirees for defined health care services or coverage of defined health care costs, such as hospital and medical coverage, dental benefits, and eye care.

**35 Subsequent Measurement**

**>>> Assumptions that Are Unique to Postretirement Health Care**

**35-90** Measurement of an employer's postretirement health care obligation requires the use of several assumptions unique to health care benefits. Most significantly, it includes making several assumptions about factors that will affect

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the amount and timing of future benefit payments for postretirement health care. Those factors include consideration of historical per capita claims cost by age, health care cost trend rates (for plans that provide a benefit in kind), and medical coverage to be paid by governmental authorities and other providers of health care benefits. Recent claims cost experience and the claims cost experience of other employers in the same industry or geographical location may provide useful information in developing the assumed per capita claims cost by age from the earliest age at which a plan participant could receive benefits under the plan to the longest life expectancy. Data files developed and maintained by insurers or benefits consultants about employers' claims costs for similar benefits programs and national or regional statistics about claims cost patterns also may provide information that may be used for developing the per capita claims cost by age.

**35-91** In principle, an employer's share of the expected future postretirement health care cost for a plan participant is developed by reducing the assumed per capita claims cost at each age at which the plan participant is expected to receive benefits under the plan by both of the following:

a. The effects of coverage by Medicare and other providers of health care benefits
b. The effects of the cost-sharing provisions of the plan (deductibles, copayment provisions, out-of-pocket limitations, caps on the limits of the employer-provided payments, and retiree contributions).

**35-92** The resulting amount represents the **assumed net incurred claims cost** at each age at which the plan participant is expected to receive benefits under the plan. If contributions are required to be paid by active plan participants toward their postretirement health care benefits, the actuarial present value of the plan participants' future contributions reduces the actuarial present value of the aggregate assumed net incurred claims costs.

**35-93** The assumed per capita claims cost shall be the best estimate of the expected future cost of the benefits covered by the plan. It may be appropriate to consider other factors in addition to age, such as sex and geographical location, in developing the assumed per capita claims cost.

**35-94** Past and present claims data for the plan, such as a historical pattern of gross claims by age (claims curve), should be used in developing the current per capita claims cost to the extent that those data are considered to be indicative of the current cost of providing the benefits covered by the plan. Those current claims data shall be adjusted by the assumed health care cost trend rate. The resulting assumed per capita claims cost by age, together with the **plan demographics**, determines the amount and timing of expected future **gross eligible charges**.

**35-95** In the absence of sufficiently reliable plan data about the current cost of the benefits covered by the plan, the current per capita claims cost should be based, entirely or in part, on the claims information of other employers to the extent those costs are indicative of the current cost of providing the benefits covered by the plan. For example, the current per capita claims cost may be based on the claims experience of other employers derived from information in data files developed by insurance entities, actuarial firms, or employee benefits consulting firms. The current per capita claims cost developed on those bases shall be adjusted to best reflect the terms of the employer's plan and the plan demographics. For example, the information should be adjusted, as necessary, for differing demographics, such as the

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age and sex of plan participants, health care utilization patterns by men and women at various ages, and the expected geographical location of retirees and their dependents, and for significant differences between the nature and types of benefits covered by the employer's plan and those encompassed by the underlying data.

**35-96** For a plan that stipulates that the benefit to be provided is the payment of certain health insurance premiums for retirees rather than the payment of their health care claims, the employer shall project the cost of those future premiums in measuring its benefit obligation. That projection requires an assessment of how future health care costs will affect future premiums.

**35-97** In some cases, retiree contributions are established based on the average per capita cost of benefit coverage under an employer's health care plan that provides coverage to both active employees and retirees. However, the medical cost of the retirees may cause the average per capita cost of benefit coverage under the plan to be higher than it would be if only active employees were covered by the plan. In that case, the employer has a postretirement benefit obligation for the portion of the expected future cost of the retiree health care benefits that are not recovered through retiree contributions, Medicare, or other providers of health care benefits.

**35-98** If significant, the internal and external costs directly associated with administering the postretirement benefit plan also shall be accrued as a component of assumed per capita claims cost.

**35-99** The assumption about health care cost trend rates represents the expected annual rates of change in the cost of health care benefits currently provided by the postretirement benefit plan, due to factors other than changes in the demographics of the plan participants, for each year from the measurement date until the end of the period in which benefits are expected to be paid. Past and current health care cost trends shall be used in developing an employer's assumed health care cost trend rates, which implicitly consider estimates of health care inflation, changes in health care utilization or delivery patterns, technological advances, and changes in the health status of plan participants.

**35-100** Differing services, such as hospital care and dental care, may require the use of different health care cost trend rates. It is appropriate for that assumption to reflect changes in health care cost trend rates over time. For example, the health care cost trend rates may be assumed to continue at the present level for the near term, or increase for a period of time, and then grade down over time to an estimated health care cost trend rate ultimately expected to prevail.

**35-101** An assumption about changes in the health status of plan participants considers, for example, the probability that certain claims costs will be incurred based on expectations of future events, such as the likelihood that some retirees will incur claims requiring technology currently being developed or that historical claims experience for certain medical needs may be reduced as a result of participation in a wellness program.

**35-102** Certain medical claims may be covered by governmental programs under existing law or by other providers of health care benefits. Benefit coverage by those governmental programs shall be assumed to continue as provided by the present law and by other providers pursuant to their present plans. Presently enacted changes in the law or amendments of the plans of other health care providers that take effect in future periods and that will affect the future

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level of their benefit coverage shall be considered in current-period measurements for benefits expected to be provided in those future periods. Future changes in laws concerning medical costs covered by governmental programs and future changes in the plans of other providers shall not be anticipated.

**35-103** As an example of another provider of health care benefits, a retiree's spouse also may be covered by the spouse's present (or former) employer's health care plan. In that case, the spouse's employer (or former employer) may provide either primary or secondary postretirement health care benefits to the retiree's spouse or dependents.

**35-104** In some cases, determining the assumed per capita claims cost by age as described in paragraphs 715-60-35-93 through 35-95 may not be practical because credible historical information about the gross per capita cost of covered benefits may not be available or determinable to satisfy the stated measurement approach. However, credible historical information about incurred claims costs may be available. In those cases, an alternative method of developing the assumed per capita claims cost may be used provided the method results in a measure that is the best estimate of the expected future cost of the benefits covered by the plan. For example, the assumed health care cost trend rates may be determined by adjusting the expected change in the employer's share of per capita incurred claims cost by age by a factor that reflects the effects of the plan's cost-sharing provisions. However, an approach that projects **net incurred claims** costs using unadjusted assumed health care cost trend rates would implicitly assume changes in the plan's cost-sharing provisions at those assumed rates and, therefore, is not acceptable unless the plan's cost-sharing provisions are indexed in that manner or the substantive plan (see paragraphs 715-60-35-48 through 35-56) operates in that manner.

**35-105** See paragraphs 715-60-55-5 through 55-9 for implementation guidance on assumed per capita health care costs.

**55 Implementation Guidance and Illustrations**

**>> Assumed Per Capita Health Care Costs**

**55-5** An employer sponsors a health care plan that provides benefits to both active employees and pre-age-65 **retirees**. The plan requires active employees and retirees to contribute to the plan. The contributions of active employees may be used to reduce the employer's cost of providing benefits to retirees, but only if the amount contributed by active employees over their service periods exceeds the cost of providing their health care benefits while they are employed and the employer has no obligation to refund that excess. In that case, the excess would be applied to reduce the cost of the retirees' benefits. If active employee contributions do not exceed the cost of active benefits, the full amount of the active employees' contributions should be applied to the cost of their active benefits. The cost of providing health care benefits to active employees should be measured assuming only active employees are covered by the plan.

**55-6** An employer has a contributory health care plan covering active employees and retirees under which retirees pay 100 percent of the average cost of benefits determined based on the combined experience of active employees and retirees. The employer pays all of the remaining cost. The active employees do not contribute to the plan. Under this arrangement, the employer has an obligation under this Subtopic if the actual cost of providing benefits to the retirees

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is greater than their contributions. In that case, the employer is subsidizing a portion of the cost of the retirees' benefits. See paragraph 715-60-35-97. Thus, the employer would have an obligation for the difference between the expected cost of providing the retirees' benefits and the retirees' expected contributions, whether those contributions are established at 100 percent of the average cost or at a lesser amount.

**55-7** For a plan that stipulates that the benefit to be provided is the payment of retirees' health care claims, the cost of premiums for insurance that an employer expects to purchase to finance its obligation may be used to measure the obligation if it produces a reasonable estimate of the future cost of benefits covered by the plan. In some situations, such as in a community-rated insurance plan that provides the type of benefits covered by the employer's plan and in which the premium cost to the employer is based on the experience of all participating employers, the claims experience of a single employer generally will have little impact on its premiums. Accordingly, in those situations a projection of future premiums based on the current premium structure and expected changes in the general level of health care costs may provide a reasonable estimate of the employer's obligation. However, if premiums are adjusted for the actual claims experience or the age and sex of the plan's participants (an experience-rated plan), the foregoing projection of the employer's obligation may not produce a reasonable estimate of the future cost of the underlying benefits of the plan.

**55-8** An employer that has measured its postretirement health care benefit obligation by projecting the cost of premiums for purchased health care insurance has not reduced or eliminated the applicability of any provisions of this Subtopic. The employer should follow this Subtopic in its entirety including calculating and disclosing the components of **net periodic postretirement benefit cost**, which would still include service cost for active employees and interest cost.

**55-9** When determining its postretirement benefit obligation , an employer should assume a trend of decreasing (or increasing) **Medicare reimbursement rates** (for example, certain health care costs may have increased by 15 percent last year but Medicare may have only covered a smaller increase, which increased the employer's or retirees' share of the cost of benefits) only if those changes result from currently enacted legislation or regulations. For instance, to the extent that certain coverage under Medicare changes as a result of applying a legislated formula or historical administrative practice, an employer should consider the effects of those changes in projecting Medicare coverage in future years. Doing so may result in a higher or lower amount of coverage. Future legislation that would change the portion of costs covered by Medicare should not be anticipated even though a historical trend of those changes may be apparent.

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## Question 8.2.40

**What are some of the key assumptions when determining the benefit obligation and costs for healthcare plans?**

*This interpretive response applies to Subtopic 715-60 only.*

**Interpretive response:** Some actuarial assumptions are unique to postretirement healthcare plans – e.g. healthcare cost trend rates, medical coverage to be paid by government authorities and other providers of healthcare benefits, percentage of future retirees assumed to participate in the healthcare plan, and per capita base year claims cost. The per capita base year claims cost is the benefit being projected into future years to determine the benefit obligations. [715-60-35-90]

The per capita claims cost assumption may be developed using a variety of sources, including claims experience of the health plan when that experience is sufficiently credible, healthcare premiums or healthcare rating manuals. Using some of these sources requires additional data to develop the age-based per capita claims cost assumption. While this additional data may be used, it is still an assumption that is subject to the timing guidance of Topic 715. This means the per capita claims cost assumption used for fiscal year-end disclosure information is also used to develop the following fiscal-year net periodic postretirement benefit cost unless a significant event occurs for which a remeasurement is required. However, in our experience, there may be diversity in practice on the treatment of per capital claims costs because of the timing of when updated data is available. [715-60-35-93]

Some entities use the prior year's per capita claims cost assumption to estimate the fiscal year-end disclosure information and subsequently update the per capita claims cost assumption to develop the following fiscal-year net periodic postretirement benefit cost. When doing so, an entity needs to evaluate whether the benefit obligation using the updated per capita claims cost assumption materially differs from the disclosed benefit obligation. A material difference requires an adjustment to the balance sheet accounts (the benefit obligation and AOCI) and disclosure of the effect in the quarter in which the adjustments are recognized. Any adjustments due to errors are accounted for under Topic 250; see chapter 4 of KPMG Handbook, Accounting changes and error corrections. [715-60-35-125]

## Example 8.2.10

**Remeasuring when new facts become known**

### Background

ABC Corp. is a public entity that has a DB OPEB plan. For fiscal year-end reporting, ABC measures plan assets and benefit obligations as of December 31.

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In Year 2 (and annually):

- ABC's actuary completes an actuarial valuation in late January, Year 2.
- ABC uses assumptions from the Year 1 fiscal year-end measurements of plan assets and obligations to estimate its net periodic postretirement benefit cost for Year 2.
- ABC records the net periodic postretirement benefit costs ratably throughout Year 2.
- In May, the actuary advises ABC that a new study indicates the assumption for the healthcare cost trend rate could be revised downward by 1%. The change in the healthcare cost trend rate results in a material difference from the initially determined expectation.

#### Analysis

Because ABC received updated healthcare cost trend data in May, Year 2 that it determined was materially different from its expectation in January, Year 2, it considers this a significant event and a basis for a new measurement date. Therefore, ABC remeasures plan assets and obligations in May to facilitate measuring the net periodic postretirement benefit cost for the rest of the year (May – December, Year 2).

ABC completes a full remeasurement and updates all assumptions (e.g. discount rate, fair value of plan assets) to May, with the resulting change to net periodic postretirement benefit costs reflected through the remainder of the year.

ABC does not adjust previously reported interim periods for the new measurement because the change in estimate is based on information that did not exist at the time of the original plan valuation.

ABC does not revise the January valuation to remeasure net periodic postretirement benefit costs for the full year.

#### Other considerations

When there are plan assets that previously did not qualify as plan assets under Topic 715 but subsequently qualify, this change is another change in a factor affecting an entity-specific assumption that may be considered a significant event requiring remeasurement. In effect, this event is like a contribution by ABC to the plan. Although Topic 715 does not discuss whether significant contributions by an entity during the year require remeasuring net periodic postretirement benefit cost at an interim date, ABC evaluates whether this contribution constitutes a significant event that affects an assumption.

Specifically, if ABC has an unfunded plan, the assumed return on plan assets is zero when measuring net periodic postretirement benefit cost. If ABC were to designate investments as plan assets in May (if significant) this would in effect partially fund the plan. ABC considers the size of the contribution in relation to the plan's APBO and the date of the contribution in relation to its fiscal year-end to determine whether the contribution is a significant event.

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If ABC determines the contribution results in remeasurement, a process similar to the one described above should be followed – i.e. full remeasurement and prospective application to net periodic postretirement benefit cost.

Section 8.7 further discusses remeasuring at interim periods for significant events.

## 8.3 Discount rate assumption

| Excerpt from ASC 715-30 | Excerpt from ASC 715-60 |
|---|---|
| **35 Subsequent Measurement** | **35 Subsequent Measurement** |
| **>> Discount Rates** | **>>> Discount Rates** |
| **35-43** 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 (including information about available annuity rates published by the Pension Benefit Guaranty Corporation). 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. Assumed discount rates are used in measurements of the projected, accumulated, and vested benefit obligations and the service and interest cost components of net periodic pension cost.<br><br>**35-44** The preceding paragraph permits an employer to look to rates of return on high-quality fixed-income investments in determining assumed discount rates. The objective of selecting assumed discount rates using that method is to measure the single amount that, if invested at the measurement date in a portfolio of high-quality debt instruments, would provide the necessary future cash | **35-79** Assumed discount rates shall reflect the time value of money as of the measurement date in determining the present value of future cash outflows currently expected to be required to satisfy the postretirement benefit obligation. In making that assumption, employers shall look to rates of return on high-quality fixed-income investments currently available whose cash flows match the timing and amount of expected benefit payments. If settlement of the obligation with third-party insurers is possible (for example, the purchase of nonparticipating life insurance contracts to provide death benefits), the interest rates inherent in the amount at which the postretirement benefit obligation could be settled are relevant in determining the assumed discount rates. Assumed discount rates are used in measurements of the expected and accumulated postretirement benefit obligations and the service cost and interest cost components of net periodic postretirement benefit cost.<br><br>**35-80** Pursuant to paragraph 715-60-35-79, an employer shall look to rates of return on high-quality fixed-income investments in determining assumed discount rates. The objective of selecting assumed discount rates using that |

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flows to pay the pension benefits when due. Notionally, that single amount, the projected benefit obligation, would equal the fair value of a portfolio of high-quality zero-coupon bonds whose maturity dates and amounts would be the same as the timing and amount of the expected future benefit payments. Because cash inflows would equal cash outflows in timing and amount, there would be no reinvestment risk in the yields to maturity of the portfolio. However, in other than a zero coupon portfolio, such as a portfolio of long-term debt instruments that pay semiannual interest payments or whose maturities do not extend far enough into the future to meet expected benefit payments, the assumed discount rates (the yield to maturity) need to incorporate expected reinvestment rates available in the future. Those rates shall be extrapolated from the existing yield curve at the measurement date. The determination of the assumed discount rate is separate from the determination of the expected rate of return on plan assets whenever the actual portfolio differs from the hypothetical portfolio described in this paragraph. Assumed discount rates shall be reevaluated at each measurement date. If the general level of interest rates rises or declines, the assumed discount rates shall change in a similar manner.

**35-45** Interest rates vary depending on the duration of investments; for example, U.S. Treasury bills, 7-year bonds, and 30-year bonds have different interest rates. Thus, the weighted-average discount rate (interest rate) inherent in the prices of annuities (or a dedicated bond portfolio) will vary depending on the length of time remaining until individual benefit payment dates. A plan covering only retired employees would be expected to have significantly different discount rates from one covering a work force of 30-year-olds. The disclosures required by Subtopic 715-20 regarding components of the pension benefit obligation will be more representationally

method is to measure the single amount that, if invested at the measurement date in a portfolio of high-quality debt instruments, would provide the necessary future cash flows to pay the postretirement benefits when due. Notionally, that single amount, the accumulated postretirement benefit obligation, would equal the fair value of a portfolio of high-quality zero coupon bonds whose maturity dates and amounts would be the same as the timing and amount of the expected future benefit payments. Because cash inflows would equal cash outflows in timing and amount, there would be no reinvestment risk in the yields to maturity of the portfolio.

**35-81** However, in other than a zero coupon portfolio, such as a portfolio of long-term debt instruments that pay semiannual interest payments or whose maturities do not extend far enough into the future to meet expected benefit payments, the assumed discount rates (the yield to maturity) need to incorporate expected reinvestment rates available in the future. Those rates shall be extrapolated from the existing yield curve at the measurement date.

**35-82** The determination of the assumed discount rate is separate from the determination of the expected rate of return on plan assets whenever the actual portfolio differs from the hypothetical portfolio described in the preceding paragraph. Assumed discount rates shall be reevaluated at each measurement date. If the general level of interest rates rises or declines, the assumed discount rates shall change in a similar manner.

**35-83** See paragraph 715-60-55-4 for implementation guidance on discount rates used to measure an employer's postretirement benefit obligation.

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faithful if individual discount rates applicable to various benefit deferral periods are selected. A properly weighted average rate can be used for aggregate computations such as the interest cost component of net pension cost for the period.

**35-46** An insurance entity deciding on the price of an annuity contract will consider the rates of return available to it for investing the premium received and the rates of return expected to be available to it for reinvestment of future cash flows from the initial investment during the period until benefits are payable. That consideration is indicative of a relationship between rates inherent in the prices of annuity contracts and rates available in investment markets. Therefore, it is appropriate for employers to consider that relationship and information about investment rates in estimating the discount rates required for application of this Subtopic. Thus a current settlement rate best meets that objective and is consistent with measurement of plan assets at fair value for purposes of recognizing as a net asset or a net liability, and disclosing the plan's funded status. Each year the discount rates shall be reevaluated to determine whether they reflect the best estimate of the current effective settlement rates. As established in paragraph 715-30-35-44, if interest rates generally decline or rise, the assumed discount rates shall change.

**55 Implementation Guidance and Illustrations**

**>> Selection of Discount Rates**

**55-23** Paragraphs 715-30-35-43 through 35-46 establish the requirements for discount rates to be used in measurements of the vested, accumulated, and projected benefit obligations and the service and interest cost components of net periodic pension cost.

**55-24** The assumed discount rates used to discount the

**55 Implementation Guidance and Illustrations**

**>> Discount Rates**

**55-4** The assumed **discount rates** used to measure an employer's postretirement benefit obligation may be the same rates used to measure its pension benefit obligation under Subtopic 715-30 or they may not be for various reasons. Differences could occur between the discount rates used to measure the pension benefit obligation and the discount rates used to measure the postretirement

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vested, accumulated, and projected benefit obligations may be different if the employer can justify such differences in terms of the paragraph 715-30-35-46 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 shall not differ, however, regardless of whether the obligation for those pension benefits is presently classified as a vested, accumulated, or projected benefit obligation.

**55-25** An employer shall not select arbitrarily the assumed discount rates from within a range but shall select the best estimate of the interest rates at which the pension benefits could be effectively settled at that point in time.

**55-26** A change in the 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 not a change in method of applying an accounting principle because of the objective of selecting assumed discount rates to determine the interest rates inherent in the price at which the pension benefits could be effectively settled—currently.

**55-27** If an employer that previously used AA 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 being the determination of the effective settlement rates. The key is that the employer is using the rates implicit in current benefit obligation. For example, the expected timing of postretirement benefit payments may differ from the expected timing of pension benefit payments. Those differences could occur particularly if the participants in each plan are different. In addition, rates implicit in current prices of annuity contracts might be used to measure the pension benefit obligation, and no similar contracts may be available to settle the postretirement benefit obligation (see paragraphs 715-20-55-1 through 55-2).

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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.

**55-28** Another aspect of this estimation issue is determining when to change the basis of estimation from one particular methodology to another, for example, AA bond rates to rates implicit in current prices of annuity contracts. There is no prescribed mathematical formula for making that decision. As indicated in the preceding paragraph, the emphasis in selecting assumed discount rates shall 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 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.

**55-29** A pension plan may have a bond portfolio that was dedicated at a yield significantly higher or lower than current interest rates. The historical rates of return as of the dedication date are not acceptable for use in discounting the projected and accumulated benefit obligations to their present value. Although it is acceptable

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for an employer to look to rates of return on high-quality fixed-income investments in selecting the assumed discount rates, it is the current rates of return on those investments, not the historical rates of return as of the dedication date, that are relevant.

**55-30** Use of assumed discount rates based on historical rates of return is inconsistent with the paragraph 715-30-35-50 requirement to value plan assets at fair value. If interest rates decline or rise, the effect of the 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.

**55-31** Ordinarily, an employer would not want to purchase annuities for that portion of the pension benefit obligation related to future compensation levels and an insurance entity would be unwilling to undertake an unconditional obligation based on future compensation levels without charging increased premiums for the additional risk. Even though a current settlement of the portion of the projected benefit obligation that relates to future compensation levels is unlikely, an employer shall not 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. The use of rates implicit in future annuity prices is not consistent with the requirements of paragraph 715-30-35-46 to use current settlement rates.

**55-32** Those factors that are relevant for determining the timing and amount of estimated future annuity payments

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| | |
|---|---|
| shall 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 that, 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).<br><br>**55-33** As required by paragraph 715-30-35-43, the assumed discount rates used to determine the projected, accumulated, and vested benefit obligations shall reflect the interest rates inherent in the price at which the pension benefits could be effectively settled—currently. However, 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.<br><br>**55-34** See paragraph 715-60-55-4 for a discussion of the relationship of discount rates used to measure a pension benefit obligation to discount rates used to measure an other postretirement benefit obligation. | |

The discount rate is an important assumption used to measure the pension and OPEB obligations, as well as the service and interest cost components of net periodic benefit cost.

The discount rate reflects the rates at which the pension or OPEB benefits could be effectively settled. This is different from 'settling' the obligation, which incorporates an insurer's risk factor. Effectively settling focuses only on the time value of money. This section explains the different approaches that are commonly used to determine the discount rate. [715-30-35-43]

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## Question 8.3.10
**How is the discount rate determined?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** The discount rate is used to determine the present value of the benefit cash flows (i.e. the PBO or APBO). An entity determines the discount rate by applying an acceptable approach in accordance with its stated policy. The entity applies the approach consistently from period to period so that the rate reflects the general change in interest rates since the prior measurement date; but see Question 8.3.70 for when the assumption may be changed. [715-30-35-44]

Common approaches to determine a discount rate include:

- A projected benefit cash flow model:
  - Bond matching approach (see Question 8.3.30)
  - Yield curve approach (see Question 8.3.20)
- A published index or indices (see Question 8.3.60).

All of these approaches are acceptable under Topic 715. However, the SEC references the projected benefit cash flow models (either the bond matching approach or yield curve approach) as providing the most direct way to determine the discount rate for measuring DB plan obligations. [715-20-S99-1, 715-30-35-44, 715-60-35-80, 2015 AICPA Conf]

Determining a discount rate can be complex and it is common for entities to employ actuarial specialists to assist with this process. Many retirement obligations are large and small changes to the discount rate assumption may significantly affect the obligation calculation; therefore, careful consideration should be given to determining the discount rate.

### Discount rate selection issues

The following are approaches to determining a discount rate that may not be appropriate under Topic 715 (not exhaustive):

- selecting the same discount rate for plans with different cash flow patterns – i.e. because the objective of selecting discount rates is to measure the single amount that, if invested, would provide the future cash flows to pay the benefits when due, different plans may need different discount rates;
- materially rounding the actual discount rate. In general, we believe an entity should use the actual rate derived from a yield curve analysis. If an entity prefers to use a rounded rate, rounding in a narrow range, for example, rounding to the nearest 5 or 10 basis points, would be acceptable if applied consistently;

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— using a well-known published index with bond cash outflows that do not match (or lacking evidence that they match) the cash outflows for the plan.

### Incremental guidance for Subtopic 715-60

The discount rates used to measure an entity's OPEB plan may or may not be the same rates used to measure its pension obligation, because the unit of account is the plan itself. Differences may occur due to payment timing, different plan participants and from other plan differences. Question 8.3.40 further discusses the appropriate discount rate to use. [715-60-55-4]

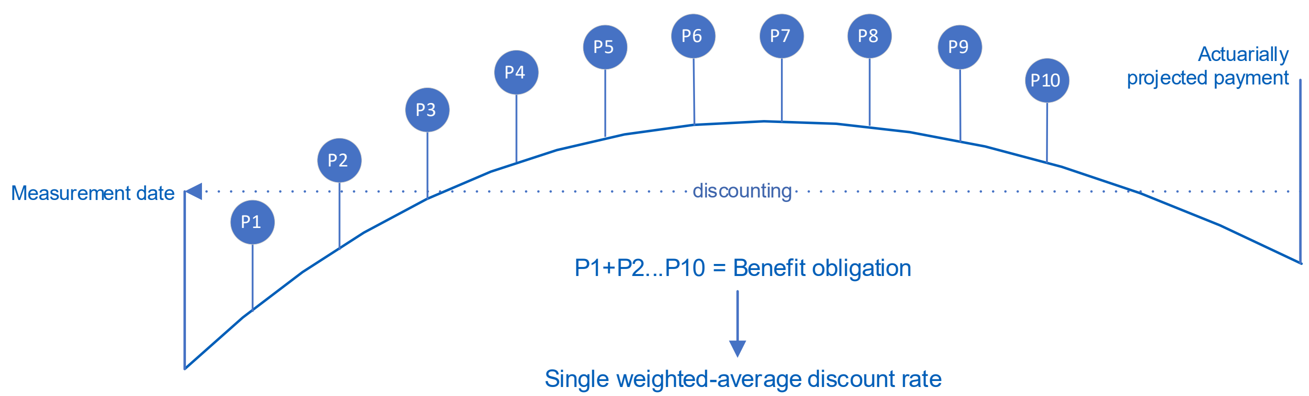
## Question 8.3.20

### What is the yield curve approach?

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** For entities that follow a yield curve approach to calculating the benefit obligation, the discount rate is effectively an output of the benefit obligation calculation, rather than a single rate used to discount the projected cash flows.

As shown in the following diagram, to calculate the benefit obligation, an entity can use the spot rates along a high-quality bond yield curve to discount each period's projected benefit payment (i.e. P1 through P10) to their actuarial present value at the measurement date. The sum of these discounted cash flows produces the benefit obligation. In addition, the entity derives a single weighted-average discount rate from this calculation used for disclosure purposes.

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### Constructing a high-quality bond yield curve

A yield curve is based on the rates of return on high-quality fixed-income investments (bonds) currently available and expected to be available during the current period to the maturity of the pension benefits. Question 8.3.50 discusses the types of bonds that can be used. [715-30-35-43, 715-60-35-80]

While rare, an entity can create its own yield curve, but many actuarial firms develop proprietary yield curves to support their clients' selection of a discount rate at any period-end. It is common for actuarial firms to produce multiple curves that include different parts of the bond universe. To determine the percentiles (e.g. median or 50th percentile, top quartile or 75th percentile), the bonds are ranked from highest to lowest yields. The 50th percentile bond or median represents the bond that has an equal number of bonds ranked above and below it. [715-30-55-25]

The following are examples:

— a curve that includes the entire population of AAA- or AA-rated bonds (excluding bonds considered to be outliers – e.g. the top and bottom 10% of the universe, or bonds whose yield to maturity significantly deviates from the calculated yield);
— a curve that segments the population to include only those bonds that are above median (top 50% yielding bonds); and
— a curve that segments the population to include only those bonds that are the top quartile (top 25% yielding bonds).

The SEC staff has indicated that 'high quality' for purposes of applying the provisions of Topic 715 are corporate bonds with ratings of AAA or AA. [715-20-S99-1]

Question 7.4.30 discusses how entities that use the yield curve approach to calculate their benefit obligation also use the output of the yield curve to calculate service cost and interest cost for the succeeding period.

### Documentation

An entity needs adequate documentation to support its selected discount rate. Therefore, when using the yield curve approach, an entity should document the yield curve analysis along with a full description of the process used to select the bonds.

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## Question 8.3.30#

**What is the bond matching approach?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Under the bond matching approach – referred to by other names including bond match[ing] portfolio and bond match[ing] model – an entity constructs a hypothetical bond portfolio (HBP) by identifying bonds that are expected to generate cash flows from principal and interest that are closely aligned with the estimated benefit payments of the plan. Notionally, the aggregate market value of the identified bonds is viewed as equivalent to the benefit obligation. From that information, a single equivalent discount rate is derived using the estimated benefit payments of the plan and the aggregate market value of the identified bonds.

The following table indicates how this approach leads to the components related to the balance sheet and income statement.

| | |
|---|---|
| **Benefit obligation (PBO or APBO)** | The single discount rate is used to discount all future cash flows related to benefits attributed to service to date. |
| **Service cost (for the following fiscal year)** | The single discount rate is used to discount all incremental future cash flows related to benefits projected to be earned during the following fiscal year. |
| **Interest cost (for the following fiscal year)** | The single discount rate is multiplied by the beginning-of-year benefit obligation (from the first line above) less the projected benefit payments to be made during the following fiscal year, adjusted for benefit payment timing. |

### Documentation

An entity needs adequate documentation to support its selected discount rate. Therefore, when using the bond matching approach, an entity should document the bond model along with a full description of the process used to select the bonds.

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## Question 8.3.40

**What are the considerations when selecting the interest rates used to calculate the discount rate?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** The following are key considerations specific to determining the interest rates used in the approaches to determining the discount rate under either the yield curve or bond matching approaches. [715-60-55-4]

### Current interest rates

The actuarial present value of plan obligations must be based on current interest rates in the same way that the fair value of plan assets depends to a considerable extent on current interest rates. Using discount rates based on historical rates of return is inconsistent with the requirement to value plan assets at fair value. Changes in interest rates increase or decrease the present value of the PBO/APBO. That increase or decrease in the obligation results in a loss (when the obligation increases) or a gain (when the obligation decreases) that the entity recognizes in OCI. [715-30-35-44, 715-60-55-4]

### Weighted-average discount rate

Interest rates vary depending on the duration of investments; for example, US Treasury bills, five-year bonds and 30-year bonds generally have different interest rates at the same date. The weighted-average interest rate inherent in the prices of a dedicated bond portfolio varies depending on the length of time remaining until individual benefit payment dates. An entity selects individual discount rates to apply to various benefit deferral periods based on the expected maturity of its benefit obligations. A properly weighted-average rate can be used for aggregate computations (e.g. the interest cost component of net periodic benefit cost) if it: [715-30-35-45, 715-60-55-4]

- is calculated using the expected maturities inherent in the entity's benefit obligations; and
- results in materially accurate approximations.

Question 8.3.130 discusses SEC disclosure guidance for discount rates.

### Discount rates based on futures contracts

It is not appropriate to use discount rates that are implicit in futures contracts or other estimates of future interest rates. Although part of the current benefit obligation may relate to assumptions about future compensation levels, benefits attributed to past service create obligations incurred by the entity. The discount rate that an entity uses to determine the benefit obligation needs to reflect current interest rates assuming effective settlement of incurred obligations using high-grade bonds (bonds rated AAA or AA) at the measurement date. [715-30-35-44, 715-60-55-4]

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### Participant status – active vs retired employees

An entity uses different discount rates to measure the benefit obligations for active and retired employees if it is necessary to use different rates to reflect differences in the maturity and duration of retirement benefit payments. However, the discount rates for retirement benefits that mature in the same year should not be different. [715-30-35-45, 715-60-55-4]

### Incremental guidance for Subtopic 715-60

The discount rate an entity uses to compute the EPBO and APBO may differ if the entity can justify the differences consistent with the requirement to measure obligations based on the price of effective settlement. Question 8.3.10 discusses determining discount rates under Subtopic 715-30 versus Subtopic 715-60. [715-60-55-4]

## Question 8.3.50

**What types of bonds are included in a hypothetical bond portfolio or yield curve?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** It depends. An entity selects bonds with a risk profile similar to its portfolio and also considers the nature of the bonds. It also considers whether the terms of the DB obligation and the terms of the bonds are similar. The following table includes more information about the different types of bonds and whether there is judgment required when considering their inclusion in a hypothetical bond portfolio or yield curve.

**Consideration of types of bonds when constructing a hypothetical bond portfolio or yield curve**

| Type of bond | Judgment required | Example and rationale |
|---|---|---|
| **High-quality corporate unsecured bonds** | Minimal | Topic 715 specifically discusses that employers may look to high-quality fixed-income investments when constructing a hypothetical bond portfolio or yield curve. The SEC staff clarified that high-quality fixed-income investments are those that receive one of the two highest ratings given by a recognized ratings agency (e.g. Aa or higher from Moody's). [715-30-35-44, 715-20-S99-1] |
| **High-quality corporate collateralized bonds** | Careful consideration and judgment required – see discussion below | High-quality corporate collateralized bonds may be considered, but judgment is needed to determine if they are appropriate. In general, corporate collateralized bonds are constructed from other bonds whose ratings may not meet the high-quality fixed-income requirement in Topic 715. This may result in rating inconsistencies |

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| Consideration of types of bonds when constructing a hypothetical bond portfolio or yield curve | | |
|---|---|---|
| **Type of bond** | **Judgment required** | **Example and rationale** |
| | | between the collateralized bond and unsecured bonds issued by the same corporate entity.<br>Collateralized bonds may have market yields inconsistent with other issuers' high-quality fixed-income instruments, or anomalous relative to other instruments issued by the same issuer, resulting in too high of a discount rate. |
| **Quasi-government bonds (also referred to as 'agency' bonds)** | Careful consideration and judgment required –see discussion below | These bonds are sold by non-government entities (e.g. a transit authority), but are generally guaranteed by the government. Because of the government guarantee, quasi-government bonds may have a lower risk profile and judgment is needed to determine if they are appropriate. |
| **Government bonds** | N/A – Generally excluded | Bonds sold and guaranteed by federal or municipal governments are generally excluded when constructing a hypothetical bond portfolio or yield curve. This is because their risk profile is exceptionally low compared to the risk profile of a non-government entity. |
| **Callable bonds** | N/A – Generally excluded, although some consideration is required because callable bonds may be included depending on the timing of the call feature | Callable bonds are generally excluded because the bond payment timing is uncertain and therefore the cash flows cannot be matched to the plan's expected payments. However, if the call feature is only exercisable toward the very end of the bond's maturity (e.g. the bond can only be called in the last three months of its life), it may be included when constructing a hypothetical bond portfolio (HBP) or yield curve. |
| **Low-quality bonds** | N/A – Not permitted | Low-quality bonds are not permitted. [715-30-35-44] |

### High-quality corporate collateralized bonds

In our experience, some entities use collateralized bonds to construct a hypothetical bond portfolio (HBP) or yield curve to select a discount rate if they are high-quality, but judgment is required. [715-30-35-45]

While Topic 715 does not preclude the use of high-quality collateralized bonds, using them when constructing the models may create the following results.

— An HBP that is constructed and relies heavily on collateralized bonds that are rated as high-quality could result in a discount rate that is higher than similar HBP models constructed with non-collateralized high-quality bonds.

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— A yield curve that is constructed based on a universe that includes above and below median high-quality collateralized bonds could result in a discount rate that is higher than a universe excluding collateralized bonds.

The variation in results has raised questions about whether to use high-quality collateralized bonds when selecting discount rates under Topic 715. [715-30-35-45]

We generally do not object to including high-quality collateralized bonds when constructing either a HBP or yield curve assuming that: [715-30-35-45]

— the bonds reflect the cash flows necessary to pay the pension benefits when due; and
— the yield is generally consistent with other high-quality fixed-income investments.

However, certain high-quality collateralized or other bonds may have characteristics that make their cash flows potentially inconsistent with the cash flows necessary to pay the benefits when due – e.g. callable or mortgaged-backed securities subject to prepayment risk. Further, other collateralized bonds may have market yields inconsistent with other issuers' high-quality fixed income instruments or yields considered anomalous relative to other instruments issued by the same issuer – e.g. a collateralized bond obligation rated AA with a yield equal to or higher than a lesser rated unsecured obligation of the same issuer. Judgment should also be used when considering the inclusion of such other collateralized bonds. These characteristics and other characteristics specific to collateralized bonds could raise uncertainty about their relevance when selecting a discount rate. [715-30-35-45]

### Quasi-government bonds

In our experience, some entities use quasi-government bonds when constructing a HBP or yield curve to select a discount rate if they are high-quality bonds, but judgment is required.

While Topic 715 does not preclude the use of quasi-government bonds, using them when constructing the models may result in a lower discount rate due to a lower risk profile from the government guarantee. Some quasi-government bonds may also have a government subsidy that reduces the interest rate temporarily and could change if the subsidy were terminated. Topic 715 requires an entity to look to rates of return currently available and expected to be available during the entire period to maturity of the pension benefits. An entity needs to carefully consider whether the rate of the quasi-government bond represents a rate at which the pension could effectively be settled and whether that rate will be available for the entirety of the period. [715-30-35-43-44]

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## Question 8.3.60
### What is the published index approach?

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** The bond matching and yield curve approaches discussed in prior Questions determine the discount rate by discounting projected benefit payments under the plan. However, while not common, some entities refer to high-quality bond indices as a proxy for the discount rate that would be determined by analyzing projected benefit payments under one of these approaches. This Handbook refers to this alternative approach as the 'published index' approach.

Two readily available indices are the FTSE Pension Liability Index (FTSE) series (formerly known as the Citigroup Pension Liability Index or CPLI series) and the Merrill Lynch 10+ Index. The FTSE is created monthly using the FTSE Pension Discount Curve (FPDC) and represents the single discount rate that would produce the same present value as calculated by discounting a standardized set of liabilities using the FPDC. The FTSE series includes three indices. Each index represents a maturity of different types of DB benefit pension plans, including fully open plans and fully closed plans.

| | |
|---|---|
| **Fully open plan** | Provides ongoing future benefit accruals, is open to new participants who meet eligibility requirements, and has a relatively long average benefit payment period (FTSE - Standard) |
| **Partially open/closed plan** | Provides ongoing future benefit accruals for a closed group of participants and has an intermediate length average benefit payment period (FTSE - Intermediate) |
| **Fully closed plan** | Ceases future benefit accruals (i.e. freezes accrued benefits) for a closed group of participants and has a relatively short average benefit payment period (FTSE - Short) |

We believe entities should provide clear disclosure about how discount rates determined by reference to an index correspond to the discount rate that would be expected if a more robust bond matching approach was used, along with disclosure about how the index is adjusted for differences in the duration of liabilities compared with the duration of the bonds in the index. [SEC Speech 2004, 715-20-50]

### Documentation

An entity needs adequate documentation showing how the timing and amount of cash outflows in the index matches the estimated cash flows for benefit payments and for adjustments made to the index, if any.

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## Question 8.3.70

### Can the basis for determining the discount rate be changed?

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Yes, but only in limited circumstances. The main objective in determining a discount rate is to determine the interest rate at which the pension benefits could effectively be settled at the measurement date. If an entity identifies a better approach of determining the discount rate, it generally can make a change – whether the change be a change in approach or a change in the way it applies an approach. For example, it can change from using a general corporate bond index (i.e. a published index approach) to applying rates indicated by a yield curve (i.e. a yield curve approach) if sufficiently supported by a change in facts and circumstances. The change in discount rates is considered a change in estimate, not a change in accounting principle, because the objective in all cases is obtaining the best measure of the effective settlement rate. [715-30-55-26 – 55-27]

Nonetheless, an entity cannot change its approach to determining the discount rate unless it is changing to an approach that yields a better measure of that rate. Therefore, there must be a change in facts and circumstances, or available data, to warrant using a different approach – one that better reflects the rates at which the obligation effectively settles at the measurement date. A change that is made merely to avoid recognizing a change that occurred in the overall interest rate environment is not acceptable.

Further, it would be inappropriate to switch from a more precise approach to a less precise approach. For example, a yield curve approach is considered more precise than a published index approach because the yield curve approach matches the duration of the benefit streams, whereas a published index approach does not and requires an adjustment to reflect duration of the benefit streams; therefore, it is not as accurate as the yield curve method. [715-30-55-26 – 55-28]

Based on the above, we believe an entity must have a reasonable basis to support a change in the way it determines the discount rate. As part of that analysis, we believe the basis should be evaluated against the facts and circumstances that existed in prior periods to assess whether the proposed change is supported by a change in facts and circumstances. This is particularly true when there is a downward trend in the overall interest rate environment and an entity proposes to switch to a yield curve that by its design will result in a higher discount rate than would be the result of the entity's prior policy.

The following are summaries of some situations we have encountered in practice and how we evaluated them.

#### Scenario 1: Change to a model that was previously available

ABC Corp. asserts that if it were to settle its plan obligations then it would do so by the cheapest means possible – i.e. it would select the highest discount rate possible. It proposes to switch from the generalized curve to the above median

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or top quartile curves that its actuarial firm produces (or from above median to the top quartile curve or a bond model). Each of those methods was available to ABC in prior periods but were not used to select the discount rate.

We believe this is not a sufficient basis to support the change for the following reasons.

— ABC could have made a similar assertion in prior periods but did not. In addition, the other yield curves were available to ABC in those periods but were not used.
— If this were an acceptable basis to make a change without considering other facts and circumstances, any entity would be able to make a change like this in any period it desired.

Subtopic 715-30 is clear that any change must be supported by a change in facts and circumstances. Once an approach is selected, it is used until a change in facts supports a change in approach. [715-30-55-28]

### Scenario 2: Change in investment strategy

DEF Corp. makes a similar assertion as ABC in Scenario 1. However, DEF indicates that management, with the appropriate level of authority, has approved a strategy of migrating the investment portfolio of plan assets to a bond portfolio that will be made up principally of AA-rated bonds from the above median bond universe.

In this scenario, we believe that the change in the funding strategy for the plan in the current period provides a reasonable basis to support the change in the current period. [715-30-35-45]

### Scenario 3: Change in actuaries

JKL Corp. makes a similar assertion to ABC in Scenario 1. JKL previously used the above median curve of its actuarial firm to select its discount rate. In the current period, JKL changed external actuaries and the new actuary publishes an above median curve and a top quartile curve. The prior actuary did not publish a top quartile curve.

We believe it may be acceptable for JKL to change its method in the year that it changes actuaries provided that JKL asserts that: [715-30-35-45]

— it always would have settled the obligation using the cheapest means possible; and
— the above median curve was the closest methodology to that view that was available to it in prior periods.

### Scenario 4: Change in market conditions

MNO Corp. previously used the top quartile yield curve that its external actuary developed and had previously documented that it believed the top quartile curve was the best reflection of how it would settle its plan obligations. However, starting in the current year, MNO began using the above median curve because it believed that market conditions were unusually volatile resulting in anomalies in the top quartile population. In the following fiscal year, MNO reasserted that the top quartile curve would be the most appropriate for its circumstances and reevaluated market conditions to determine whether it should change back to that curve. In the third year, MNO concludes that circumstances have changed, and it will revert to the top quartile curve. This includes documenting that the significant

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difference that had existed between the top quartile and above median curves in the prior two years has returned to more normal spreads.

We believe these facts would provide a reasonable basis to support the change (see Question 8.6.10). [715-30-35-45]

### Scenario 5: Change from a bond matching to a yield curve approach

PQR Corp. previously used a bond matching approach to determine its discount rate. PQR wants to use the alternative spot rate approach (a yield curve approach) to determine service and interest cost. However, because the bond matching approach is not conducive to calculating the alternative spot rate approach, PQR proposes to switch to a yield curve methodology to calculate the discount rate because the yield curve can be used in calculating the service and interest cost under the alternative spot rate approach. We do not believe this would be an acceptable change.

The SEC staff's view is that a bond matching approach is a fundamentally different approach of deriving the benefit obligation from a yield curve. An entity must support switching from a bond matching approach to a yield curve by a change in facts and circumstances that demonstrate that the yield curve produces a better measure of the obligation. The SEC staff encourages public companies to engage in a dialogue with them if they believe they have experienced changes in facts and circumstances that justify a change in the approach to calculating the benefit obligation. [2015 AICPA Conf]

### Scenario 6: Change from a yield curve to a published index

XYZ Corp. previously used a yield curve that its external actuary published in determining its discount rate. XYZ proposes to use a published index approach. XYZ asserts that the published index approach is appropriate because their foreign competitors and foreign subsidiary pension plans use it.

We believe these facts would not provide a reasonable basis to support a change. Yield curves are viewed as a more precise way of calculating a discount rate because the yield curve matches the duration of the plan's specific benefit stream to the estimated discount rate. A published index approach is not as precise and switching from a precise method to a less precise method is not appropriate.

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## Question 8.3.80

**What are acceptable ways of determining discount rates during a period of volatility?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** During highly volatile market conditions, an entity may change its approach to selecting its discount rate to better reflect the overall trends in interest rates on the measurement date. The approach used to select the discount rate should be consistent with the overall objective under Topic 715 to select a discount rate at a point-in-time that best reflects the rate: [715-30-35-45, 715-60-35-80]

— at which the benefit obligation could be settled currently; and
— that considers the general trend in interest rates since the last measurement date.

We believe Approaches 1 and 2 below are consistent with this objective; however, we do not believe the other approaches described are acceptable.

### Approach 1: Exclude more outliers than existing approach used

This approach selects bonds to include in a yield curve or a bond matching approach that excludes outliers when compared to the median or the average of the entire bond universe. In periods of volatility, more bonds may be identified as outliers.

There could be various approaches to defining outliers. For example, some actuarial firms express this in terms of the number of standard deviations of a bond's yield compared to the median (or average, if selected). Other firms express this in terms of a fixed number of basis points.

We do not believe it is necessary (although it is acceptable) to adopt an approach where all bonds issued by a specific sector of the bond universe experiencing volatility are excluded. The yields on bonds that financial services companies have issued have historically been higher than other bonds. If a period of volatile market conditions causes the spread to widen, it is unnecessary to exclude them completely (subject to the definition of outlier that a firm adopts).

### Approach 2: Broader bond universe

This approach selects a yield curve or bond matching approach that considers a broader cross-section of the bond universe than used in the past.

Some entities use models that consider cross-sections of the bond universe skewed toward the higher yielding bonds (e.g. an above median curve). We believe these approaches are acceptable if there is adequate capacity in the bonds used to construct the curve for the size of the plan being valued. During a period of volatile market conditions, this

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approach may yield a result that is a larger change in the discount rate since the last measurement date, when compared to the general trend in interest rates over the same period. [715-30-35-45, 715-30-55-27, 715-60-35-80, 55-4]

### Approaches that are not acceptable

We do not believe the following approaches to considering the volatile market conditions when selecting the discount rate are acceptable.

— Averaging the observed bond yield rates for some period before and/or after the measurement date. This is not consistent with a point-in-time measurement objective – even if there is unusual activity on the measurement date and the market returns to normal activity shortly after.

— Weighting the yields on outlier bonds differently from the bonds that are more representative of the overall market. This is inherently arbitrary and inconsistent with the measurement objective. See Question 6.2.30 for discussion about the measurement date and measurement objective.

### Reverting to a previous approach

If an entity changes its approach to selecting the discount rate to reflect volatile market conditions on the measurement date, it may be appropriate for it to revert to its original approach in a future period. See Question 8.3.70, Scenario 4. [715-30-55-26 – 55-28, 715-60-55-4]

Section 715-30-55 does not describe the market conditions that need to be present to determine whether it is appropriate to change back to the original approach or to change to a different approach. Instead, an entity needs to base the discount rate selected on the facts and circumstances that exist at the measurement date and that best achieve the overall objective. [715-30-55-26 – 55-28]

A change in the approach used to select the discount rate is appropriate when the entity makes the change in response to the facts and circumstances at a specific point in time. That is, it would be acceptable to change approaches if an entity has been using an above medium yield curve but believes it would be more appropriate in the market conditions on the measurement date to use a broader yield curve. In contrast, it would not be acceptable for that entity to use a published index instead of a yield curve because the published index is less precise.

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## Question 8.3.90

**What are jurisdictional considerations when determining discount rates?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Entities select a discount rate that is consistent with the interest rate environment for the currency in which the benefit obligations are denominated. The interest rate environment differs by jurisdiction. A variety of factors cause this, including: [715-30-35-43 – 44]

— central banking policies and the mix of industries of bond issuers in the bond universe in that market;
— which entities issue bonds with or without call features in a market; and
— supply and demand.

## Question 8.3.100

**How are changes in published indices that are not published until the month following the change evaluated?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Some entities use published indices to select the discount rate. For example, US companies with pension plans for European employees frequently use discount rates based on the iBoxx AA Euro index. The publisher of iBoxx index rates does not remove bonds downgraded during a month until the first business day of the following month. Therefore, entities using those indices should evaluate whether there has been a change in the index between the last day of the month and the first day of the subsequent month that is not explained by market events on that day. Adjustments to the prior month-end index may be necessary.

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## Question 8.3.110

**How are post-balance sheet downgrades of bonds used in determining the discount rate treated?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Bonds may be included in a yield curve or bond matching approach at the measurement date and subsequently downgraded by a rating agency such that they no longer meet the high-quality requirement. When this occurs, an entity evaluates the facts and circumstances to determine whether to view the downgrade as a recognized or nonrecognized subsequent event and considers possible disclosure requirements under Topic 855 (subsequent events). If it is a recognized subsequent event, the entity removes the bond from the analysis. If a bond matching approach is used, the entity may consider replacing the bond with a similar bond issue to meet various objectives (e.g. maintaining an appropriate match to benefit cash flows) of the bond matching approach. [855-10-25-1, 25-3, 50-1 – 50-3]

Clear evidence about the reason for and the timing of the downgrade is useful in determining whether to remove the bond from the analysis. In the absence of specific information, the entity applies judgment. The closer the downgrade occurs to the measurement date, the more likely it is that the condition(s) giving rise to the downgrade existed as of the measurement date, resulting in a potential need to remove the bond from the model.

## Example 8.3.10

**Evaluating the effect of post-balance sheet bond downgrades on the discount rate**

### Background

ABC Corp. has a September 30 fiscal year-end and uses a bond matching approach to select its discount rate. In November Year 1, before issuing its financial statements, a bond in the portfolio used to model the plan's cash flows was downgraded. ABC must evaluate the effect of the downgrade on its financial statements at September 30, Year 1 and whether to include the bond in its portfolio.

### Analysis

ABC considers the reasons for the downgrade of the selected bonds when evaluating its effect on the discount rate as of the reporting date and evaluates the following subsequent event factors.

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| Indicators to include the bond | Indicators to exclude and replace the bond |
|---|---|
| **Subsequent event factors** | |
| Change in creditworthiness of a bond issuer due to a specific event or transaction occurring after September 30, Year 1. | Difference between actual earnings that the issuer reported at September 30, Year 1, and predictions about what those earnings would be for that period. |
| **Bond price comparison to similarly priced bonds** | |
| Market data indicates that the bond is priced consistently with others in the market. | The bond spread indicates its yield is on the high side of the market as of September 30, Year 1. The market may have already effectively downgraded the bond ahead of the rating agencies, particularly where there is no specific Type 2 event to cause the downgrade. |

## Question 8.3.120

**Can an entity with non-US-dollar denominated benefit payments use US-dollar denominated bonds to select its discount rate?**

### Excerpt from IAS 19

**Actuarial assumptions: discount rate**

**83** The rate used to discount post-employment benefit obligations (both funded and unfunded) shall be determined by reference to market yields at the end of the reporting period on high quality corporate bonds. For currencies for which there is no deep market in such high quality corporate bonds, the market yields (at the end of the reporting period) on government bonds denominated in that currency shall be used. The currency and term of the corporate bonds or government bonds shall be consistent with the currency and estimated term of the post-employment benefit obligations.

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Background:** ABC Corp. is domiciled in Canada and has pension and OPEB obligations with its employees and retirees denominated in Canadian dollars. Its functional currency is the Canadian dollar. To determine the discount rates for

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these obligations, it identified interest rates for AA or better rated US-dollar denominated bonds and adjusted those interest rates for inherent rate differentials using currency swap rates.

**Interpretive response:** No. We do not believe it is acceptable under US GAAP for an entity with Canadian-dollar denominated benefit payments to select the discount rate for a pension or OPEB plan using the interest rates for US-dollar denominated bonds.

Although Topic 715 does not provide specific guidance, IAS 19 addresses this issue, as discussed in Question 8.3.80. US GAAP permits an entity to consider nonauthoritative guidance when an issue is not addressed in the authoritative US guidance. This alternative guidance includes IFRS® Accounting Standards that are widely recognized and prevalent. [105-10-05-2 – 05-3]

**Note:** We believe the guidance cited under IAS 19 is directly on point and can be used for US GAAP purposes. That guidance states that if there is no deep market in high-quality corporate bonds in the entity's currency, the entity uses the market yields on government bonds. [IAS 19.83]

## Question 8.3.130

### What expectations does the SEC have regarding disclosures about discount rates?

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** The SEC staff expects a registrant with DB plans to include clear disclosures of how it determines the discount rate, either in its financial statement notes or in the critical accounting policies section of MD&A. [2004 AICPA Conf, 2006 CA&D.II(J)(1)]

**Guidance for select SEC discount rate disclosures for registrants with DB plans (not all inclusive)**

| Disclose | Explain how the entity determined | Details to include |
|---|---|---|
| Discount rate method | Its assumed discount rate | Specific source data used to support the discount rate. |
| Assumptions benchmarked against published bond indices | That the timing and amount of cash outflows for the bonds match its estimated DB payments | Any adjustments for differences between bond terms and terms of the DB obligations, if applicable – e.g. for callable bonds. |

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| Guidance for select SEC discount rate disclosures for registrants with DB plans (not all inclusive) | | |
|---|---|---|
| **Disclose** | **Explain how the entity determined** | **Details to include** |
| | | **Note:** A registrant should not increase the benchmark rates unless it has performed detailed analysis that supports the increase. |

## 8.4 Mortality assumption for determining probability of payment

To measure the components of a pension or OPEB plan, an entity needs to project its net cash flows over the life of the plan. To do so requires the entity to make several demographic assumptions about plan participants, such as turnover, projected retirement age and mortality. This section focuses on the mortality assumption. [715-30-35-42]

### Question 8.4.10
**How is the mortality assumption evaluated?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Plan assumptions must reflect the best estimate of the plan's future experience and also consider the life expectancy of the entity's specific plan participants. Therefore, mortality tables used in benefit plan computations must reflect the characteristics of the plan's participants. If an entity operates in a service industry, it is not appropriate to use a mortality table developed from employee data in manufacturing industries because it does not reflect the entity's plan participants. [2004 AICPA Conf]

Many entities use mortality data compiled and published by the Society of Actuaries (SOA) to estimate the life expectancy input necessary to calculate their obligation and net periodic benefit cost. The SOA periodically updates the Mortality Improvement Scale (e.g. MP-2021) that accompanies its most recent Mortality Table (e.g. Pri-2012). The updated mortality improvement scale incorporates the most recent Social Security Administration mortality data.

We believe an entity should consider the SOA's most recent data for US-based DB pension and OPEB plans when making its mortality assumptions for fiscal year-end financial reporting and any remeasurement dates, including SOA

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data that becomes available after the measurement date but before the financial statements are issued (see Question 8.4.20).

## Question 8.4.20

**Is an updated mortality table published after the year-end reporting / measurement date considered?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Yes. In additional to the general guidance in Topic 855 (subsequent events), the AICPA specifically addresses how an entity should evaluate the release of updated mortality tables after fiscal year-end (the measurement date) but before financial statements are issued (or available to be issued). For accounting purposes, the release of new updated mortality tables information is viewed as a recognized subsequent event. An entity therefore evaluates the effect of this new information on its financial statements that are not yet issued (or available to be issued). In addition, even if new mortality data became available relatively late in the year or was not considered for budgeting and forecasting purposes, it does not justify failing to evaluate it when establishing mortality assumptions for fiscal year-end financial reporting. [TQA 3700.01]

## Question 8.4.30

**How is the mortality for lump-sum pension benefit payments evaluated?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Many qualified pension plans (plans that meet the requirements of Section 401(a) of the IRC) offer participants an optional payment of benefits as a lump sum. When lump sums are elected, participants' future benefit payments are converted to a lump-sum amount based on the then-current IRS tables – or the greater of the amount calculated using such tables and the amount calculated using another specified set of tables. For actuarial valuations of pension plans that offer lump-sum payments, management is required to choose a mortality table and projection scale assumption for accounting purposes to determine the lump-sum amounts expected to be paid at each expected future payment date. [715-30-35-42]

The IRS has released (through Treasury Regulations and Notices) the mortality tables to be used in determining the minimum amount of lump-sum distributions required by the IRC.

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Under current federal tax law, for payment of lump sums, mortality for US plans is required to be based on US retirement plan experience, and the Secretary of the Treasury is required to consider updating the lump-sum tables at least every 10 years. However, there are no formulaic or automatic provisions required as part of that consideration, and the Secretary has latitude in implementing the updates.

There are two views about how to apply the IRS mortality tables when estimating future lump-sum payments; note that the IRS publishes mortality tables for different purposes such as minimum funding requirements and minimum lump sum amounts, so the correct tables should be used. We believe either view is acceptable if it is consistently applied. [715-30-35-42]

### View 1: Consider anticipated future updates

This view considers the anticipated future updates by the IRS to its lump-sum mortality tables as periodic updates that can be anticipated and reasonably estimated pending the publication of the updated Treasury regulations (much like annual cost of living increases). This is consistent with the general approach in Topic 715 to reflect the entity's best estimate of future benefit payments, incorporating a wide variety of projections of future events. [715-30-35-42]

When choosing a lump-sum mortality assumption, management should reflect its best estimate of what it believes the IRS-prescribed mortality table will be in future years when the expected lump-sum amounts are to be calculated and paid. To assess the reasonableness of the lump-sum mortality assumption under this view, we would expect management (usually through its third-party actuary) to provide a rationale for the lump-sum tables chosen.

### View 2: Use current Treasury regulations

This view calculates future lump-sum payments based on current Treasury regulations. It considers changes to the IRS table as equivalent to a change in law – even though no law change is required for the IRS to make such changes. Changes in law are not considered under the Subtopic 715-30 measurement guidance paragraphs until the IRS publishes new tables. [715-30-35-31, 715-30-35-42, 715-60-35-102]

Under this view, management assumes that mortality rates used to calculate lump-sum payments in all future years are based on the current IRS table in effect as of the measurement date. When the IRS updates lump-sum mortality tables, the effect on the projection of future lump-sum payments is a loss (assuming an increase in life expectancy) at the next measurement date following the IRS update. [715-30-35-42]

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## 8.5 Economic assumptions for determining the expected long-term rate of return on plan assets#

The expected long-term rate of return on plan assets represents the average rate of earnings on plan assets over the period in which benefits will be paid in the future. The EROA component of net periodic benefit cost represents the EROA during the year using the expected long-term rate of return. Therefore, it is an important metric for estimating the change in value of the plan assets during the following fiscal year. Section 6.3 explains the accounting for plan assets and the estimated change in plan assets. [715-30 Glossary, 715-60-35-84]

### Question 8.5.10

**How are assumptions for the expected long-term rate of return on plan assets developed?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** In estimating the expected long-term rate of return on plan assets, appropriate consideration is given to the returns being earned by the plan assets in the fund and the rates of return expected to be available for reinvestment. [715-30-35-47, 715-60-35-84]

The time horizon for providing benefits included in the PBO or APBO includes the period to assumed retirement and the benefit payout period after retirement based on the assumed form of payment. For a plan with active, deferred vested and retired participants that provides lifetime benefits, the time period could extend beyond 30 years. In our experience, 20- and 30-year periods tend to be used as the long-term horizon for the expected long-term rate of return on plan assets assumption. [715-30-35-47]

Subtopic 715-30 does not provide detailed guidance about considerations for selecting the expected long-term rate of return on plan assets assumption; however, the actuarial standards of practice (ASOPs) provide guidance to consider. When selecting economic assumptions, an entity includes identifying components that make up the assumption, which can lead to a building-block approach. Under a building-block approach, consideration is given to assumed inflation, assumed real returns for different asset classes and, if applicable, active management of the plan's asset portfolio. When using a building-block approach, an expectation exists that long-term inflation should be consistent with other economic assumptions. [715-30-35-47, ASOP 27]

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### Question 8.5.20

**How are historical economic data considered when developing assumptions for the expected long-term rate of return on plan assets?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** We believe it is appropriate to review recent and long-term historical economic data. However, undue weight should not be given to recent experience. Instead, consideration should be given to the possibility that some historical economic data may not be appropriate in developing assumptions for future periods because of changes in the underlying environment. Therefore, considering forward-looking assumptions is appropriate, which can lead to using capital market assumption studies. [715-30-35-47]

The use of either an arithmetic or geometric expected return to calculate the expected long-term rate of return on plan assets is acceptable and should be applied consistently as the basis of estimate for the expected long-term rate of return on plan assets assumption. An expected arithmetic return produces a result that is like a weighted-average portfolio expected return with the weights equal to the asset allocation. An expected geometric return converges to a median expected return, which is typically less than the arithmetic expected return. [715-30-35-47]

## 8.6 Attribution methods

| Excerpt from ASC 715-30 | Excerpt from ASC 715-60 |
|---|---|
| **35 Subsequent Measurement**<br><br>**>> Attribution**<br><br>**35-36** For purposes of this Subtopic, pension benefits ordinarily shall be attributed to periods of employee service based on the plan's benefit formula to the extent that the formula states or implies an attribution. For example, if a plan's formula provides for a pension benefit of $10 per month for life for each year of service, the benefit attributed to each year of an employee's service is $10 times the number of months of life expectancy after | **35 Subsequent Measurement**<br><br>**>> Attribution**<br><br>**35-61** In the context of this Subtopic, attribution is the process of assigning the expected cost of benefits to periods of employee service. The general objective is to assign to each year of service the cost of benefits earned or assumed to have been earned in that year.<br><br>**35-62** An equal amount of the expected postretirement benefit obligation for an employee generally shall be |

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retirement, and the cost attributable to each year is the actuarial present value of that benefit. For plan benefit formulas that define benefits similarly for all years of service, that attribution is a **benefit-years-of-service approach** because it attributes the same amount of the pension benefit to each year of service. For final-pay and career-average-pay plans, that attribution is also the same as the projected unit credit or unit credit with service prorate actuarial cost method. For a flat-benefit plan, it is the same as the unit credit actuarial cost method.

**35-37** Some plans define different benefits for different years of service. For example, a step-rate plan might provide a benefit of 1 percent of final pay for each year of service up to 20 years and 1½ percent of final pay for years of service in excess of 20. Another plan might provide 1 percent of final pay for each year of service but limit the total benefit to no more than 20 percent of final pay. For such plans the attribution called for by this Subtopic will not assign the same amount of pension benefit to each year of service.

**35-38** Some plans may have benefit formulas that attribute all or a disproportionate share of the total benefits provided to later years of service, thereby achieving in substance a delayed vesting of benefits. For example, a plan that provides no benefits for the first 19 years of service and a vested benefit of $10,000 for the 20th year is substantively the same as a plan that provides $500 per year for each of 20 years and requires 20 years of service before benefits vest. For such plans the total projected benefit shall be considered to accumulate in proportion to the ratio of the number of completed years of service to the number that will have been completed when the benefit is first fully vested. If a plan's benefit formula does not specify how a particular benefit relates to services rendered, the benefit attributed to each year of service in the attribution period (a benefit-years-of-service approach).

**35-63** Some plans may frontload benefits, that is some plans have a **benefit formula** that defines benefits in terms of specific periods of service to be rendered in exchange for those benefits but attributes all or a disproportionate share of the expected postretirement benefit obligation to employees' early years of service in the attribution period.

**35-64** For that type of plan, the expected postretirement benefit obligation shall not be attributed ratably to each year of service in the attribution period but shall be attributed in accordance with the plan's benefit formula.

**35-65** Whether a plan is frontloaded is determined by considering the active participants as a group rather than applying the benefit formula to each individual participant. Paragraph 715-60-55-59 contains an example of a benefit formula that results in a frontloaded benefit for a plan that provides only postretirement death benefits.

**35-66** The beginning of the attribution period generally shall be the date of hire. However, if the plan's benefit formula grants credit only for service from a later date and that credited service period is not nominal in relation to employees' total years of service before their full eligibility dates, the expected postretirement benefit obligation shall be attributed from the beginning of that credited service period.

**35-67** For a plan with a benefit formula that attributes benefits to a credited service period that is nominal in relation to employees' total years of service before their full eligibility dates, an equal amount of the expected postretirement benefit obligation for an employee is attributed to each year of that employee's service from date of hire to date of full eligibility for benefits.

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shall be considered to accumulate in either of the following manners:

a. For benefits of a type includable in **vested benefits** (for example, a supplemental early retirement benefit that is a vested benefit after a stated number of years), in proportion to the ratio of the number of completed years of service to the number that will have been completed when the benefit is first fully vested
b. For benefits of a type not includable in vested benefits (for example, a death or disability benefit that is payable only if death or disability occurs during active service), in proportion to the ratio of completed years of service to total projected years of service.

**35-39** Under the attribution approach described in paragraphs 715-30-35-36 through 35-38, the projected benefit obligation will always equal or exceed the accumulated benefit obligation.

**55 Implementation Guidance and Illustrations**

**>> Attribution**

**55-7** The following attribution-related implementation guidance illustrates the application of the guidance in paragraph 715-30-35-36 that establishes that pension benefits ordinarily shall be attributed to periods of employee service based on the **plan's benefit formula** to the extent that the formula states or implies an **attribution**.

**55-8** Under the paragraph 715-30-35-36 guidance, 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), the projected unit credit method should be used to attribute the service cost component of net periodic pension cost over employees' service periods because a pension plan that describes the pension benefits

**35-68** In all cases, the end of the attribution period shall be the full eligibility date. For postretirement benefit plans that are pay-related or that otherwise index benefits during employees' service periods to their retirement date, the full eligibility date and retirement date may be the same. The attribution period for those benefits will differ from the attribution period for a similarly defined pension benefit with a capped credited service period.

**35-69** Therefore, the present value of all of the benefits expected to be received by or on behalf of an employee is attributed to the employee's credited service period, which ends at the full eligibility date.

**35-70** See paragraphs 715-60-55-57 through 55-59, which illustrate the attribution provisions of this Subtopic, and paragraphs 715-60-55-10 through 55-18 for implementation guidance on attribution provisions.

**55 Implementation Guidance and Illustrations**

**>> Attribution**

**55-10** An employer modifies the eligibility requirements under its **postretirement benefit plan** by changing the plan's **credited service period** from 25 years of service after age 40 to 15 years of service after both reaching age 50 and rendering 10 years of service. Under the amended plan, the **attribution period** begins at the date of hire because the plan has an undefined credited service period. The amended plan still requires 25 years of credited service. However, it grants credit for 10 years of service before age 50 and those years of service are not defined. The effect of the change in eligibility requirements is to lengthen the **attribution** period for employees hired before age 40.

**55-11** An employer provides retiree health care and life insurance benefits under one plan. Employees are eligible for health care and death benefits upon attaining age 55

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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.

**55-9** A career-average-pay pension plan may have a formula that provides pension benefits equal to 1 percent of each year's salary for that year's service with, for example, prospective (flat-benefit) plan amendments granted every 3 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 3 years of service). In such a plan, the projected unit credit method should not be used for both the career-average-pay and the flat-benefit portions of the pension benefits provided under the pension plan. Rather, 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, in this example, is three years.

**55-10** In 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 with, for example, final pay frozen at the 20th year, the employer should not 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. Although total projected and having rendered 20 years of service; however, the life insurance benefits are based on final pay. Basing the life insurance benefits on final pay extends the **full eligibility date** to a plan participant's expected retirement date, provided the incremental increase in the life insurance benefits offered under the plan for an employee's service after age 55 is not trivial in relation to the total benefits expected to be received by the employee under that plan. For example, if an employee is expected to fulfill the 20-year service requirement before age 55 and is expected to retire at age 62 with salary increases in all years of service, the employee's full eligibility date is the date he or she reaches age 62. Note that the plan described has an indefinite credited service period, because the qualifying 20-year period is unspecified. Accordingly, the attribution period for that plan begins at the date of hire and ends on the full eligibility date.

**55-12** Moreover, even if the terms of the plan described in paragraphs 715-60-55-10 through 55-11 specified which 20-year service period constituted the credited service period, for example, the first 20 years after date of hire, or the first 20 years of service after age 35, basing life insurance benefits on final pay would still extend the full eligibility date to the expected date of retirement, again, assuming the incremental life insurance benefits after the defined 20 years of service are nontrivial. If the plan formula specifies the first 20 years as the credited service period, the employer needs to assess whether that results in a frontloaded benefit as described in paragraph 715-60-35-62. If that provision results in a frontloaded benefit, the benefit obligation should not be attributed ratably to each year of service in the attribution period but should be attributed in accordance with the plan's **benefit formula**.

**55-13** However, the attribution period for the plan described in paragraphs 715-60-55-10 through 55-11 would be different if the benefits are provided and accounted for

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benefits ordinarily should be attributed to years of service based on the pension plan's formula, paragraph 715-30-35-38 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. In 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**. If the pension plan's formula in this example 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, the result is the same except that gains or losses will occur after the 20-year period if experience is different from that assumed regarding the final level of compensation.

**55-11** A pension plan may have more than one formula with an employee's pension benefits 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. In a pension plan that effectively has a formula that defines different benefits for different years of service, 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 two separate plans, one providing life insurance benefits and the other providing health care benefits. In that case, the full eligibility date for participants in the life insurance plan would not influence the determination of the full eligibility date for participants in the health care plan. A frontloaded plan may provide two or more benefits, such as health care and life insurance benefits, that are earned under different benefit formulas. For example, assume the typical participant covered by the plan described in paragraphs 715-60-55-10 through 55-11 is an individual hired at age 20 who is expected to retire at age 62 with 42 years of service. If the **expected postretirement benefit obligation** at age 40 for that employee is $39,405 ($28,500 for health care benefits and $10,905 for life insurance benefits), a ratable (1/42) allocation of the expected postretirement benefit obligation to each year of service would result in an accumulated postretirement benefit obligation of $18,764 ($13,571 for health care benefits and $5,193 for life insurance benefits) at the end of the 20th year. However, if the plan's benefit formulas for both health care and life insurance benefits stipulate that employees are not required to render additional service after their first 20 years in order to receive those benefits, the aggregate benefits under the plan may be frontloaded, even though life insurance benefits increase for additional years of service beyond the 20th year. See the following calculations:

a. $10,915 equals the **actuarial present value** of life insurance benefits based on final pay, assuming the employee was hired at a salary of $15,000 that increases by 5 percent annually, a life expectancy of 75 years, and a discount rate of 7 percent.
b. 20/42 × $39,405 = $18,764.
c. 20/42 × $28,500 = $13,571.
d. 20/42 × $10,905 = $5,193.

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**55-12** If a pension plan has more than one formula, the **accumulated benefit obligation** shall 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 shall 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 in the preceding paragraph, that may result in differing levels of benefits attributed to different years of an employee's service.

**55-13** See Example 3 (paragraph 715-30-55-108) for an illustration of how an employer would determine the accumulated and projected benefit obligations for a pension plan that has more than one benefit formula.

**55-14** An employer may sponsor both a qualified pension plan (for tax purposes) and an excess benefit plan (sometimes referred to as a top-hat pension plan) during an employee's service period and the employee may be 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 limitations imposed by the U.S. Internal Revenue Code). In this situation, the projected benefit obligation should be attributed to the qualified pension plan (for tax purposes) until it equals the assumed benefit limitations imposed by the U.S. Internal Revenue Code. See paragraph 715-30-55-21 for considerations of future changes in limitations. Any incremental projected benefits for subsequent years of service should then be attributed to the excess benefit pension plan. 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

**55-14** If the combined values of both health care and life insurance benefits earned based on their respective benefit formulas after 20 years are significantly greater than the accumulated postretirement benefit obligation that would result from a ratable allocation of the expected postretirement benefit obligation, a disproportionate share of the expected postretirement benefit obligation is attributable under the benefit formulas to the employee's early years of service. In that case, the attribution of the obligation for both benefits under the plan should follow their respective benefit formulas. Following the benefit formulas in this example, the accumulated postretirement benefit obligation for health care and for life insurance benefits for the hypothetical employee at the end of 20 years is $28,500 and $3,728, respectively. Accordingly, the accumulated postretirement benefit obligation for that employee at the end of the first 20 years of service should be $32,228 rather than $18,764; that is, the plan is frontloaded and benefits should be attributed following the benefit formula. (Assumed life insurance benefit equal to Year 20 salary of $39,799 discounted at 7 percent for 35 years = $3,728.)

**55-15** An employer has a retiree health care plan that bases benefits on length of service and requires employees to render a minimum of 10 years of service after attaining age 45 to be eligible for any benefits. However, upon attaining age 45, employees receive credit for 3 percent of the maximum benefit for each year of service before age 45. For example, at age 45 an employee hired at age 25 receives credit for 60 percent (3 percent × 20 years) of the plan's **postretirement health care benefits**. The credited service period begins at the date of hire because the amount of total benefits is based on the years of service rendered after that date.

**55-16** An employer requires an employee to participate in its contributory active health care plan to be eligible to

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pension plan.

**55-14A** In most circumstances involving excess benefit pension plans, 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 in earnings of the cost of retroactive plan amendments and gains or losses should be on a plan-by-plan basis. Also, the disclosures required by paragraph 715-20-50-2 may need to be made separately for each plan.

**55-14B** The fact that an employer could fund less to the qualified pension plan and use those withheld funds to pay the benefits of the nonqualified pension plan or 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. An additional reason that excess benefit 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.

**55-15** See Example 4 (paragraph 715-30-55-118) for an illustration of attribution of pension benefits to a qualified pension plan (for tax purposes) and an excess benefit pension plan.

participate in its retiree health care plan. An employee can join the active plan at any time before retirement but must have worked 10 years and attained age 55 while in service to be eligible for benefits under the retiree plan. The attribution period for an employee who is or is expected to be a participant in the active plan begins at the date of hire because the plan's eligibility requirements do not specify which 10 years of service must be rendered in exchange for the benefits. That an employee must participate in the contributory active plan does not affect the determination of the attribution period. However, an employee would not be considered a **plan participant** if the employer expects that the employee will never contribute to the active plan and, therefore, will not be eligible to participate in the retiree plan.

**55-17** An employer's annual accrual for the service cost component of net periodic postretirement benefit cost should generally relate to only those employees who are in their credited service periods. However, if the credited service period begins later than the date of hire and is considered nominal relative to the employees' average total expected years of service to full eligibility, employees expected to receive benefits under the retiree plan should be considered plan participants at the date of hire, and the expected obligation for their benefits should be accrued from that date.

**55-18** In determining the attribution period, judgment is required to determine whether a credited service period is nominal. Generally, a nominal credited service period is a period that is very short compared to employees' average total expected years of service before full eligibility.

**>>> Attribution**

**55-56A** The following illustrates the guidance in paragraphs 715-60-35-61 through 35-70 related to attribution.

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**>>>> Attribution Pattern**

**>>>>> Attribution Period**

**55-57** A plan that provides benefit coverage to employees who render 30 or more years of service or who render at least 10 years of service and attain age 55 while in service, without specifying when the credited service period begins, the expected postretirement benefit obligation is attributed to service from the date of hire to the earlier of the date at which a plan participant has rendered 30 years of service or has rendered 10 years of service and attained age 55 while in service. However, for a plan that provides benefit coverage to employees who render at least 20 years of service after age 35, the expected postretirement benefit obligation is attributed to a plan participant's first 20 years of service after attaining age 35 or after the date of hire, if later than age 35.

**55-58** A plan with a benefit formula that defines 100 percent benefit coverage for service for the year in which employees attain age 60 has a 1-year credited service period. If plan participants are expected to have rendered an average of 20 years of service at age 60, the credited service period is nominal in relation to their total years of service before their full eligibility dates. In that case, the service cost is recognized from date of hire to age 60.

**>>>>> Frontloaded Plans**

**55-59** An example of a frontloaded plan is a life insurance plan that provides postretirement death benefits of $250,000 for 10 years of service after age 45 and $5,000 of additional death benefits for each year of service thereafter up to age 65 (maximum benefit of $300,000). For plans that frontload the benefit, the expected postretirement benefit obligation is attributed to employee service in accordance with the plan's benefit formula (see paragraph 715-60-35-62). In this example, the actuarial present value

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| | |
|---|---|
| | of a $25,000 death benefit is attributed to each of the first 10 years of service after age 45, and the actuarial present value of an additional $5,000 death benefit is attributed to each year of service thereafter up to age 65. |

Once an entity determines its actuarial present value of future benefits, it then attributes the actuarial present value of future benefits to past service (e.g. PBO or APBO) and current service (e.g. service cost) as described in section 8.6.

## Question 8.6.10

**How is the attribution period for recognizing the obligation and related service cost determined?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** A DB plan's benefit obligation and service cost is recognized over the attribution period. This period begins when the participant begins rendering services that entitle them to potential benefits and ends on the date the participant is fully eligible to receive the benefits (i.e. the full eligibility date). For pension plans, the full eligibility date may be the participant's retirement date, but for OPEB plans the full eligibility date may occur before the retirement date. [715-30-35-7, 715-60-35-68]

An entity must select an attribution method to assign amounts of the benefit obligation and service costs to each accounting period during the attribution period. [715-30-35-29]

## Example 8.6.10

**Attribution period matches service period**

### Background

An employee of ABC Corp. becomes fully eligible for benefits under an OPEB plan after five years of service. The plan states that if the employee dies or becomes disabled, benefits will be payable immediately.

### Analysis

If ABC expects the employee to render service over the next five years, it attributes benefits over that service period.

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If death or disability occurs during the five-year period and the employee becomes eligible to receive the benefits immediately – an acceleration of the benefits compared to expectations – then ABC remeasures the benefit obligation and recognizes a loss in AOCI at the next measurement date of the event.

If the employee is expected to terminate service within the next five years, an accrual is normally not required because the employee is not expected to receive benefits under the plan.

## Example 8.6.20●

## Traditional unit credit method

### Background

ABC Corp. established a new DB plan that provides employees with an annual retirement benefit of $300 for each year of service payable for as long as the participant lives (i.e. a single life annuity). The employee has 20 years of service and a salary of $80,000. The employee is age 42 and is expected to retire at age 65.

### Analysis

ABC uses the traditional unit credit method to measure the PBO because the benefit is a non-pay related benefit; the employee's salary is not relevant to the benefit the employee will receive. The PBO is calculated as the present value of $6,000 ($300 × 20 years) per year single life annuity commencing at age 65 and discounted back to age 42 using the assumed discount rate. The assumed discount rate reflects the rate at which the PBO could be effectively settled (see section 8.3).

## Example 8.6.30●

## Projected unit credit method

### Background

ABC Corp. established a new DB plan that provides an annual retirement benefit of 2% (for each year of service) of an employee's four-year average compensation earned over the last four years before retirement, payable as a single life annuity. The employee has 20 years of service and a current salary of $80,000. The employee's salary is expected to increase 3% each year. The employee is age 42 and is expected to retire at age 65.

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### Analysis

ABC uses the projected unit credit method to measure the PBO because the benefit depends on the employee's last four years' salary, which makes it a pay-related benefit.

| Employee Age | Salary |
|---|---|
| 61 | $ 140,280 |
| 62 | 144,489 |
| 63 | 148,824 |
| 64 | 153,288 |
| 4-year average | $ 146,720 |

At age 42, the PBO is calculated as the present value of a $58,688 ($146,720 × 2% × 20 years of service) per year single life annuity commencing at age 65 and discounted back to age 42 using the assumed discount rate. The assumed discount rate reflects the rate at which the PBO could be effectively settled (see section 8.3). At age 65, the PBO will be calculated as the present value of a $126,179 (146,720 × 2% × 43 years of service) per year single life annuity commencing at age 65.

## 8.7 Timing of measurement

**Excerpt from ASC 715-30**

**35 Subsequent Measurement**

**> Timing of Measurement**

**35-62** The measurements of plan assets and benefit obligations required by this Subtopic shall be as of the date of the employer's fiscal year-end statement of financial position except in both of the following cases:

**Excerpt from ASC 715-60**

**35 Subsequent Measurement**

**> Timing of Measurement**

**35-121** The measurements of plan assets and benefit obligations required by this Subtopic shall be as of the date of the employer's fiscal year-end statement of financial position, unless either of the following conditions applies:

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a. The plan is sponsored by a subsidiary that is consolidated using a fiscal period that differs from its parent's, as permitted by paragraph 810-10-45-12.
b. The plan is sponsored by an investee that is accounted for using the equity method of accounting under paragraph 323-10-35-6, using financial statements of the investee for a fiscal period that is different from the investor's, as permitted by that Subtopic.

**35-63** If the exceptions in the preceding paragraph apply, the employer shall measure the subsidiary's plan assets and benefit obligations as of the date used to consolidate the subsidiary's statement of financial position and shall measure the investee's plan assets and benefit obligations as of the date of the investee's financial statements used to apply the equity method. For example, if a calendar year-end parent consolidates a subsidiary using the subsidiary's September 30 financial statements, the funded status of the subsidiary's benefit plan included in the consolidated financial statements shall be measured as of September 30.

**35-63A** If an employer's fiscal year-end does not coincide with a month-end, the employer may measure plan assets and benefit obligations using the month-end that is closest to the employer's fiscal year-end. That election shall be applied consistently from year to year. The election shall be applied consistently to all of its defined benefit plans if an employer has more than one defined benefit plan.

**35-63B** If an employer measures plan assets and benefit obligations in accordance with paragraph 715-30-35-63A and a contribution or significant event caused by the employer (such as a plan amendment, settlement, or curtailment that calls for a remeasurement) occurs between the month-end date used to measure plan assets and benefit obligations and the employer's fiscal year-end, the employer shall adjust the fair value of plan assets and

a. The plan is sponsored by a subsidiary that is consolidated using a fiscal period that differs from its parent's, as permitted by paragraph 810-10-45-12.
b. The plan is sponsored by an investee that is accounted for using the equity method of accounting under Subtopic 323-10, using financial statements of the investee for a fiscal period that is different from the investor's, as permitted by paragraph 323-10-35-6.

**35-122** In those cases, the employer shall measure the subsidiary's plan assets and benefit obligations as of the date used to consolidate the subsidiary's statement of financial position and shall measure the investee's plan assets and benefit obligations as of the date of the investee's financial statements used to apply the equity method.

**35-123** For example, if a calendar year-end parent consolidates a subsidiary using the subsidiary's September 30 financial statements, the funded status of the subsidiary's benefit plan included in the consolidated financial statements shall be measured as of September 30.

**35-123A** If an employer's fiscal year-end does not coincide with a month-end, the employer may measure plan assets and benefit obligations using the month-end that is closest to the employer's fiscal year-end. That election shall be applied consistently from year to year. The practical expedient shall be applied consistently to all of its defined benefit plans if an employer has more than one defined benefit plan.

**35-123B** If an employer measures plan assets and benefit obligations in accordance with paragraph 715-60-35-123A and a contribution or significant event caused by the employer (such as a plan amendment, settlement, or curtailment that calls for a remeasurement) occurs between the month-end date used to measure plan assets

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the actuarial present value of benefit obligations so that those contributions or significant events are recognized in the period in which they occurred. An employer shall not adjust the fair value of plan assets and the actuarial present value of benefit obligations for other events occurring between the month-end date used to measure plan assets and benefit obligations and the employer's fiscal year-end that may be significant to the measurement of defined benefit plan assets and obligations, but are not caused by the employer (for example, changes in market prices or interest rates).

**35-64** Requiring that the pension measurements be as of a particular date is not intended to require that all procedures be performed after that date. As with other financial statement items requiring estimates, much of the information can be prepared as of an earlier date and projected forward to account for subsequent events (for example, employee service).

**35-65** Unless an entity remeasures both its plan assets and benefit obligations during the fiscal year, the funded status it reports in its interim-period statement of financial position shall be the same asset or liability recognized in the previous year-end statement of financial position adjusted for both of the following:

a. Subsequent accruals of net periodic pension cost that exclude the amortization of amounts previously recognized in other comprehensive income (for example, subsequent accruals of service cost, interest cost, and return on plan assets)
b. Contributions to a funded plan, or benefit payments.

**35-66** Paragraph 715-30-25-5 notes that, sometimes, an entity remeasures both plan assets and benefit obligations during the fiscal year, for example, when a significant event such as a plan amendment, settlement, or

and benefit obligations and the employer's fiscal year-end, the employer shall adjust the fair value of plan assets and the actuarial present value of benefit obligations so those contributions or significant events are recognized in the period in which they occurred. An employer should not adjust the fair value of plan assets and the actuarial present value of benefit obligations for other events occurring between the month-end date used to measure plan assets and benefit obligations and the employer's fiscal year-end that may be significant to the measurement of defined benefit plan assets and obligations, but are not caused by the employer (for example, changes in market prices or interest rates).

**35-124** Even though the postretirement benefit measurements are required as of a particular date, all procedures are not required to be performed after that date. As with other financial statement items requiring estimates, much of the information can be prepared as of an earlier date and projected forward to account for subsequent events (for example, employee service).

**35-125** Measurements of net periodic postretirement benefit cost for both interim and annual financial statements generally shall be based on the assumptions at the beginning of the year (assumptions used for the previous year-end measurements of plan assets and obligations) unless more recent measurements of both plan assets and the accumulated postretirement benefit obligation are available.

**35-126** For example, if a significant event occurs, such as a plan amendment, settlement, or curtailment, that ordinarily would call for remeasurement, the assumptions used for those later measurements shall be used to remeasure net periodic postretirement benefit cost from the date of the event to the year-end measurement date.

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curtailment occurs that calls for a remeasurement.

**35-66A** If a significant event caused by the employer (such as a plan amendment, settlement, or curtailment) that requires an employer to remeasure both plan assets and benefit obligations does not coincide with a month-end, the employer may remeasure plan assets and benefit obligations using the month-end that is closest to the date of the significant event.

**35-66B** If an employer remeasures plan assets and benefit obligations during the fiscal year in accordance with paragraph 715-30-35-66A, the employer shall adjust the fair value of plan assets and the actuarial present value of benefit obligations for any effects of the significant event that may or may not be captured in the month-end measurement (for example, if the closest month-end is before the date of a partial settlement, then the measurement of plan assets may include assets that are no longer part of the plan). An employer shall not adjust the fair value of plan assets and the actuarial present value of benefit obligations for other events occurring between the month-end date used to measure plan assets and benefit obligations and the employer's fiscal year-end that may be significant to the measurement of defined benefit plan assets and obligations, but are not caused by the employer (for example, changes in market prices or interest rates).

**35-67** As required by paragraph 715-30-25-5, upon remeasurement, an entity shall adjust its statement of financial position in a subsequent interim period to reflect the overfunded or underfunded status of the plan consistent with that measurement date.

**35-68** 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 or a significant

**35-126A** If a significant event caused by the employer (such as a plan amendment, settlement, or curtailment) that requires an employer to remeasure both plan assets and benefit obligations does not coincide with a month-end, the employer may elect to remeasure plan assets and benefit obligations using the month-end that is closest to the date of the significant event.

**35-126B** If an employer remeasures plan assets and benefit obligations during the fiscal year in accordance with paragraph 715-60-35-126A, the employer shall adjust the fair value of plan assets and the actuarial present value of benefit obligations for any effects of the significant event that may or may not be captured in the month-end measurement (for example, if the closest month-end is before the date of a partial settlement, then the measurement of plan assets may include assets that are no longer part of the plan). An employer shall not adjust the fair value of plan assets and the actuarial present value of benefit obligations for other events occurring between the month-end date used to measure plan assets and benefit obligations and the employer's fiscal year-end that may be significant to the measurement of defined benefit plan assets and obligations, but are not caused by the employer (for example, changes in market prices or interest rates).

**35-127** Unless an employer remeasures both its plan assets and benefit obligations during the fiscal year, the funded status it reports in its interim-period statement of financial position shall be the same asset or liability recognized in the previous year-end statement of financial position adjusted for subsequent accruals of net periodic postretirement benefit cost that exclude the amortization of amounts previously recognized in other comprehensive income (for example, subsequent accruals of service cost, interest cost, and return on plan assets) and contributions to a funded plan, or benefit payments.

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event occurs, such as a plan amendment, that would ordinarily call for such measurements.

**55 Implementation Guidance and Illustrations**

**>> Timing of Measurements**

**55-56** Paragraph 715-30-35-68 provides guidance on measuring net periodic pension cost when measurements more recent than the previous year-end are available and establishes that the measurement of net periodic pension cost shall be based on the most recent measurements of plan assets and obligations.

**55-57** It may be necessary to have an actuarial valuation as of the employer's fiscal year-end (for example, December 31) in addition to the actuarial valuation made as of the pension plan's preceding year-end (for example, June 30). In such an example, 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).

**55-58** If an employer that has a December 31 financial report 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, net periodic pension cost for the remainder of the fiscal year should be based on the most recent pension measurements. Net periodic pension cost for the preceding interim periods should not be adjusted.

**55-59** An employer may use a measurement date of December 31 but not complete the actual measurements until some time later, for example, in January. In this situation, the determination of the pension obligations should not be based on the assumed discount rates and other actuarial assumptions as of January. The employer should use the actuarial assumptions, including assumed

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discount rates, that were appropriate as of the measurement date of December 31 because the objective is to determine the various pension measurements, including plan assets, as of that date.

**55-60** The projected benefit obligation reflects the **actuarial present value** of all benefits attributed to employee service rendered before the date of the employer's fiscal year-end statement of financial position, with limited exceptions as addressed in paragraphs 715-30-35-62 through 35-68. The measurement of that obligation shall be based on actuarial assumptions appropriate for the date of the employer's fiscal year-end statement of financial position (for example, **turnover**, **mortality**, **discount rates**, and so forth) and census data as of that date.

**55-61** If an actuarial valuation is made as of a pension plan's year-end and that date precedes the date of the employer's fiscal year-end statement of financial position, it is, however, not always necessary to have another actuarial valuation made as of that date. If an employer is assured that the reliability of the measurement of that obligation determined by rolling forward data based on a valuation before the date of the employer's fiscal year-end statement of financial position 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 before the financial report date if it has been demonstrated that reliance can be placed on perpetual records or another system that reflects subsequent events.

Subtopic 715-30 requires that measurements of plan assets and benefit obligations be as of the date of the entity's fiscal year-end balance sheet. If the entity's fiscal year-end does not coincide with a calendar month-end, it permits the

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entity to use the calendar month-end closest to the end of the fiscal year as the measurement date. If an entity adopts a calendar month-end that differs from its fiscal year-end, it must consistently apply that chosen annual measurement date to all of its DB plans. [715-30-35-62, 715-30-35-63A, 715-60-35-121, 715-60-123A]

Remeasurements of plan assets and benefit obligations occur if a significant event (e.g. a plan amendment, settlement or curtailment) occurs during the fiscal year. If the significant event does not coincide with a month-end, the entity may remeasure using the month-end that is closest to the significant event's date. [715-30-35-66A, 715-60-35-126A]

If a significant event requiring remeasurement occurs between the annual measurement date and the entity's fiscal year-end (when those dates do not coincide), the entity must adjust the plan assets' fair value and the benefit obligations' actuarial present value so that the significant event is recognized in the annual period. An entity should not make such adjustments for other events occurring between these two dates that may be significant to the measurement of DB plan assets and obligations, but are not caused by the entity (e.g. changes in market prices or interest rates). [715-30-35-63B, 715-60-35-123B]

## Question 8.7.10

### What are the methods to roll forward an obligation to the measurement date?

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Measurements of plan assets and benefit obligations are as of the date of the entity's fiscal year-end balance sheet. Interim measurements of plan assets and benefit obligations occur if a significant event (e.g. a plan amendment, settlement or curtailment) occurs during the fiscal year. The measurement date may be the closest month-end if an entity's fiscal year-end or if a significant event does not coincide with a calendar month-end. See Question 8.7.90 for subsidiary considerations. [715-30-35-63A, 715-30-35-65]

Subtopic 715-30 states that estimates, averages or computational shortcuts are appropriate if their results are reasonably expected not to materially differ from the results of a detailed application. Further, an entity can prepare much of the information at an earlier date and project it forward. Over the years, this has led to the general practice of using benefit obligation rollforward techniques. [715-30-35-1, 715-60-35-1]

Reasons for using benefit obligation rollforward techniques include:

— the inability to timely update census information to be as of the measurement date related to when financial statements are issued;
— differences between the plan year and sponsor's fiscal year – e.g. July 1 to June 30 plan year versus January 1 to December 31 fiscal year for the sponsor; and

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— insufficient time to update actuarial assumptions such as base year claims cost for OPEB benefits.

Actuaries often collect census data information as of the beginning of the plan year to perform funding actuarial valuations. This same census data is typically used to perform Topic 715 actuarial valuations for the plan sponsor. Because the census data is collected once as of a point in time (e.g. January 1 for a calendar fiscal year-end entity), actuaries often refer to this census data as snap-shot census data. [715-30-35-64]

The general benefit rollforward technique involves snap-shot census data to compute a beginning-of-the-plan-year benefit obligation and:

— increasing the benefit obligation by service cost and interest cost during the period;
— reducing the benefit obligation for actual benefits paid during the period; and
— adjusting for
  – unanticipated activity that occurred during the period – e.g. plan amendments, reduction in force that was not considered significant enough to result in an interim remeasurement, and
  – changes in actuarial assumptions – e.g. discount rate, mortality.

An entity uses the rollforward information to compute the following fiscal year's net periodic benefit cost. In using this rollforward technique, it considers all relevant facts and circumstances that existed as of the measurement date to the extent known or knowable before issuing the financial statements. [715-30-35-64]

An entity then updates its calculation of the following fiscal year's net periodic benefit cost based on updated census data, and possibly updates in some actuarial assumptions, to compute a final net periodic benefit cost. The updated information used to compute the final net periodic benefit cost typically becomes available in Q2 or Q3 of the following fiscal year. It is generally developed in connection with a new beginning-of-year valuation that the entity performs to comply with IRS funding requirements for qualified US pension plans. The current year net periodic benefit cost is then adjusted up or down when the updated beginning-of-year valuation is obtained. The entity makes a one-time catch-up adjustment in the current month or spreads the adjustment over the remaining months of the fiscal year. [715-30-35-64]

When information is identified after the financial statements are issued, an entity considers whether the prior-period financial statements contain an error using the guidance in Topic 250. If the information does not indicate an error in the previously issued financial statements, the entity evaluates whether the benefit obligation using the updated information materially differs from the disclosed benefit obligation. A material difference may warrant adjusting the balance sheet amounts (benefit obligation and AOCI) and disclosing the effect in the quarter in which the adjustments are recognized. See chapter 4 of KPMG Handbook, Accounting changes and error corrections. [715-30-35-64]

In lieu of a benefit rollforward technique, some entities use an end-of-the-year valuation. The end-of-the-year valuation may be based on beginning-of-the-year or end-of-the-year census information. For example, an entity may use beginning-of-the-year census information for its qualified pension plan and end-of-the-year census information for its nonqualified supplemental pension plan due to the different sizes of the respective plan populations. [715-30-35-64]

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### Guidance specific to Subtopic 715-60

When considering relevant facts and circumstances that existed as of the measurement date, an entity bases prior-year healthcare claims information used in developing the base year claims cost assumption on the best information available at the time the financial statements are issued. [715-60-35-123A, 715-60-35-124]

## Question 8.7.20

**Are entities ever required to remeasure plan assets and benefit obligations during the year?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Yes, in certain circumstances. An entity may be required to remeasure plan assets and benefit obligations during the year (i.e. a date other than its annual measurement date) due to a significant event such as a plan amendment, settlement or curtailment caused by the entity. Settlements and curtailments are discussed in chapter 9. Although remeasurement is required at the date of the significant event, an entity is permitted to remeasure as of the closest month-end to the significant event. [715-30-35-66 – 35-66A, 715-60-35-126 – 35-126A]

An entity that uses the closest month-end date as its remeasurement date adjusts the fair value of the plan assets and actuarial present value of the benefit obligation at the month-end for the effects of the significant event caused by the entity. However, see also Example 8.2.10, which discusses interim remeasurements for healthcare plans when new facts become known. [715-30-35-66A, 715-60-35-126A – 35-126B]

## Question 8.7.30

**How is a significant event that occurs between a measurement date and a fiscal year-end accounted for?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** If an entity's fiscal year-end does not coincide with a month-end and the entity uses the closest month-end as its measurement date, contributions or other significant events that occur between the month-end measurement date and its fiscal year-end may or may not be captured in the measurement of its DB plan assets and obligations as of month-end.

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Therefore, Topic 715 requires an entity to adjust the net asset or liability recognized on the balance sheet for contributions and significant events caused by the entity that occur between the month-end measurement date and its fiscal year-end. This ensures the net asset or liability accurately reflects the funded status of the plan as of the entity's fiscal year-end. The entity does not need to adjust the net asset or liability recognized on the balance sheet for other significant events that are not caused by the entity (e.g. changes in market prices or interest rates). [715-30-35-63A – 35-63B, 715-60-35-123A – 123B, ASU 2015-04.BC8–BC11]

The following table illustrates how to adjust plan assets and benefit obligations as of the month-end measurement date when a significant event occurs between the measurement date and the entity's fiscal year-end. [715-30-35-66A – 35-66B, 715-60-35-126A – 126B]

| | Measurement date after fiscal year-end | | Measurement date before fiscal year-end | |
|---|---|---|---|---|
| **Event** | **Effect on obligation** | **Effect on plan assets** | **Effect on obligation** | **Effect on plan assets** |
| Contribution | — | Subtract | — | Add |
| Settlement | Add | Add | Subtract | Subtract |
| Positive amendment | Subtract | — | Add | — |
| Negative amendment | Add | — | Subtract | — |
| Curtailment decrease | Add | — | Subtract | — |
| Curtailment increase | Subtract | — | Add | — |

## Question 8.7.40

### Are voluntary remeasurements permitted?

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Yes, in certain circumstances. Remeasurements during the year are *required* in some circumstances, such as when a significant event like a plan amendment occurs.

Voluntary remeasurements in interim periods are *permitted*. Examples include when an entity: [715-30-35-62 – 35-68]

- has a policy to remeasure every period (e.g. quarterly); or
- decides to voluntarily remeasure in response to infrequently occurring events other than plan amendments, curtailments or settlements that are not considered significant events. However, an entity that voluntarily

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remeasures at an interim date in this circumstance establishes a policy and will need to remeasure if similar circumstances arise at a future date.

## Example 8.7.10

### Remeasurement for a plan amendment

#### Background

ABC Corp's fiscal year ends on December 31. On October 31, Year 1 (amendment date) ABC's board of directors approves a plan amendment to retroactively increase pension benefits for plan participants beginning January 1, Year 2 (effective date). ABC considers this plan amendment to be a significant event requiring remeasurement.

#### Analysis

ABC remeasures the plan assets and benefit obligation as of October 31, Year 1 provided that the amendment has been communicated to its plan participants within a reasonable period of time. It records the revised amount of net periodic pension cost in November and December, Year 1.

Also see Example 8.2.10 for an interim remeasurement when new facts become known related to a change in healthcare cost trend rates.

## Question 8.7.50

### When is a plan amendment significant?

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Topic 715 does not define the term significant event, and therefore entities need to use judgment. We believe that an entity should assess whether the result of the plan amendment is significant based only on an evaluation of the effect of the plan amendment compared with the benefit obligation. The entity should ignore the effect of the other assumption changes that would be incorporated into a new measurement. An entity should elect a policy of what constitutes a significant event and how significance would be evaluated.

For example, we believe it would be acceptable for an entity to implement the following policy.

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— Events that cause a change greater than 10% of the benefit obligation constitute a significant event.
— For events that cause a change of between 5% and 10% of the benefit obligation, the entity evaluates the qualitative aspects of the event.
— Events that cause a change of less than 5% of the benefit obligation are not considered significant.

See Question 9.4.15 for a related discussion about determining when the effects of a curtailment are significant.

## Question 8.7.60

**Does a significant change in the fair value of plan assets or other changes in estimates require a remeasurement?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Not necessarily. Generally, a significant change in the fair value of plan assets or changes in the estimate of a parameter used in measurements are not events that require remeasurement of plan assets and obligations during an interim period.

As discussed in Question 8.7.40, an entity may decide to voluntarily remeasure its plan assets and obligations in response to infrequently occurring events and may consider a significant change in the fair value of assets or other changes in estimates as one such event. However, if the entity voluntarily remeasures at an interim date in response to these circumstances, it has established a policy, and it would need to remeasure if the same circumstances arise at a future date. [715-30-35-66 – 35-68, 715-60-35-127]

If, however, the fair value of plan assets changes significantly after the previous fiscal year-end measurement date, we believe an entity should consider disclosing the potential effect of that change on future funding requirements and future changes in amortization of gains and losses in the quarterly or annual financial statements.

## Question 8.7.70

**On what date does an entity remeasure its plan assets and obligation for a plan amendment?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** When an entity considers a plan amendment to be a significant event, it remeasures on the date the plan amendment is approved, as long as the changes are also communicated to the plan participants within a

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reasonable period. Topic 715 describes 'a reasonable period of time' relative to this communication requirement as being 'within' the time period that would ordinarily be required to prepare information about the amendment and disseminate it to employees and retirees. [715-60-35-21]

If the entity delays communicating the plan amendment to participants and the length of that delay is considered unreasonable, the existing unamended plan continues to be the substantive plan that should be accounted for; this is because it represents the last plan whose terms were mutually understood by the entity and the plan participants.

From the remeasurement date forward, the entity records the revised amount of net periodic benefit cost, which includes revised amounts for: [715-30-35-10, 715-60-35-12]

- service cost;
- interest cost;
- amortization of prior service cost; and
- amortization of gains/losses.

An entity would not wait until the effective date of the plan amendment to remeasure the plan assets and benefit obligation. See Example 8.7.10. [715-30-25-5, 715-30-35-66, 715-60-35-21, 715-60-55-19]

## Question 8.7.80

### How does an entity account for changes in an estimate after the measurement date?

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** An entity may obtain improved actuarial data to determine its pension obligations after the measurement date such as from a compilation of annual census data. The compilation of that data is not considered a significant event that requires remeasuring plan assets and liabilities. That information also would not require an entity to revise previously determined year-end measurements or funded status. However, we believe it is acceptable to update the current-year benefit cost estimate and the pension obligation (Practice 2 in Example 8.7.20).

In contrast, if it is determined that the initial measurements were in error – e.g. due to the misuse of facts that existed at the time of initial measurement – the effect on previously reported year-end and interim results should be evaluated to determine whether it is material. The data should be used to update measures of net periodic benefit cost in the current period. Question 8.7.10 discusses rollforwards.

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## Example 8.7.20

### Change in estimate

#### Background

ABC is a calendar fiscal year-end entity with a December 31 measurement date. To estimate the PBO for its pension plan as of December 31, Year 1 ABC used the census data as of January 1, Year 1 and rolls it forward to December 31 using various actuarial assumptions. ABC uses this calculation for purposes of its fiscal year-end financial statements for Year 1 and to generate an estimate of the pension cost for Year 2.

ABC takes a considerable amount of time with its actuary to annually collect the census data and refine it for missing data and errors and completes its analysis of the January 1, Year 2 census data on June 30, Year 2. ABC identifies differences in the calculations of the Year 1 fiscal year-end benefit obligation and/or the estimate of Year 2 net periodic pension cost when it compares the results of the detailed collection process with the estimate that was prepared using the prior year data rolled forward.

If the estimates performed at the measurement date are not materially different nor in error – i.e. they fairly reflected the facts available at the time the estimates were made – ABC chooses between two acceptable practices.

#### Practice 1: No adjustments

Under this practice, ABC and its actuary make no adjustments to the Year 2 estimated net periodic pension cost or to the December 31, Year 1 benefit obligation. Changes are reflected at the next measurement date as a gain or loss in AOCI.

#### Practice 2: Update current-year cost estimate and pension obligation

Under this practice, ABC updates the Year 2 net periodic pension cost estimate and the pension obligation / AOCI. The new valuation as of December 31, Year 1 (with no changes in assumptions other than updated census data) is finalized on June 30, Year 2 and results in an increase to the PBO of $1 million and an increase in Year 2 benefit cost of $100,000.

ABC records the following journal entries at June 30, Year 2.

| | *Debit* | *Credit* |
|---|---|---|
| AOCI | 1,000,000 | |
| PBO | | 1,000,000 |
| *To recognize increase in Dec. 31, Year 1 PBO.* | | |

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| | *Debit* | *Credit* |
|---|---|---|
| Pension cost | 50,000 | |
| PBO | | 50,000 |
| *To recognize additional current year pension cost for 6 months ended June 30, Year 2.* | | |

## Question 8.7.90

### Does an equity method investee or subsidiary measure plan assets and obligations using the investor/parent's measurement date?

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** No. Equity method investees and subsidiaries that sponsor a DB plan measure plan assets and obligations as of their own fiscal year-ends for purposes of their stand-alone financial statements. If differences exist in the fiscal year-ends, there is no requirement to remeasure the equity method investee's or subsidiary's plan assets and obligations to coincide with the investor's or parent's measurement date if the investee or subsidiary has a fiscal year-end that is within three months of the investor's / parent's fiscal year-end. [715-30-35-62]

The investor or parent measures the investee's or subsidiary's plan assets and benefit obligations as of: [715-30-35-63]

— the date used to consolidate the subsidiary; or
— the date of the investee's financial statements that are used to apply the equity method of accounting. See chapter 7 of KPMG Handbook, Consolidation.

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# 9. DB pension and OPEB plans: Settlement, curtailment and certain termination benefits

## Detailed contents

**Item significantly updated in this edition #**



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## 9.1 How the standard works

Subtopics 715-30 and 715-60 address the accounting for settlements and curtailments. These are defined under Topic 715 as follows.

— **Settlement.** A transaction that is an irrevocable action, relieves the entity (or the plan) of primary responsibility for a pension or OPEB obligation, and eliminates significant risks related to the obligation and the assets used to effect the settlement.

— **Curtailment.** An event that significantly reduces the 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.

Subtopics 715-30 and 715-60 also address accounting for special or contractual termination benefits provided by DB plans. These termination benefits are discussed in this chapter, and termination benefits provided outside DB plans are discussed in chapter 4.

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# 9.2 Overview

## Excerpt from ASC 715-30

**05 Overview and Background**

**05-9** The Settlements, Curtailments, and Certain Termination Benefits Subsections establish standards for an employer's accounting for **settlement** of defined benefit pension obligations, for **curtailment** of a **defined benefit pension plan**, and for certain termination benefits, and define the events that require adjustments to assets and liabilities and that require certain amounts previously recognized in accumulated other comprehensive income to be recognized in earnings. The Settlements, Curtailments, and Certain Termination Benefits Subsections provide guidance that results in the net **gain or loss** and **prior service cost**, which were previously recognized in accumulated other comprehensive income, being recognized in income in the period when specific conditions are met.

**15 Scope and Scope Exceptions**

**> Overall Guidance**

**15-5** The Settlements, Curtailments, and Certain Termination Benefits Subsections follow the same Scope and Scope Exceptions as outlined in the General Subsection of this Subtopic, see paragraph 715-30-15-1, with specific exceptions noted below.

**> Transactions**

**15-6** The guidance in the Settlements, Curtailments, and Certain Termination Benefits Subsections applies to the following transactions and activities:

## Excerpt from ASC 715-60

**05 Overview and Background**

**05-12** The Settlements, Curtailments, and Certain Termination Benefits Subsections provide guidance on an employer's accounting for **settlement** of defined benefit postretirement obligations, for **curtailment of a defined benefit postretirement plan**, and for **termination benefits**.

**15 Scope and Scope Exceptions**

**> Overall Guidance**

**15-14** The Settlements, Curtailments, and Certain Termination Benefits Subsections follow the same Scope and Scope Exceptions as outlined in the General Subsection of this Subtopic, see paragraph 715-60-15-1, with specific exceptions noted below.

**> Transactions**

**15-15** The guidance in the Settlements, Curtailments, and Certain Termination Benefits Subsections applies to the following transactions and activities:

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a. If all or part of the plan's pension benefit obligation is settled or the plan is curtailed:
   1. Plan settlements. Examples of transactions that constitute a **settlement** include making lump-sum cash payments to plan participants in exchange for their rights to receive specified **pension benefits** and purchasing nonparticipating annuity contracts to cover **vested benefits**.
   2. **Plan curtailments**, which include:
      i. Termination of employees' services earlier than expected, which may or may not involve closing a facility or discontinuing a component of an entity.
      ii. Termination or suspension of a plan so that employees do not earn additional defined benefits for future services. In the latter situation, future **service** may be counted toward vesting of benefits accumulated based on past service.
b. Termination benefits provided under an ongoing defined benefit pension arrangement.
c. Other termination benefits not otherwise addressed in the following:
   1. Topic 420
   2. Topic 710
   3. Topic 712
   4. Subtopic 715-60.

**15-7** The guidance in the Settlements, Curtailments, and Certain Termination Benefits Subsections does not apply to the following transactions and activities:

a. An employer's withdrawal from a multiemployer pension plan
b. Other termination benefits addressed in the following:

a. **Settlement** of all or a part of an employer's **accumulated postretirement benefit obligation** or **curtailment of a postretirement benefit plan**
b. Other **termination benefits** not otherwise addressed in the following:
   1. Topic 420
   2. Topic 710
   3. Topic 712
   4. Subtopic 715-30.

**15-16** Examples of transactions that constitute a settlement include making lump-sum cash payments to **plan** participants in exchange for their rights to receive specified **postretirement benefits** and purchasing long-term nonparticipating insurance contracts for the accumulated postretirement benefit obligation for some or all of the plan participants.

**15-17** Curtailments include the following:

a. Termination of employees' services earlier than expected, which may or may not involve closing a facility or discontinuing a component of an entity
b. Termination or suspension of a plan so that employees do not earn additional **benefits** for future service. In the latter situation, future service may be counted toward eligibility for benefits accumulated based on past service.

**15-18** The guidance in the Settlements, Curtailments, and Certain Termination Benefits Subsections does not apply to the following transactions and activities:

a. Other termination benefits addressed in the following:
   1. Topic 420
   2. Topic 710
   3. Topic 712
   4. Subtopic 715-30.

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1. Topic 420
2. Topic 710
3. Topic 712
4. Subtopic 715-60.

**25 Recognition**

**25-4** The Settlements, Curtailments, and Certain Termination Benefits Subsections provide recognition guidance for the postretirement benefit incentive to be received by employees in exchange for early termination. **Postretirement benefits** offered as special or contractual termination benefits shall be recognized in accordance with paragraph 715-30-25-10.

**25-5** Situations involving special or contractual **termination benefits** may also result in a curtailment to be accounted for under paragraphs 715-60-35-161 through 35-171.

**25-6** The liability and loss recognized for employees who accept an offer of special termination benefits to be provided by a **postretirement benefit plan** shall be the difference between:

a. The **accumulated postretirement benefit obligation** for those employees, assuming that those employees (**active plan participants**) not yet fully eligible for **benefits** would terminate at their **full eligibility date** and that **fully eligible plan participants** would retire immediately, without considering any special termination benefits
b. The accumulated postretirement benefit obligation as measured in (a) adjusted to reflect the special termination benefits.

See Example 4 (paragraphs 715-60-55-135 through 55-139) and Example 7 (paragraphs 715-60-55-161 through 55-175).

**35 Subsequent Measurement**

**35-149** This Subtopic provides for delayed recognition in **net periodic postretirement benefit cost** of the effects

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| | |
|---|---|
| | of a **plan** initiation or a **plan amendment**, the **transition obligation** or **transition asset**, and gains or losses arising in the ordinary course of operations. That is, generally, those amounts are recognized in other comprehensive income with subsequent **amortization** in net periodic postretirement benefit cost. However, in certain circumstances, as discussed in these Subsections, recognition in net periodic postretirement benefit cost of some or all of those amounts initially recognized in other comprehensive income is appropriate. |

Chapter 7 describes accounting for amendments to DB plans that increase benefits to plan participants and result in an increase to the benefit obligation and additional costs. This chapter addresses other events that may impact the benefit obligation and related costs.

The following are common ways in which each type of event may occur; see also Question 9.2.20.

| Event | How the event may occur | Reference |
|---|---|---|
| **Settlement** | — Making lump-sum payments to participants in exchange for their right to pension benefits.<br>— Purchasing nonparticipating insurance contracts. | Section 9.3, Section 10.2 |
| **Curtailment** | — Terminating employees' services earlier than expected – e.g. by closing a facility or division.<br>— Terminating or suspending a plan so that employees do not earn additional defined benefits for future services. | Section 9.4 |
| **Negative plan amendment** | — Reducing plan benefits.<br>— Extending service lives by delaying pension age. | Section 9.4 |

Section 9.5 discusses events that cause a settlement and a curtailment.

Section 9.6 addresses the accounting for an increase to the benefit obligation and related cost under the terms of an existing DB plan in connection with the termination of employees. Section 9.7 reviews some presentation matters that arise related to these events.

Chapter 4 discusses termination benefits outside the scope of Topic 715.

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## Question 9.2.10
**What is the difference between a settlement, curtailment and negative plan amendment?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** A decrease in benefits under a DB plan can relate to prior service or future service periods.

— A plan amendment that reduces or eliminates benefits already earned during prior service periods is called a negative plan amendment.
— A plan amendment that reduces future service periods or eliminates – partial or total – defined benefits for future services for a significant number of employees is a curtailment.

A settlement is a transaction that relieves the entity of primary responsibility for the benefit obligation and eliminates significant risks related to the obligation and plan assets and cannot be reversed or changed (i.e. it is irrevocable). Additionally, an entity can partially curtail its obligation resulting in a curtailment.

We believe determining whether there is a curtailment or a negative plan amendment requires judgment (see Example 9.4.10).

As discussed in section 9.5, settlements and curtailment events may be difficult to distinguish from each other and can occur simultaneously.

## Question 9.2.20
**What are example settlements, curtailments and plan amendment scenarios?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** The following table provides example scenarios that help to distinguish between a plan amendment, settlement and curtailment.

| Scenario | Plan change | Explanation | Reference |
|---|---|---|---|
| Entity makes lump-sum payments to plan participants | Plan settlement | This is an example of a ***plan settlement*** because it irrevocably relieves the entity of its responsibility for a benefit obligation and | Section 9.3 |

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| Scenario | Plan change | Explanation | Reference |
|---|---|---|---|
| in exchange for their right to a pension benefit. | | eliminates significant risks related to the obligation. | |
| Entity increases plan participants' pension benefit from 1.5% to 3% of final salary. | Positive plan amendment | This is an example of a ***positive plan amendment*** because it changes the existing terms of the plan by increasing participants' benefits and the entity's obligation. It does not reduce the entity's obligation (which would be positive from a financial perspective). | Section 7.3.20 |
| Entity terminates plan participants' services earlier than expected, due to the closing of a plant. | Plan curtailment | This is an example of a ***plan curtailment*** because the plant closure significantly reduces the expected future years of service of present employees (i.e. those that work at the plant).<br>A curtailment can also eliminate the accrual of benefits for some (or all) future services for a significant number of employees. | Section 9.4 |
| Entity decreases plan participants' postretirement healthcare benefits accumulated for prior service from a maximum of $30,000 per year to $20,000 per year. | Negative plan amendment | This is an example of a ***negative plan amendment*** because it changes the existing terms of the plan by decreasing the entity's obligation (and decreasing participants' benefits).<br>In contrast, a plan curtailment reduces the expected future years of service of present employees or eliminates for a significant number of employees the accrual of benefits for some or all of their future services. | Section 9.4 |

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### Question 9.2.30
**Does an entity combine plans when determining the effect of a settlement or curtailment?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** No. An entity generally does not divide or combine plans when determining the effect of a settlement or curtailment. Sections 9.3 and 9.4 discuss accounting for settlements and curtailments, respectively. Section 9.5 discusses events that cause both a settlement and curtailment. [715-30-15-5, 715-60-15-14]

## 9.3 Accounting for a settlement

| Excerpt from ASC 715-30 | Excerpt from ASC 715-60 |
|---|---|
| **20 Glossary** | **20 Glossary** |
| **Settlement of a Pension or Postretirement Benefit Obligation –** A transaction that is an irrevocable action, relieves the employer (or the plan) of primary responsibility for a pension or postretirement benefit obligation, and eliminates significant risks related to the obligation and the assets used to effect the settlement. | **Settlement of a Pension or Postretirement Benefit Obligation –** A transaction that is an irrevocable action, relieves the employer (or the plan) of primary responsibility for a pension or postretirement benefit obligation, and eliminates significant risks related to the obligation and the assets used to effect the settlement. |
| **35 Subsequent Measurement** | **35 Subsequent Measurement** |
| **> Settlements** | **> Remeasurement of Cost Due to Settlements** |
| **35-79** The maximum gain or loss subject to recognition in earnings when a pension obligation is settled is the net gain or loss remaining in accumulated other comprehensive income plus any transition asset remaining in accumulated other comprehensive income from initial application of this Subtopic. That maximum amount includes any gain or **loss** first measured at the time of settlement. The maximum | **35-150 Settlements** are events that may require income or expense recognition of certain amounts initially recognized in other comprehensive income and adjustments to liabilities or assets recognized in the employer's statement of financial position. The settlement of all or part of the **accumulated postretirement benefit obligation** is an event that requires recognition in income |

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amount shall be recognized in earnings if the entire **projected benefit obligation** is settled. If only part of the projected benefit obligation is settled, the employer shall recognize in earnings a pro rata portion of the maximum amount equal to the percentage reduction in the projected benefit obligation. If the purchase of a **participating annuity contract** constitutes a settlement under the guidance in paragraphs 715-30-35-85 through 35-89, the maximum gain (but not the maximum loss) shall be reduced by the cost of the **participation right** before determining the amount to be recognized in earnings.

**35-80** See Example 2 (paragraph 715-30-55-202) for illustrations of the settlement related guidance presented in this Subsection.

**35-81 Plan assets** and the projected benefit obligation shall be measured as of the date the settlement occurs (that is, as of the date that the criteria for a settlement are met and settlement accounting becomes appropriate) to determine the maximum gain or loss subject to pro rata recognition in earnings and the percentage reduction in the projected benefit obligation. The effects of a settlement can be reliably measured only if based on measures of plan assets and the projected benefit obligation as of the date of the settlement because intervening events (such as investment gains or losses, or gains or losses from changes in interest rates) after a prior measurement date could change the relevant amounts.

**35-82** Recognition in earnings of gains or losses from settlements is required 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. However, if the cost of all settlements in a year is less than or equal to the sum of the service cost and interest cost components of net periodic pension cost for the plan for the year, gain or loss

of all or part of a net **gain or loss** and transition asset remaining in accumulated other comprehensive income. A settlement also may accelerate recognition in income of a transition obligation under the constraint in paragraph 715-60-35-39.

**35-151** For purposes of this Subsection, the maximum gain or loss subject to recognition in income when a postretirement benefit obligation is settled is the net **gain or loss** included in accumulated other comprehensive income defined in paragraphs 715-60-35-23 through 35-32 plus any transition asset remaining in accumulated other comprehensive income. That maximum gain or loss includes any gain or loss resulting from remeasurements of **plan assets** and the accumulated postretirement benefit obligation at the time of settlement.

**35-152** If the entire accumulated postretirement benefit obligation is settled and the maximum amount subject to recognition is a gain, the settlement gain shall first reduce any transition obligation remaining in accumulated other comprehensive income; any excess gain shall be recognized in income.

**35-153** If the entire accumulated postretirement benefit obligation is settled and the maximum amount subject to recognition is a loss, the maximum settlement loss shall be recognized in income. If only part of the accumulated postretirement benefit obligation is settled, the employer shall recognize in income the excess of the pro rata portion (equal to the percentage reduction in the accumulated postretirement benefit obligation) of the maximum settlement gain over any remaining transition obligation or a pro rata portion of the maximum settlement loss.

**35-154** As discussed in paragraph 715-60-35-39, in measuring the gain or loss subject to recognition in income when a postretirement benefit obligation is settled, an employer must determine whether recognition in income

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recognition in earnings is permitted but not required for those settlements. The accounting policy adopted for recognition in earnings of gains or losses from settlements shall be applied consistently from year to year.

**35-83** The cost of a settlement is determined as follows for each of the different settlement types:

a. For a cash settlement, the amount of cash paid to employees
b. For a settlement using nonparticipating annuity contracts, the cost of the contracts
c. For a settlement using participating annuity contracts, the cost of the contracts less the amount attributed to participation rights. See paragraph 715-30-35-57.

**>> Using Annuity Contracts in Settlement Transactions**

**35-84** The intent of the guidance in this Subsection is that if the substance of an insurance contract is such that the employer remains subject to all or most of the risks and rewards associated with the covered pension benefit obligation or the assets transferred to the insurance entity, the purchase of the contract does not constitute a settlement. The circumstances under which an employer shall recognize in earnings the net gain or loss included in accumulated other comprehensive income are limited and such recognition shall not occur if the settlement transaction is between an employer and an entity that it controls because such a transaction merely shifts the risks from one part of the entity to another part of the same entity.

**35-85** **Annuity contracts** purchased from an entity that is controlled by the employer are excluded from settlement accounting. Therefore, an employer that purchases annuity contracts from an insurance entity that it controls shall not recognize any settlement gain or loss associated with the

of an additional amount of any transition obligation remaining in accumulated other comprehensive income is required pursuant to the constraint on delayed recognition in income. Any additional transition obligation required to be recognized in income as a result of a settlement is recognized when the related settlement is recognized (see paragraph 715-60-35-40).

**35-155** Because the plan is the unit of accounting, the determination of the effects of a settlement considers only the net gain or loss and transition obligation or asset included in accumulated other comprehensive income related to the plan for which all or a portion of the accumulated postretirement benefit obligation is being settled.

**35-156** If the purchase of a **participating insurance** contract constitutes a settlement, the maximum gain (but not the maximum loss) shall be reduced by the cost of the **participation right** before determining the amount to be recognized in income (see paragraphs 715-60-35-109 through 35-120 and 715-60-35-160).

**35-157** For the following types of settlements, the cost of the settlement is:

a. For a cash settlement, the amount of cash paid to plan participants
b. For a settlement using nonparticipating insurance contracts, the cost of the contracts
c. For a settlement using participating insurance contracts, the cost of the contracts less the amount attributed to participation rights (see paragraphs 715-60-35-115 and 35-116).

**35-158** If the cost of all settlements in a year is less than or equal to the sum of the service cost and interest cost components of net postretirement benefit cost for the plan for the year, gain or loss recognition is permitted but not

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transaction (that is, the transaction does not qualify for settlement accounting).

**35-86** If there is any reasonable doubt that the insurance entity will meet its obligations under the annuity contract, the purchase of the contract does not constitute a settlement.

**35-87** If the substance of a **participating annuity contract** is such that the employer remains subject to all or most of the risks and rewards associated with the benefit obligation covered or the assets transferred to the insurance entity, the purchase of the contract does not constitute a settlement.

**35-88** It may be difficult to determine the extent to which a participating annuity contract exposes the purchaser to the risk of unfavorable experience, which would be reflected in lower than expected future dividends. Additionally, under some annuity contracts described as participating, the purchaser might remain subject to all or most of the same risks and rewards related to future experience that would have existed had the contract not been purchased. Some **participating insurance** contracts may require or permit payment of additional premiums if experience is unfavorable. Accordingly, if a participating insurance contract requires or permits payment of additional premiums because of experience losses, or if the substance of the contract is such that the purchaser retains all or most of the related risks and rewards, the purchase of that contract does not constitute a settlement.

**35-89** An employer may decide to make up a deficiency in annuity contract payments following a settlement and subsequent insolvency by the insurance entity. The following guidance addresses how the employer shall account for the cost of making up the deficiency in annuity payments to the retirees.

required for those settlements. However, the accounting policy adopted shall be applied consistently from year to year.

**35-159** A settlement requires remeasurement of the accumulated postretirement benefit obligation before the settlement. In addition, after the settlement, net periodic postretirement benefit cost for the remainder of the year is remeasured.

**>> Insurance Contracts**

**35-160** If an **insurance contract** is purchased from an insurance entity controlled by the employer, or if a participating insurance contract causes the employer to remain subject to all or most of the risks and rewards associated with the benefit obligation covered or the assets transferred to the insurance entity, that contract is not an insurance contract and the purchase of that contract does not constitute a settlement pursuant to paragraphs 715-60-35-150 through 35-160.

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**35-90** The following circumstances identify the fact pattern to which the required accounting would apply. An employer sponsors a **defined benefit pension plan**. The employer settles its pension obligation through the purchase of insurance annuity contracts from an insurance entity. The employer may or may not terminate the defined benefit pension plan. The employer appropriately applies the guidance in this Subsection. Subsequently, the insurance entity becomes insolvent and is unable to meet all of its obligations under the annuity contracts. The employer decides to make up some portion or all of any deficiency in annuity payments to the retirees.

**35-91** The employer shall recognize a loss in the circumstances described in the preceding paragraph at the time the deficiency is assumed by the employer if any gain was recognized on the original settlement. The loss recognized would be the lesser of any gain recognized on the original settlement or the amount of the benefit obligation assumed by the employer. The excess of the obligation assumed by the employer over the loss recognized shall be accounted for as a **plan amendment** or plan initiation in accordance with paragraphs 715-30-35-10 through 35-17. Subsequent accounting shall be in accordance with the provisions of this Subtopic.

**55 Implementation Guidance and Illustrations**

**> Implementation Guidance**

**>> Relationship of Settlements and Curtailments to Other Events**

**55-130** Paragraphs 715-30-35-74 through 35-78 establish general guidance on the relationship of settlements and curtailments to other events. That guidance is affected by whether there is a successor pension plan. A new pension plan that is established by an employer, or one or more existing pension plans that are amended by the employer,

**55 Implementation Guidance and Illustrations**

**> Implementation Guidance**

**>> Settlements**

**55-104** A transaction that does not meet the three criteria in the definition of the term **settlement** does not constitute a settlement for purposes of the Settlements, Curtailments, and Certain Termination Benefits Subsections.

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to provide for the accrual of defined **pension benefits** for the future services of present employees that were previously covered by another pension plan (old plan) sponsored by that employer shall be considered a successor pension plan except under any of the following conditions:

a. The new plan's pension **benefit formula** or the amendment or amendments to the existing pension plan(s) provide for accrual of only insignificant defined pension benefits for those employees.
b. The new or existing pension plan or plans cover only an insignificant number of employees previously covered by the old plan.

**55-131** The guidance in the Settlements, Curtailments, and Certain Termination Benefits Subsections of this Subtopic does not apply to an employer's withdrawal from a multiemployer pension plan, and, therefore, if the employer withdraws from a multiemployer pension plan and establishes a pension plan for its employees, that pension plan is not considered to be a successor pension plan.

**55-132** An employer may terminate its pension plan, settle a pension benefit obligation, withdraw excess **plan assets**, and establish a successor pension plan that has the same pension benefit formula. In this situation, a settlement occurs but a curtailment does not. Although employees no longer accrue pension benefits under the terminated pension plan, they do accrue pension benefits under the successor pension plan. From an accounting viewpoint, those two pension plans are viewed as one pension plan because, in substance, the pension plan has not been terminated. The only transactions requiring accounting recognition in the employer's financial statements are the settlement and the withdrawal of excess plan assets. See paragraphs 715-30-35-74 through 35-78 for guidance on whether a settlement or curtailment has occurred if

**55-105** For example, investing in a portfolio of high-quality fixed-income securities with principal and interest payment dates similar to the estimated payment dates of **benefits** may avoid or minimize certain risks. However, that investment decision does not constitute a settlement because that decision can be reversed, and investing in that portfolio does not relieve the employer (or the **plan**) of primary responsibility for a postretirement benefit obligation nor does it eliminate significant risks related to that obligation.

**>> Relationship of Settlements or Curtailments to Other Events**

**55-111** An employer that immediately recognized its transition obligation in income upon adopting the provisions of this Subtopic subsequently amends its plan to eliminate its obligation for **postretirement benefits** and partially compensates affected participants by increasing their pension benefits. In this case, the employer has terminated its postretirement benefit plan and effectively settled its remaining postretirement benefit obligation by increasing its obligation to pay pension benefits. Because the cost to the employer of settling its postretirement benefit obligation is the increase in the obligation for pension benefits, the gain on the termination of the plan must be measured taking into account the cost of the pension benefit increase. That increase should be accounted for as an increase in a pension liability (or a decrease in a pension asset). The obligation for postretirement benefits should be eliminated. The difference is a gain on **plan termination** that should be recognized pursuant to Subtopic 715-30.

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defined benefits continue to be provided for future services. If the successor pension plan provides (reduced) increased pension benefits for all years of employees' future **service**, that change in the benefit formula is accounted for as a (negative) pension **plan amendment**. See paragraph 715-30-55-54 for guidance on negative plan amendments.

**55-133** A settlement of the pension benefit obligation as part of a pension **plan termination** (with no successor pension plan) may occur in a financial reporting period that differs from the period in which the effects of the curtailment resulting from the pension plan termination ordinarily would be recognized. The effects of the settlement and the effects of the curtailment that result from a pension plan termination shall be recognized in accordance with paragraphs 715-30-35-79 through 35-82 and 715-30-35-92 through 35-94, respectively, which may result in the effects of those events being recognized in different periods. See Example 8 (paragraph 715-30-55-236) for an illustration of a termination and a settlement recognized in different periods.

**55-136** A settlement occurs if the criteria in the definition of the term **settlement** are satisfied. If there is any reasonable doubt that the purchaser will meet the pension benefit obligation assumed under the sales agreement and the seller remains contingently liable for that pension benefit obligation, a settlement does not occur.

**>> Settlements**

**55-139** The Settlement, Curtailments, and Special Terminations Subsection of Section 715-30-35 provides the general guidance on settlement transactions. The following settlement related implementation guidance is organized in three categories:

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a. Meeting the criteria for settlement
b. Settlement measurement issues
c. Application of accounting policy.

**>>> Meeting the Criteria for Settlement**

**55-140** A transaction that does not meet all of the criteria in the definition of the term **settlement** does not constitute a settlement for purposes of applying the guidance in the Settlement, Curtailment, and Certain Termination Benefits Subsections of this Subtopic. One of the criteria is that the transaction is irrevocable. In this context, irrevocable means that a transaction or event cannot be revoked, recalled, or undone; the transaction or event is unalterable.

**55-141** For example, investing in a portfolio of high-quality fixed-income securities with principal and interest payment dates similar to the estimated payment dates of benefits may avoid or minimize certain risks. However, that does not constitute a settlement because the investment decision can be reversed and such a strategy does not relieve the employer or the plan of primary responsibility for a pension obligation, nor does it eliminate significant risks related to the obligation.

**55-142** Another example of a transaction that does not meet the requirements for a settlement involves an employer with a situation in which all of the following occur in a period:

a. The employer decides to terminate a pension plan and establish a successor pension plan.
b. A **nonparticipating annuity contract** for the **vested benefits** of all plan participants is purchased but can be rescinded if certain regulatory approvals for the termination of the pension plan are not obtained.
c. It is determined that the regulatory approvals are probable.

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**55-143** An employer shall not recognize a settlement gain or loss until all three criteria inherent in the definition of a settlement are satisfied. In the situation described in the preceding paragraph, an irrevocable action has not occurred that relieves the employer or the pension plan of primary responsibility for a pension benefit obligation and eliminates significant risks related to the pension benefit obligation and the plan assets used to effect the settlement. Therefore, recognition of a settlement gain or loss should await completion of the irrevocable action necessary to relieve the employer or the pension plan of the primary responsibility for the pension benefit obligation. The probability of completion of the irrevocable action is not relevant.

**55-144** Another example illustrating the need to meet the criteria inherent in the definition of a settlement is a situation in which an employer decides in 20X1 to terminate its pension plan, withdraw excess plan assets, and establish a successor pension plan, but is unable to effect the transactions, which include the settlement of the **vested benefit obligation**, until regulatory approval is obtained. The purchase of nonparticipating annuity contracts occurs in January 20X2 after regulatory approval has been obtained and before the 20X1 financial statements have been issued or are available to be issued (as discussed in Section 855-10-25). A settlement gain or loss is not recognized until all three criteria for a settlement are satisfied. That does not occur until January 20X2. In this situation, adjustment of the 20X1 financial statements would not be appropriate, although disclosure of the event may be required.

**55-145** An employer may withdraw excess plan assets (cash) from a pension plan and not be required to settle a pension benefit obligation as part of an asset reversion transaction. Because a settlement has not occurred, none of the net gain or loss included in accumulated other

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comprehensive income shall be recognized in earnings. See paragraph 715-30-55-6 for guidance on the accounting required in this situation.

**>>> Settlement Measurement Issues**

**55-160** A pension plan may use a **market-related value of plan assets** other than fair value for purposes of determining the **expected return on plan assets** under the guidance in paragraph 715-30-35-51. That basis shall not be used in determining the maximum gain or loss subject to pro rata recognition in earnings when a pension benefit obligation is settled. The fair value of plan assets as of the date of settlement shall be used.

**55-161** An employer may settle a pension benefit obligation and withdraw excess plan assets as part of terminating its pension plan. The settlement gain or loss determined pursuant to paragraph 715-30-35-79 should not be adjusted to eliminate any gains or losses included in accumulated other comprehensive income relating to securities issued by the employer if those securities are included in the plan assets withdrawn. In this situation, the settlement of a pension benefit obligation, not the withdrawal of plan assets, is the event that requires the employer to recognize in earnings any of the net gain or loss included in accumulated other comprehensive income. Further, withdrawal of plan assets does not affect the determination of the settlement gain or loss. Likewise, the nature of the plan assets withdrawn does not affect that determination. Whether the securities are sold by the pension plan and the employer repurchases them in the market with cash withdrawn from the pension plan or whether the securities are withdrawn should not affect the determination of the settlement gain or loss.

**55-162** If nonparticipating annuity contracts are purchased from a less-than-majority-owned investee that is not controlled by the employer and the criteria for a settlement

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are satisfied, the resulting settlement gain or loss is not subject to partial recognition (that is, it should not be reduced to reflect the employer's ownership). The employer's noncontrolling ownership interest in the insurance entity that issues the nonparticipating annuity contracts does not affect the accounting for the settlement. Therefore, the entire settlement gain or loss should be recognized in earnings. The treatment of this intra-entity transaction is acknowledged to be a departure from traditional accounting under the equity method and is not intended to be a precedent for nonpension intra-entity transactions.

**55-163** The interest rates implicit in the purchase price of nonparticipating annuity contracts used to effect a settlement may be different from the assumed discount rates used to determine net periodic pension cost. If the rates are different, the employer should measure the portion of the **projected benefit obligation** being settled and the remaining portion, if appropriate, using the implicit annuity interest rates. Consequently, the measurement of the portion of the projected benefit obligation being settled is the purchase price of the nonparticipating annuity contracts. Any gains or losses resulting from measuring the projected benefit obligation and the plan assets are included in the maximum gain or loss subject to pro rata recognition in earnings before the settlement gain or loss to be recognized is determined. In determining whether it is appropriate to measure the unsettled portion of the projected benefit obligation using the implicit annuity interest rates, consideration should be given to the demographics of the participants related to the settled and unsettled portions of the projected benefit obligation. If the demographics are similar and, therefore, there is a similar length of time until payments are due and the implicit annuity interest rates reflect the best estimate of the rates at which the unsettled portion could be effectively settled

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(as discussed in paragraphs 715-30-35-43 through 35-46), then it is appropriate to measure the unsettled portion of the projected benefit obligation using those rates. If use of those rates is not appropriate, then rates as of the date of the settlement that do satisfy the requirements of those paragraphs shall be used to measure the unsettled portion of the projected benefit obligation.

**55-164** Paragraph 715-30-35-79 provides accounting guidance on the use of participating annuity contracts in settlement transactions. Example 2, Case C (see paragraph 715-30-55-209) illustrates a settlement transaction using participating annuity contracts and a method that determines the maximum gain subject to pro rata recognition in earnings by first reducing the net gain included in accumulated other comprehensive income by the cost of the participation right. The allocation method illustrated in that Case is not the only permitted method that may be used. In determining the maximum gain subject to pro rata recognition in earnings, any of the following alternative methods may be used, provided the approach selected is applied consistently from year to year. An amount equal to the cost of the participation right could be allocated in any of the following ways:

a. Initially to the transition asset remaining in accumulated other comprehensive income
b. Initially to the net gain included in accumulated other comprehensive income
c. On a pro rata basis to the transition asset remaining in accumulated other comprehensive income and the net gain included in accumulated other comprehensive income.

**55-165** Because the allocation method can affect the determination of subsequent periods' net periodic pension cost, allocation on a pro rata basis (alternative [c] in the

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preceding paragraph) is recommended because it is an unbiased approach.

**>>> Application of Accounting Policy**

**55-166** Paragraph 715-30-35-82 requires recognition in earnings of gains or losses from settlements 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 and permits such recognition if the cost of settlements is less, as long as the policy is applied consistently. As an example of an acceptable accounting policy, an employer may adopt a policy that requires recognition in earnings of gains or losses from all settlements during the year for a pension plan if the cost of those settlements exceeds the service cost component of net periodic pension cost for that pension plan for the year.

**55-167** A settlement gain or loss may need to be recognized as a change in accounting estimate following the guidance in Topic 250 as in the following situation. Assume that an employer's accounting policy is not to recognize in earnings a gain or loss from a settlement if the cost of all settlements during the year does not exceed the sum of the service cost and interest cost components of net periodic pension cost for the pension plan for the year and all of the following occur:

a. It is estimated at the beginning of the year that the cost of all settlements during the year will not exceed the threshold amount described.
b. A pension benefit obligation is settled during the first quarter and a settlement gain or loss is not recognized.
c. In the second quarter and after the issuance of the first quarter's interim report, it is determined that the cost of all settlements during the year will exceed the threshold amount.

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| | |
|---|---|
| **55-168** In the situation described in the preceding paragraph, the settlement gain or loss should be recognized in the second quarter consistent with the accounting for a change in accounting estimate as required by paragraphs 250-10-45-17 and 270-10-45-14. | |

Topic 715 prescribes the accounting for a settlement, including recognition criteria for gains and losses associated with a settlement. A settlement occurs as the result of an irrevocable action that relieves the entity of primary responsibility for a pension or OPEB obligation and eliminates significant risks related to the obligation and the assets used to effect the .settlement. Section 10.2.20 discusses a settlement using annuity and insurance contracts.

## 9.3.10 What constitutes a settlement and timing of recognition

### Question 9.3.10
**When does a settlement occur?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** A plan settlement is an irrevocable action that relieves an entity or the plan of its primary responsibility for a pension or OPEB obligation and eliminates significant risks related to the obligation and the assets used to effect the settlement. The term plan settlement encompasses partial settlements, which refers to the settlement of the full amount of the obligation for a single plan participant or a portion of plan participants. In contrast, the term does not encompass the settlement of only a portion of an obligation for a single plan participant, which is discussed in Question 9.3.25.

To ensure a settlement is binding, it is generally not recognized until it is executed and the required assets are transferred. Examples of settlements include making lump-sum payments to plan participants, purchasing nonparticipating annuity (insurance) contracts, and transferring an obligation as part of the sale of a business. The obligation either moves from the entity to another party (e.g. insurer or acquirer) or is otherwise eliminated as the entity's obligation. [715-30 Glossary, 715-60 Glossary]

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## Question 9.3.20

### When are settlement gains and losses recognized?

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Settlement accounting requires an entity to recognize all or some of the unrecognized gains and losses related to the settled obligation out of AOCI into the income statement (see also Question 9.3.70). Additionally, the liabilities and plan assets are remeasured at the date of the settlement to reliably measure the effects of the settlement. [715-30-35-81 – 35-82, 715-60-35-150 – 35-153]

Entities are required to recognize a settlement gain or loss in the income statement when the cost of all settlements in a year is greater than the sum of the service cost and interest cost component of net periodic benefit cost for the fiscal year (the 'threshold'), applied on a plan-by-plan basis. Entities are permitted to elect a policy that uses a threshold to recognize settlement gains or losses that is lower than the sum of service cost and interest cost for the fiscal year (see Question 9.3.60). Topic 715 does not explicitly state whether entities recognize a settlement gain or loss when the cost of all settlements is expected to exceed the threshold by the end of the fiscal year, but that threshold has not yet been exceeded; in our experience, there is diversity in practice. As a best practice, we believe that entities should account for settlements at interim periods when the cumulative cost of settlements is *expected* to exceed the threshold for the year (or a lower threshold when an entity has adopted such a policy). [715-30-35-79, 715-30-35-81 – 55-82, 715-60-35-150, 715-60-35-158]

In addition, although Subtopic 715-30 contains no explicit guidance, it does describe a scenario in which an entity's accounting policy is to only recognize settlements during the year that exceed the threshold. The entity estimates at the beginning of the year that the cost of all settlements during the year will not exceed the threshold and therefore does not recognize a gain or loss for a Q1 settlement. However, in Q2 (after issuance of the Q1 report) it determines that the cost of all settlements during the year will exceed the threshold. In this scenario, the guidance states that the entity should recognize a settlement gain or loss in Q2 consistent with the accounting for a change in accounting estimate in Topic 250. [715-30-55-167 – 55-168]

It is not entirely clear what the FASB meant by 'will exceed' in the above scenario – i.e. whether the threshold was exceeded in Q2 or whether the threshold was expected to be exceeded by the end of the year. We believe best practice is for an entity that reports quarterly results to periodically (at least quarterly) estimate the cost of all settlements during the year and recognize settlements as they occur if the entity concludes it is probable that the threshold will be exceeded. However, due to Topic 715 not explicitly addressing this scenario, we believe it is also acceptable not to recognize settlements until the quarter in which the threshold is exceeded.

In all cases, entities should adopt an accounting policy for recognizing settlement gains or losses and apply the policy consistently. [715-30-55-166, 715-60-35-158]

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## Question 9.3.25

**Are lump-sum settlements of a pension liability related to an individual participant included in the settlement threshold?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** A plan structure may provide participants with different distribution options. A plan may offer an option for a full lump-sum distribution or a lifetime annuity payment, or, for settlement of a portion of the obligation, through a lump-sum payment with the remaining balance distributed as an annuity. A full lump-sum distribution is considered a settlement (see Question 9.3.10).

A partial lump-sum payment with the remainder of the obligation distributed by the plan as an annuity is not considered a settlement, and therefore is not included in the settlement threshold calculation. The partial lump-sum payment does not relieve the entity or the plan of its primary responsibility for the PBO and does not eliminate significant risks related to the PBO for the participant. An alternative view that allows the partial lump-sum payment to be included in the settlement threshold calculation may be acceptable, if the facts and circumstances indicate that the employer is relieved of all of the risks and rewards associated with settling the benefit obligation. [715-30-35-87, 715-60-35-160]

If the entity elects to pay out the partial lump-sum payment and purchases a nonparticipating annuity (insurance) contract for the remainder of the obligation whereby all the risks and rewards have transferred to the insurance entity, a settlement has occurred. In that case, the partial lump-sum payment and the insurance contract for the remaining payments eliminates significant risks related to the PBO for the participant. [715-30-55-149, 715-60-35-160]

## Question 9.3.30

**When is a settlement gain or loss recognized if there is a delayed cash payment?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** When there is a delayed cash payment, regardless of whether the amount is known and fixed at an earlier date, the requirement that the settlement must be irrevocable is not met until the cash is paid to the employee (i.e. the assets are transferred). A commitment does not satisfy the criteria for settlement and does not result in a settlement gain or loss. [715-30-55-148, 715-60-55-104 – 55-105]

For example, an entity has a top-hat supplemental pension plan for executives, which is an unfunded or insured pension plan for a select group of management or highly compensated employees. It accounts for the plan under Topic 715.

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Because of Treasury regulations (Section 409A), an executive who retires on May 31 cannot receive the cash payout for six months (until December 1). The entity does not record the settlement gain or loss until payment is made on December 1 even though the amount of the cash payout is known and fixed at the retirement date on May 31.

## Question 9.3.40

**How does a purchase price or premium adjustment affect when to recognize a settlement?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** When an entity purchases a nonparticipating annuity contract (a buy-out contract) to settle its benefit obligation, it considers the nature of a potential purchase price/premium adjustment when determining when to recognize the settlement gain or loss. This requires judgment based on individual facts and circumstances. [715-30-35-84, 715-30-35-87, 715-60-35-160]

A premium adjustment that is administrative does not preclude an entity from recognizing a settlement gain or loss if the entity concludes that the buy-out contract is irrevocable and the entity no longer retains the risks related to the DB plan obligation and plan assets before the adjustment is paid. However, if the premium adjustment is considered substantive, the entity does not recognize the settlement gain or loss until the requirements of a settlement are met. [715-30-35-84, 715-30-35-87, 715-60-35-160]

## Example 9.3.10

**Evaluating administrative vs substantive premium adjustments in a settlement**

ABC Corp. sponsors a DB pension plan for all of its employees. ABC executed a nonparticipating single premium group annuity contract (a buy-out contract) on December 1, Year 1. On December 28, Year 1, ABC liquidated the plan assets and the plan paid a premium of $200 million to Insurer. As of December 31, Year 1, Insurer is analyzing and verifying the participant data (e.g. to remove participants no longer eligible for benefits), which may result in an adjustment to the buy-out purchase price / premium.

In determining when the settlement should be accounted for, ABC evaluates whether Insurer's review is administrative or substantive in nature. ABC may conclude a settlement has occurred if it determines that the nature of Insurer's analysis is administrative and that ABC does not retain the risks related to the DB plan obligation and plan assets. The

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length of Insurer's review may also be relevant. A lengthy review may indicate that the review is substantive and that the settlement gain or loss is to be recognized when the review is complete and adjustments have been paid.

## Example 9.3.20

**Transferring an OPEB obligation to a union-sponsored VEBA as a settlement**

ABC Corp. enters into a settlement agreement with a union representing its retirees on postretirement healthcare coverage. Under the settlement agreement, responsibility for providing retiree healthcare benefits for ABC's retirees will permanently shift from ABC to a new retiree plan (New Plan) that is independent of ABC and funded by a VEBA trust (New VEBA). A VEBA plan is a type of tax-exempt trust used to pay for eligible medical expenses; it is typically funded by the entity and employee contributions may be mandatory.

### Initial funding requirements

ABC provides the initial funding for New VEBA through several sources, including:

- the transfer of funds that existed in current VEBA trusts;
- ABC-issued term notes and warrants; and
- cash on hand.

The parties to a settlement agreement acknowledge that ABC's obligations to pay into New VEBA are fixed and capped under the agreement and that ABC is not responsible for, and does not provide a guarantee of:

- the payment for future benefits to plan participants; or
- the asset returns of the funds in New VEBA.

### Shortfall contribution requirements

In addition to the initial funding requirements, ABC has certain shortfall contribution requirements, depending on whether there are sufficient assets in New VEBA. At the beginning of each year, using a predetermined methodology the union will determine whether New VEBA is expected to have sufficient assets to remain solvent for the next 25 years. The annual determination is independent of prior-year determinations.

- Insufficient assets: ABC will pay a shortfall contribution for that year of $50 million.
- Sufficient assets: No shortfall contribution is due for that year. There is no cumulative payment due for years in which a shortfall contribution is not due.

Based on certain cash flow projections, ABC anticipates being obligated to make shortfall contributions for 20 of the next 25 years to cover projected insufficient assets of New VEBA.

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### Prepay options for shortfall requirements

ABC may prepay the remaining shortfall amount on January 1 of each year, calculated as the present value of all future potential shortfall contributions.

On the implementation date, the cash payment for the remaining shortfall was $500 million and the APBO was approximately $20 billion. Based on actuarial calculations, ABC expects there is a very high likelihood that the shortfall amount will be due for each of the 20 years to which the $500 million relates.

### Determining whether transaction qualifies as a settlement

ABC's transfer of the OPEB obligation to New VEBA should first be considered for settlement accounting under Topic 715. The transfer of the OPEB obligation to New VEBA meets the definition of a settlement as long as the risk retained by ABC is not considered to be significant.

ABC determines significance by:

| Test | Example |
|---|---|
| — comparing the magnitude of the exposure (i.e. the shortfall) to the APBO; and | ABC's exposure is approximately 2.5% of the APBO: $500 million remaining shortfall ÷ $20 billion APBO. |
| — the expected variability in the shortfall contribution payments. | Based on actuarial calculations, the variability in those expected payments is low. |

Based on the magnitude of the exposure at 2.5% of the APBO and the low expected variability in the payments, ABC concludes that the retained risks are not significant and there is a settlement to be accounted for on the initial funding date of new VEBA.

ABC's transfer of the OPEB obligation to New VEBA would not be a:

- negative plan amendment because it does not arise from a plan amendment; or
- curtailment because it does not arise from a reduction in expected years of future service.

### Accounting phases

#### *Measurement of the obligation before the union appeal rights expire*

During the period from reaching agreement with the union until its members ratify the agreement and all potential appeals court processes are pending, we believe ABC should determine its APBO assuming an ongoing plan. ABC should make no adjustments to the EPBO or to the discount rate.

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#### *Measurement of the obligation once the union appeal rights expire*

When any appeal rights expire after union member ratification, we believe it is acceptable for ABC to determine the APBO using the settlement amount plus estimated benefit payments to be paid under the ongoing plan until the settlement date. Under the settlement measurement guidance (see Question 9.3.20), ABC uses the discount rate inherent in the settlement agreement to measure the APBO instead of the discount rate that would otherwise be determined under Subtopic 715-60. ABC recognizes the APBO reductions from that remeasurement as a gain in OCI. Additionally, if ABC determines the discount rate inherent in the settlement agreement is the best estimate of the rate at which the unsettled portion could be settled, ABC uses that rate. If not, ABC uses the rate that best estimates that rate under Subtopic 715-60.

#### *Settlement accounting on funding the new VEBA*

On initial funding of New VEBA, ABC records a settlement of the APBO and recognizes a liability for the expected future obligations for the shortfall contributions. ABC recognizes a gain on settlement in the income statement.

### Question 9.3.50

**How are settlement gains and losses recognized when the service and interest cost threshold has not been met?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** When settlement accounting applies, an entity recognizes all or some of the unrecognized gains and losses related to the settled obligation out of AOCI into the income statement. When settlement accounting is not applied because the service and interest cost threshold has not been exceeded (see Question 9.3.20), the settlement gain or loss effectively becomes part of the gains and losses recognized in AOCI at the next measurement date. [715-30-35-79, 715-30-35-82, 715-60-35-150]

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### Question 9.3.60

**Can an entity recognize settlement gains and losses if they don't exceed service cost and interest cost for the year?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Yes. An entity is permitted to recognize settlement gains and losses in net income when aggregate settlement costs are less than interest cost and service cost for the year by selecting an alternative recognition policy and applying it consistently.

For example, two alternative policies permitted under Topic 715 are to recognize: [715-30-35-82, 715-60-35-158]

— all settlement gains and losses in net income – i.e. regardless of whether they exceed interest cost and service cost for the year; or
— settlement gains and losses in net income when settlements exceed service and interest cost.

## 9.3.20 Calculating settlement gains and losses

### Question 9.3.70#

**How is a total or partial settlement of a benefit obligation accounted for?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** To account for the settlement of all or part of a pension obligation, an entity recognizes in the income statement all or some of the gains or losses previously recognized in AOCI related to the plan being settled. The maximum gain or loss an entity recognizes in the income statement (assuming no remaining initial transition amount in AOCI) is the net gain or loss in AOCI. That maximum amount includes any gain or loss resulting from remeasurements of plan assets and the benefit obligation at the time of settlement. The maximum amount is recognized in earnings if the entire benefit obligation is settled. If only part of the benefit obligation is settled, the entity recognizes in the income statement a pro rata portion of the maximum amount equal to the percentage reduction in the benefit obligation. [715-30-35-79, 715-60-35-150]

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## Question 9.3.80

**Does the calculation of gains and losses on a partial settlement include gains and losses not yet reflected in MRV?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Yes. As discussed in section 6.3.30 about valuing plan assets, the net gain or loss resulting from differences between the EROA and actual return on plan assets is recognized in OCI in the period in which the difference arises. An entity may use a calculated value as the MRV of plan assets other than fair value for purposes of determining the EROA. Asset gains and losses include both changes reflected in the MRV of plan assets, and changes not yet reflected (i.e. the difference between the fair value of the assets and the MRV). Topic 715 explicitly states that an entity is not required to amortize asset gains and losses that are not yet reflected in MRV. Therefore, the computation of the minimum amortization of the net gain or loss included in AOCI excludes asset gains and losses not yet reflected in MRV. [715-30-35-22, 715-30-35-24, 715-60-35-150]

When accounting for the settlement of all or part of a benefit obligation, the maximum amount of gain or loss subject to recognition in net income is the gain or loss remaining in AOCI. This includes all gains and losses, including those gains and losses not yet reflected in MRV. The basis for determining the maximum settlement gain or loss (subject to pro rata recognition in net income, when there is a partial settlement) when a benefit obligation is settled is fair value of plan assets at the settlement date. This is true even if a calculated MRV of plan assets is used in determining the expected rate of return on plan assets. [715-30-35-79, 715-60-35-151]

Sections 715-30-55 and 715-60-55 include examples of the accounting for the partial settlement of a benefit obligation, where the calculation of gain recognition reflects the amount in AOCI without adjustments.

## Question 9.3.90

**How is the PBO being settled measured when an entity purchases nonparticipating annuity contracts?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** In a partial or full settlement, an entity measures the PBO being settled. Normally, it would use the rate being used to determine net periodic pension cost. However, if the entity purchases nonparticipating annuity (insurance) contracts to achieve a partial or full plan settlement, it uses the implicit rate from the annuity contract. The implicit rate can be calculated from the purchase price of the annuity contract and the timed payments. If the implicit

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rate in the insurance contract is different from the rate being used by the entity to determine net periodic pension cost, the entity uses the implicit rate to measure the PBO being settled. The measurement of the portion of the PBO being settled equals the purchase price of the insurance contract(s). Any gain or loss is recognized as discussed in Question 9.3.20 and is included in the threshold calculation. [715-30-55-163]

The entity also measures the remainder of the PBO, if there is a remaining PBO balance. While the implicit rate may provide better information, the facts and circumstances need to be considered. The implicit rate is appropriate if the demographics of the portion remaining are similar to the demographics of the settled portion. If the demographics are not similar, the implicit rate is not appropriate. For example, if the insurance contract settled the PBO for employees over age 60, the implicit rate is not appropriate for the portion of the PBO relating to employees ranging in age from 30-60.

Section 10.2.20 further discusses settlements using annuity and insurance contracts.

## 9.4 Accounting for curtailments and negative plan amendments

### Excerpt from ASC 715-30

**20 Glossary**

**Plan Curtailment –** An event that significantly reduces the 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.

**35 Subsequent Measurement**

**> Curtailments**

**35-92** The **prior service cost** included in accumulated other comprehensive income associated with years of service no longer expected to be rendered as the result of a **curtailment** is a loss. For example, if a curtailment eliminates half of the estimated remaining future years of service of those who were employed at the date of a prior

### Excerpt from ASC 715-60

**20 Glossary**

**Curtailment (of a Postretirement Benefit Plan) –** An event that significantly reduces the expected years of future service of active plan participants or eliminates the accrual of defined benefits for some or all of the future services of a significant number of active plan participants.

**35 Subsequent Measurement**

**> Remeasurement of Cost Due to Curtailments**

**35-161 Curtailments** are events that may require income or expense recognition of certain amounts that were initially recognized in other comprehensive income.

**35-162** The reduction in active plan participants' expected years of future service or elimination of future benefit accruals caused by a curtailment raises doubt about the

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plan amendment and were expected to receive benefits under the plan, then the loss associated with the curtailment is half of the prior service cost included in accumulated other comprehensive income related to that amendment that has not been amortized as a component of net periodic pension cost. For purposes of applying the provisions of this paragraph, prior service cost includes the cost of retroactive plan amendments (see paragraphs 715-30-35-10 through 35-11) and any transition obligation remaining in accumulated other comprehensive income from initial application of this Subtopic. The calculation of prior service cost associated with services of terminated employees is illustrated in Example 3 (see paragraph 715-30-55-212).

**35-93** The projected benefit obligation, exclusive of increases that reflect termination benefits that are excluded from the scope of this paragraph (see paragraphs 715-30-25-9 through 25-13), may be decreased (a gain) or increased (a loss) by a curtailment. To the extent that such a gain exceeds any net loss included in accumulated other comprehensive income (or the entire gain, if a net gain exists), it is a curtailment gain. To the extent that such a loss exceeds any net gain included in accumulated other comprehensive income (or the entire loss, if a net loss exists), it is a curtailment loss. For purposes of applying the provisions of this paragraph, any transition asset remaining in accumulated other comprehensive income from initial application of this Subtopic shall be treated as a net gain and shall be combined with the net gain or loss arising thereafter. See Example 4 (paragraph 715-30-55-216) for an illustration of a curtailment if there is a remaining transition asset included in accumulated other comprehensive income.

**35-94** If the sum of the effects identified in the preceding two paragraphs is a net loss, it shall be recognized in earnings when it is probable that a curtailment will occur

continued existence of the future economic **benefits** of prior plan amendments.

**35-163** Accordingly, these Subsections require recognition in net periodic postretirement benefit cost of any related **prior service cost** included in accumulated other comprehensive income.

**35-164** The prior service cost included in accumulated other comprehensive income associated with the portion of the future years of service that had been expected to be rendered, but as a result of a curtailment are no longer expected to be rendered, is a loss. For purposes of measuring the effect of a curtailment, prior service cost includes the cost of plan amendments and any remaining transition obligation. For example, a curtailment may result from the termination of a significant number of employees who were plan participants at the date of a prior plan amendment.

**35-165** The loss associated with that curtailment is measured as the portion of the remaining prior service cost included in accumulated other comprehensive income related to that (and any prior) plan amendment attributable to the previously expected remaining future years of service of the employees who were terminated and the portion of the remaining transition obligation attributable to the previously expected remaining future years of service of the terminated employees who were plan participants at the date of transition.

**35-166** A curtailment also may result from terminating the accrual of additional benefits for the future services of a significant number of employees. The loss in that situation is both of the following:

a. A proportionate amount of the remaining prior service cost included in accumulated other comprehensive income based on the portion of the remaining

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and the effects described are reasonably estimable. If the sum of those effects is a net gain, it shall be recognized in earnings when the related employees terminate or the **plan suspension** or amendment is adopted.

**35-95** If a situation also involves termination benefits, the change in the projected benefit obligation due to the curtailment is the difference between the projected benefit obligation for the respective employees before their acceptance of the offer of termination benefits and the projected benefit obligation determined for those employees by applying the normal pension plan formula and assuming no future service because of their termination. See Examples 5 through 6 (paragraphs 715-30-55-222 through 55-230) for an illustration of this guidance.

**35-96** See also Example 7 (paragraph 715-30-55-231) for more illustrations of the curtailment-related guidance presented in this Subsection.

expected years of service in the amortization period that originally was attributable to those employees who were plan participants at the date of the plan amendment and whose future accrual of benefits has been terminated

b. A proportionate amount of the transition obligation remaining in accumulated other comprehensive income based on the portion of the remaining years of service of all participants active at the date of transition that originally was attributable to the remaining expected future years of service of the employees whose future accrual of benefits has been terminated.

**35-167** When a full curtailment occurs, the entire prior service cost and transition obligation remaining in accumulated other comprehensive income is a loss because there are no future years of service to be rendered.

**35-168** Accounting for a curtailment is not applied to any prior service cost newly created at the time of the curtailment.

**35-169** The accumulated postretirement benefit obligation may be decreased (a gain) or increased (a loss) by a curtailment. That (gain) loss shall reduce any net loss (gain) included in accumulated other comprehensive income as follows:

a. To the extent that such a gain exceeds any net loss included in accumulated other comprehensive income (or the entire gain, if a net gain exists), it is a curtailment gain.
b. To the extent that such a loss exceeds any net gain included in accumulated other comprehensive income (or the entire loss, if a net loss exists), it is a curtailment loss.

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For purposes of applying the provisions of this paragraph, any transition asset remaining in accumulated other comprehensive income shall be treated as a net gain and shall be combined with the net gain or loss arising after transition to the Settlements, Curtailments, and Certain Termination Benefits Subsections.

**35-170** Increases in the accumulated postretirement benefit obligation that reflect **termination benefits** are excluded from the scope of paragraphs 715-60-35-161 through this paragraph (see paragraphs 715-60-25-4 through 25-6 for guidance on accounting for termination benefits).

**35-171** If the sum of the effects identified in paragraphs 715-60-35-164 through 35-169 is a net loss, it shall be recognized in income when it is probable that a curtailment will occur and the net effect is reasonably estimable. If the sum of those effects is a net gain, it shall be recognized in income when the related employees terminate or the plan suspension or amendment is adopted.

**55 Implementation Guidance and Illustrations**

**55-128** This Subsection is an integral part of the requirements of this Subtopic. This Subsection provides additional guidance and illustrations that address the application of accounting requirements to specific aspects of accounting for matters related to **settlements**, **curtailments**, and certain termination **benefits** related to defined benefit pension plans. The guidance and illustrations that follow may be based on provisions of law that are subject to change. These assumptions about the law are for illustrative purposes only.

**>> Relationship of Settlements and Curtailments to Other Events**

**55-134** If an employer's disposal of a component of an entity (see paragraph 715-30-55-193) results in a

**55 Implementation Guidance and Illustrations**

**> Implementation Guidance**

**>> Plan Amendments**

**55-19** An employer's previous accounting for postretirement benefits has considered the written plan to be the substantive plan. On July 1, 20X1, its board of directors approves a negative **plan amendment** (that is, an amendment that reduces benefits attributable to prior service) that will be effective on January 1, 20X3. The employer intends to announce the negative plan amendment to plan participants on July 1, 20X2. The effects of the negative plan amendment should be accounted for as of July 1, 20X2, when it is communicated to plan participants and not as of July 1, 20X1, the date of the board's approval. The amendment in this instance will

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termination of some employees' services earlier than expected but does not significantly reduce the expected years of future service of present employees covered by the pension plan, the effects of the reduction in the work force on the pension plan should be measured in the same manner as a curtailment (see paragraphs 715-30-35-92 through 35-93) to determine the gain or loss on the disposal pursuant to paragraph 205-20-45-3. Although the reduction in the work force does not result in a significant reduction in the expected years of future service of present employees covered by the pension plan and, therefore, a curtailment does not occur, measuring the effects of the reduction in the work force in the same manner as a curtailment (see paragraphs 715-30-35-92 through 35-93) is appropriate for purposes of determining the gain or loss on the disposal.

**55-137** A curtailment occurs if the sale significantly reduces the expected years of future service of present employees covered by the employer's pension plan. Even if a curtailment does not occur, the effects of the reduction in the work force should be considered for purposes of determining the gain or loss on the sale.

**55-138** See paragraph 715-60-55-111 for a discussion of the interaction of the termination of a postretirement plan with a related increase in an employer's obligation for pension benefits.

**>>> Meeting the Criteria for Curtailment**

**55-170** In the definition of the term **plan curtailment**, there is no specific threshold for determining if an event results in a significant reduction of expected years of future service of present employees covered by a pension plan or an elimination of the accrual of pension benefits for some or all future services of a significant number of employees covered by a pension plan. Judgment shall be applied to determine what is significant for each pension plan (the

not be communicated within a reasonable period of time after its adoption. Therefore, the extant unamended written plan continues to be the substantive plan that should be accounted for because it represents the last plan whose terms were mutually understood by the employer and the plan participants.

**55-20** It is important to distinguish between a reduction in the accumulated postretirement benefit obligation caused by a negative plan amendment and a reduction caused by a curtailment. Unless the plan is being terminated, a reduction in the accumulated postretirement benefit obligation caused by a negative plan amendment that exceeds any **transition obligation** or **prior service cost** included in accumulated other comprehensive income is not immediately recognized as a reduction of current postretirement benefit costs.

**55-21** An employer adopts an amendment to its postretirement health care plan that has the dual effect of expanding the plan's coverage and increasing the deductible. The increase in the deductible should not be measured and recognized separately from the benefit improvement. If a plan amendment results in numerous changes to a plan that both increase and decrease benefits attributed to prior service, the net effect of all those changes should be considered at the same time to determine whether there has been a net positive or negative plan amendment. If the combined effect of all the changes is a net increase in benefits (a positive plan amendment), the resulting prior service cost should be accounted for in accordance with paragraphs 715-60-35-16 through 35-17 or paragraph 715-60-35-18. If the combined effect is a net decrease in benefits (a negative plan amendment), the effect should be accounted for in accordance with paragraph 715-60-35-20.

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unit of accounting) based on the facts and circumstances. For example, an employer may have a pension plan covering employees in several divisions. The employer terminates employees in one of those divisions and the expected years of future service of present employees in that division are reduced significantly, but the reduction is not significant in relation to the expected years of future service of all employees covered by the pension plan. Because the event involves an insignificant reduction of expected years of future service of present employees covered by the pension plan, a curtailment does not occur. The results of the event are a gain or loss as described in paragraphs 715-30-35-18 through 35-19 that is subject to the requirements of paragraphs 715-30-35-24 through 35-25.

**55-171** If a layoff significantly reduces the expected years of future service of present employees covered by a pension plan, a curtailment occurs even if the layoff is expected to be temporary. For example, a curtailment occurs in both of the following actions:

a. The employer temporarily lays off a significant number of present employees covered by a pension plan.
b. The employer temporarily suspends a pension plan so that employees covered by the pension plan do not earn additional pension benefits for some or all of their future services.

**55-172** Likewise, if a pension **plan suspension** eliminates significant pension benefit accruals for some or all of present employees' future services, a curtailment occurs even if the pension plan suspension is expected to be temporary. Unrelated, individually insignificant reductions of expected years of future service of employees covered by a pension plan that accumulate over a single year or more than one year to a significant reduction do not constitute a curtailment. However, each of the reductions

**>> Curtailments**

**55-106** This Subtopic requires recognition in **net periodic postretirement benefit cost** of any related **prior service cost** or **transition obligation** included in accumulated other comprehensive income.

**55-107** A curtailment does not only result from events that occur outside a **postretirement benefit plan**.

**55-108** Although many curtailments may result from events that occur outside a plan, such as closing a plant, discontinuing a component of an entity, or otherwise terminating employees, a curtailment also can result from a **plan amendment** (including a negative plan amendment) that has the effect of eliminating the accrual of defined benefits for some or all of the future services of a significant number of active plan participants. (See Example 5, Case B [paragraphs 715-60-55-143 through 55-145].)

**55-109** If such an amendment occurs, accounting for a curtailment should be applied to all of the following:

a. Any decrease in the **accumulated postretirement benefit obligation** representing the reduction or elimination of benefits attributable to future service, which may result in a curtailment gain
b. Any increase in the accumulated postretirement benefit obligation resulting from employees retiring earlier than expected as a result of the amendment, which may result in a curtailment loss
c. Any prior service cost or any transition obligation remaining in accumulated other comprehensive income attributable to the future years of service of the employee group for which future accrual of benefits has been eliminated.

**55-110** A gain results if at the time of a curtailment there exists negative prior service cost included in accumulated

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results in a gain or loss as described in paragraphs 715-30-35-18 through 35-19 that is subject to the requirements of paragraphs 715-30-35-24 through 35-25. This evaluation is in contrast to the situation in which individually insignificant reductions of expected years of future service of employees covered by a pension plan are caused by one event, such as a strike, or are related to a single plan of reorganization and those reductions accumulate during more than one fiscal year to a significant reduction. The fact that the reductions occur over a period of time in this situation does not affect the determination that an event giving rise to a curtailment has occurred.

**55-173** Paragraph 715-30-55-130 points out that the guidance in the Settlements, Curtailments, and Certain Termination Benefits Subsections of this Subtopic on settlements and curtailments is affected by whether there is a successor pension plan. If an employer terminates a pension plan and establishes a successor pension plan that provides additional but reduced pension benefits for all years of employees' future service, a curtailment does not occur. If the successor pension plan provides incremental but reduced pension benefits for all years of employees' future service, the substance of the transactions is to maintain the same pension plan but with reduced pension benefits. Accordingly, the reduction in pension benefits is accounted for as a negative pension plan amendment. See the guidance in paragraph 715-30-55-54 related to a negative retroactive plan amendment. In this situation, pension benefits are reduced but not eliminated since employees continue to accrue pension benefits for all years of future service.

**55-174** A curtailment can occur if a pension plan is terminated and replaced by a successor pension plan under certain conditions. A curtailment occurs if the successor pension plan eliminates for a significant number of other comprehensive income due to a previous plan amendment that reduced benefits under the plan. Under paragraph 715-60-35-20, negative prior service cost included in accumulated other comprehensive income that results from an amendment that reduces benefits under the plan is treated the same as prior service cost that results from an amendment that improves benefits. For purposes of measuring the effect of a curtailment, prior service cost included in accumulated other comprehensive income includes any negative prior service cost from a prior plan amendment. Thus, the negative prior service cost included in accumulated other comprehensive income associated with the future years of service that are affected by the curtailment is a gain. That gain, to the extent it is not offset by any other effects of the curtailment, is currently recognized as a component of income. (See paragraphs 715-60-55-143 through 55-146.).

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employees the accrual of defined pension benefits for some or all of their future services. Two examples follow:

a. A successor pension plan that covers only half of the employees previously covered by the terminated pension plan. The reference to half of the employees in this example is for illustrative purposes only and is not intended to be indicative of the minimum coverage necessary to qualify a pension plan as a successor pension plan. See paragraph 715-30-55-130.
b. A successor pension plan that does not provide for the accrual of additional defined pension benefits for certain years of future services. To illustrate this situation, assume a pension plan provides a flat benefit of $1,500 per year of service. At the end of 20X0, the employer terminates that pension plan and establishes a successor pension plan that provides a flat benefit of $1,000 per year for all years of service, including service under the terminated pension plan. Pension benefits earned under the successor pension plan are reduced by the pension benefits earned under the terminated pension plan. At the end of 20X0, Employee A with 5 years of service has an accumulated pension benefit of $7,500 per year under the terminated pension plan ($1,500 × 5 years of service). For years 20X1, 20X2, and the first half of 20X3, Employee A will accrue no additional pension benefits. The accrual of additional pension benefits will commence in the second half of 20X3. If a significant number of employees will not accrue additional pension benefits for some or all of their future services (as is the situation for Employee A), a curtailment occurs.

**>>> Curtailment Measurement Issues**

**55-175** An employer is permitted to amortize **prior service cost** on a straight-line basis over the average remaining

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service period of employees expected to receive the related pension benefits under the guidance in paragraph 715-30-35-13 in order to reduce the complexity and detail of the computations that would otherwise be required by the guidance in paragraph 715-30-35-11.

**55-176** Paragraph 715-30-35-92 specifies that the prior service cost included in accumulated other comprehensive income associated with years of service no longer expected to be rendered as a result of a curtailment is a loss. Even if the employer uses an **amortization** method permitted by paragraph 715-30-35-13 (such as straight-line amortization over average remaining service period, as described in the preceding paragraph) rather than the approach described in paragraph 715-30-35-11, the basic approach in paragraph 715-30-35-92 should be retained. In that situation, the ability to associate prior service cost included in accumulated other comprehensive income with years of service no longer expected to be rendered is more difficult and the result may be less precise. Use of the percentage reduction of years of service after the curtailment may be necessary. For example, if the future years of service determined as of the immediately preceding measurement date for those employees covered under a prior pension plan amendment are reduced by 50 percent due to a curtailment, the employer would recognize in earnings 50 percent of the prior service cost included in accumulated other comprehensive income.

**55-177** A curtailment may occur because an employer terminates or suspends a pension plan, so that employees do not earn additional pension benefits for future service, but the employees continue to work for the employer. In such a situation, any prior service cost included in accumulated other comprehensive income associated with the employees affected by the pension plan termination or

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suspension shall be included in determining the net gain or loss to be recognized for the curtailment.

**55-178** One reason that this Subtopic provides for delayed recognition in net periodic pension cost of prior service cost is the likelihood of future economic benefits to the employer as a result of a retroactive pension plan amendment. Those pension benefits are associated with the future services of those employees at the date of the pension plan amendment who are expected to receive pension benefits under the pension plan. Because a pension plan termination (or suspension) eliminates the accrual of pension benefits for all (or some) of those future services, it raises sufficient doubt about the continued existence of the future economic benefits of the retroactive pension plan amendment to justify recognition in earnings of any prior service cost included in accumulated other comprehensive income. Further, upon termination of a pension plan without the establishment of a successor pension plan, all remaining items included in accumulated other comprehensive income are recognized in earnings.

**55-179** Paragraph 715-30-55-171 provides that a curtailment may result even if a layoff or suspension of benefits is temporary. If a curtailment is due to a pension plan suspension that may be only temporary, for example, the pension plan suspension will end as soon as the employer's financial condition sufficiently improves, the net gain or loss from the curtailment shall be determined based on the **probable** duration of the pension plan suspension. If that duration is a range of years and no single period in that range is a better estimate than any other period, then the determination shall be based on the estimate of duration within that range that results in the minimum net gain or loss from the curtailment.

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**55-180** There may be a balance remaining of the transition asset or obligation included in accumulated other comprehensive income after the employer accounts for a curtailment as required by the Settlements, Curtailments, and Certain Termination Benefits Subsections of this Subtopic. If a curtailment occurs causing almost all of the pension plan's participants to become permanently inactive, the employer shall continue to amortize any transition asset or obligation remaining in accumulated other comprehensive income using the remainder of the amortization period determined at transition.

**55-181** Paragraph 715-30-35-93 describes the determination of any curtailment gain or loss, including the effect of certain amounts in accumulated comprehensive income. It is possible that both a transition asset remains in accumulated other comprehensive income and a larger (smaller) net loss included in accumulated other comprehensive income exists at the date of a curtailment that decreases (increases) the projected benefit obligation. However, the intent of that paragraph is not to provide a mechanism for offsetting a net loss included in accumulated other comprehensive income against any transition asset remaining in accumulated other comprehensive income or increasing a net loss included in accumulated other comprehensive income. Therefore, the decrease (increase) in the projected benefit obligation that is not recognized as a curtailment gain (loss) shall be offset against the net loss included in accumulated other comprehensive income (transition asset remaining in accumulated other comprehensive income). There shall be no further offsetting. See Example 4 (paragraph 715-30-55-216) for an illustration of this guidance.

**55-182** If both a transition asset remaining in accumulated other comprehensive income and a net gain included in accumulated other comprehensive income exist at the date of a curtailment that increases the projected benefit

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obligation, the effects of the curtailment shall be offset using any one of the following three approaches, provided it is applied consistently from year to year. However, for the reason noted in paragraph 715-30-55-208 on settlement accounting, the recommended approach is to offset both on a pro rata basis (alternative [c]). The three approaches for offsetting the curtailment are as follows:

a. Initially against the transition asset remaining in accumulated other comprehensive income
b. Initially against the net gain included in accumulated other comprehensive income
c. Against both on a pro rata basis.

**55-183** An employer may adopt a plan to terminate employees that will significantly reduce the expected years of future service of present employees covered by a pension plan and the sum of the effects of the resulting curtailment identified in paragraphs 715-30-35-92 through 35-93 may be expected to be a net gain. In this situation, the net gain from the curtailment shall be measured and recognized when the related employees terminate.

**55-184** If an employer amends its pension plan to provide for its termination or suspension and thereby eliminates for a significant number of employees the accrual of all or some of the pension benefits for their future services after a subsequent date (that is, the effective date of the pension plan termination or suspension is after the amendment date) and the sum of the effects of the resulting curtailment identified in paragraphs 715-30-35-92 through 35-93 is a net gain, that gain shall not be recognized in earnings when the pension plan termination or suspension is effective, but rather the net gain from the curtailment should be measured and recognized in earnings when the employer amends its pension plan.

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A negative plan amendment is an event in which:

- plan benefits earned for previous service years are reduced; or
- service lives are extended by delaying pension age.

A curtailment is an event in which:

- the expected years of future service of current employees is significantly reduced (e.g. due to terminations); or
- a DB plan is amended such that participants are no longer eligible to earn additional defined benefits, but the plan continues to exist.

The entity continues be obligated to pay benefits earned before they were curtailed. This section discusses how to identify and account for a curtailment.

## 9.4.10 What constitutes a curtailment

### Question 9.4.10
**When does a curtailment occur?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** There are two scenarios that qualify as a curtailment; a curtailment involves an event that for active plan participants either: [715-30 Glossary, 715-60-Glossary]

- significantly reduces their expected years of future service; or
- eliminates some or all their benefits for future services.

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## Question 9.4.15

**How does an entity determine significance when assessing whether an event qualifies as a curtailment?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Topic 715 does not define the term significant event, and therefore entities need to use judgment. We believe that an entity should assess whether an event that reduces expected future years of service or eliminates the accrual of benefits for future services of employees is significant based on an evaluation of the facts and circumstance related to the individual plan. An entity should elect a policy of what constitutes a significant event and how significance would be evaluated.

For example, we believe it would be acceptable for an entity to implement the following policy.

— An event that reduces future years of service by 10% or greater constitutes a significant event.

— An event that eliminates the accrual of defined benefits for some or all of the future services of 10% or more of the employees constitutes a significant event.

— For reductions between 5% and 10%, the entity evaluates the qualitative aspects of the event.

— Reductions below 5% are not considered significant.

See Question 8.7.50 for a related discussion about determining when a plan amendment is significant.

## Question 9.4.20

**Does freezing benefits constitute a curtailment?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** In some cases, determining whether a change to benefits meets the definition of curtailment is not straightforward. In practice, the terms ‘soft freeze’ and ‘hard freeze’ are used to describe different degrees of alterations to benefits. [715-30-35-92]

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### Hard freeze

Hard freeze is generally used to describe a complete freezing of the benefit amount such that participants earn no further benefit credit for future years of service nor receive credit for future salary increases. In some cases, an entity may announce a hard freeze that will take effect one or more years in the future – this is called a 'delayed' hard freeze. A hard freeze meets the definition of a curtailment. [715-30-35-92]

### Soft freeze

The term soft freeze (or partial freeze) is used less consistently and, among other uses, can refer to: [715-30-35-92, 715-30 Glossary]

— closing a plan to new entrants, which would generally not be considered a curtailment for current participants; or
— the partial freezing of benefits, such as eliminating the accrual of benefits for future years served but maintaining the final salary element of the benefits formula.

A soft freeze needs to be analyzed in more detail than a hard freeze to determine whether a curtailment has occurred. [715-30-35-92]

The following provides alternative views about whether soft freeze scenarios constitute a curtailment or a plan amendment.

| Scenario | View A | View B |
|---|---|---|
| | **Curtailment** | **Plan amendment** |
| 1) An entity:<br>— eliminates accrual of benefits for future years of service, but<br>— maintains the final salary element of the benefit formula. | Changes to the benefit amount from the final salary formula is built into the calculation of the benefit obligation. Eliminating the additional benefit granted for each subsequent year of service means there is no further service cost to be recognized. Because there is no further accrual of defined benefits for future services, this meets the definition of a curtailment. [715-30-35-92] | Continuing the final salary adjustment maintains the link to the employee's future service so the employee continues to earn additional defined benefits for this future service as the employee's compensation changes over the remaining service period. |
| | **Curtailment and plan amendment** | **Plan amendment or curtailment** |
| 2) An entity:<br>— eliminates accrual of benefits for future years of service; | The change has two components: a curtailment to eliminate accumulating future benefits, and a plan amendment to include the fixed percentage adjustment. The amendment is an automatic benefit increase | The change is more like replacing the final salary adjustment with the fixed percentage benefit. |

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| Scenario | View A | View B |
|---|---|---|
| — eliminates the final salary element of the benefits formula; and<br>— adds a clause to state that benefit amounts determined at the date of the alteration will increase by a fixed percentage for each future year of service provided by the employee. | that should be included in measuring the benefit obligation. Including this adjustment in the benefit obligation means there is no further service cost to recognize in the future – i.e. there is no further accrual of defined benefits for future services. [715-30-35-35, 715-30-35-92] | Therefore, the change can be equally considered a plan amendment or curtailment. |

In both scenarios, we believe it is acceptable to make a policy election to account for the event as either a curtailment *or* a plan amendment; for Scenario 2 there is also a possible curtailment *and* plan amendment outcome. Section 7.3.20 discusses plan amendments. In both scenarios, the same policy usually is applied to all DB plans.

## Example 9.4.10

**Determining whether an event is a curtailment or a negative amendment in an OPEB plan**

### Background

On January 1, Year 1 ABC Corp.'s retirement program includes approximately 400 participants:

- 20 are retirees;
- 7 are fully eligible but still working;
- 368 are active employees not yet fully eligible:
  - 4 employees become fully eligible on or before December 31, Year 2; and
  - 364 become fully eligible after January 1, Year 3.

On June 27, Year 1 ABC decides to suspend the plan for all employees except those scheduled to become fully eligible on or before December 31, Year 2.

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## Analysis

ABC could account for this event as a curtailment or as a negative plan amendment. ABC's conclusion affects the timing of the gain or loss recognition because, under Subtopic 715-60, a curtailment is potentially recognized in current earnings whereas a negative plan amendment is not.

The illustrations in Subtopic 715-60 provide guidance about how to analyze the difference between a negative plan amendment and a curtailment. The determination is largely based on whether the plan amendment reduces benefits attributed to employee service already rendered and continues to provide additional benefits for future services (negative plan amendment) or reduces the expected years of service of active plan participants or eliminates benefits for future services (curtailment).

**Factors to consider when differentiating between a negative plan amendment and curtailment**

| FASB example | Conclusion | Explanation |
|---|---|---|
| Example 5: Reduction in the APBO [715-60-55-140 – 55-145] | Curtailment | The plan amendment eliminates future service for 364 of the 368 active plan participants (almost 99%). Because there is nominal future service cost to recognize after ABC suspends the plan, this is deemed a curtailment. |
| Example 6: Negative Plan Amendment Results in a Curtailment [715-60-55-146 – 55-160] | Negative plan amendment | The unrecognized future service cost is significant and relates to other participants that remain in the plan and/or to the affected participants (to the extent they re-enter the plan later in their career). |
| | Curtailment | Related to the component of the amendment where unrecognized future service cost is nominal. |

Because ABC determined that the future service cost is nominal (i.e. because of the elimination of future benefits for 364 of 368 participants leaves a nominal amount of future service cost), ABC believes it is reasonable to conclude that this transaction should be treated as a curtailment instead of as a negative plan amendment. [715-60-55-147 – 55-160]

**Note:** In this example, ABC applies its interpretation to a situation in which the event eliminates for substantially all of a plan's active participants the accrual of defined benefits for their future services. If that were not the case, ABC may have a different conclusion. We believe that this is an area of judgment and that some may conclude differently when interpreting the fact pattern in this example under the guidance in Subtopic 715-60. Based on those facts and the diversity in practice, we believe it is also acceptable for ABC to instead account for the transaction as a negative plan amendment.

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# Example 9.4.20

## Example journal entry: Negative plan amendment results in a curtailment

This example provides detailed journal entries related to the following FASB example.

## Excerpt from ASC 715-60

**55 Implementation Guidance and Illustrations**

**>>> Case A: Negative Plan Amendment Results in a Curtailment Gain**

**55-147** Entity A sponsors an unfunded postretirement benefit plan whose only benefit is life insurance coverage equal to an employee's final pay. On December 31, 20X1, Entity A amends its plan to eliminate that benefit for active employees who are not 40 years of age or older, which is a significant portion of its work force. The resulting reduction in the accumulated postretirement benefit obligation consists of two components: $150,000 represents benefits based on past pay and service already rendered by employees under age 40 (a negative plan amendment), and $250,000 represents that portion of the accumulated postretirement benefit obligation based on a projection of those employees' future pay. Because the change in plan terms eliminates the accrual of additional benefits for those employees, the $250,000 is potentially a currently recognizable curtailment gain.

| | December 31, 20X1 | | | | |
|---|---|---|---|---|---|
| | Before Negative Plan Amend-ment | Negative Plan Amendment | After Negative Plan Amend-ment | Curtail-ment | After Curtail-ment |
| Accumulated postretirement benefit obligation (recognized liability) | $ (750,000) | $ 150,000 | $ (600,000) | $ 250,000 | $ (350,000) |
| Amounts recognized in accumulated other comprehensive income: | | | | | |
| Prior service cost | $ 50,000 | $ (50,000) (a) | $ - | | |
| Transition obligation | 70,000 | (70,000) (a) | - | | |
| Net loss | 100,000 | | 100,000 | $ (100,000) (b) | |
| Negative prior service cost | | (30,000) | (30,000) | | $ (30,000) |
| | $ 220,000 | $ (150,000) | $ 70,000 | $ (100,000) | $ (30,000) |

(a) The decrease in the accumulated postretirement benefit obligation due to a negative plan amendment is used first to reduce any existing prior service cost recognized in accumulated other comprehensive income, then to reduce any transition obligation recognized in accumulated other comprehensive income.

(b) The decrease in the accumulated postretirement benefit obligation due to a curtailment is used first to reduce any net loss recognized in accumulated other comprehensive income at the date of the curtailment.

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**55-148** The journal entry to record the negative plan amendment is as follows.

| | | |
|---|---|---|
| Postretirement benefit liability | $ 150,000 | |
| Other comprehensive income | | $ 150,000 |

**55-149** The journal entry to record the curtailment gain is as follows.

| | | | |
|---|---|---|---|
| Postretirement benefit liability | $ 250,000 | | |
| Other comprehensive income | | $ 100,000 | |
| Curtailment gain | | $150,000 | (a) |

(a) The curtailment gain is not a component of net periodic postretirement benefit cost and should be disclosed separately.

**55-150** The negative plan amendment results in negative prior service cost because it reduces the accumulated postretirement benefit obligation by an amount that exceeds the prior service cost and the remaining transition obligation included in accumulated other comprehensive income. The negative prior service cost of $30,000 is recognized in net periodic postretirement benefit cost by amortizing it over future periods beginning January 1, 20X2, in accordance with paragraph 715-60-35-17. Only those participants who are active at the date of the amendment and who are not yet fully eligible for benefits (that is, participants who are 40 years of age or older) are considered in applying that paragraph to the net negative prior service cost that results from this plan amendment

**55-151** If Entity A had instead amended the plan on October 31, 20X1, and it had a calendar-year fiscal year-end, the effects of the negative plan amendment in determining net periodic postretirement benefit cost for 20X1 would be recognized prospectively starting from November 1, 20X1. The net periodic postretirement benefit cost for the first 10 months of the year would reflect the terms of the plan before the plan amendment.

Based on the detail provided in the above FASB example, Entity A records the following journal entry for the negative plan amendment.

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| | Debit | Credit |
|---|---|---|
| Postretirement benefit liability[1] | 150,000 | |
| AOCI-Prior service cost[2] | | 50,000 |
| AOCI-Transition obligation[3] | | 70,000 |
| AOCI-Negative prior service cost[4] | | 30,000 |
| *To recognize negative plan amendment to eliminate accumulated benefits for active employees under 40.* | | |

Notes:

1. The reduction in the APBO for the negative plan amendment to eliminate benefits related to past pay and service already rendered by employees under 40.
2. The elimination of existing prior service cost in AOCI. The decrease in the APBO for a negative plan amendment is used first to reduce existing prior service cost in AOCI.
3. The elimination of existing transition obligation in AOCI. The decrease in the APBO for a negative plan amendment is used first to reduce existing prior service cost in AOCI then any transition obligation in AOCI.
4. To recognize remaining negative prior service cost after considering reduction in existing prior service cost in AOCI and existing transition obligation in AOCI.

## 9.4.20 Timing of recognition

### Question 9.4.30
**When is a curtailment recognized?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** When a curtailment is recognized depends on whether it is a result of a change to the plan (e.g. amendment or plan termination), or arises from the termination of a significant number of employees.

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| Curtailment results from: | When recognized? | Timing of recognition the same regardless of curtailment gain or loss? | Probability consideration? |
|---|---|---|---|
| Change to the plan | A curtailment gain or loss is generally recognized when the plan change/amendment is adopted and the revisions are communicated within a reasonable period of time. A curtailment gain is not recognized sooner than the amendment adoption date. However, when there is a curtailment loss, it is recognized when it becomes is probable that a curtailment will occur and its effects can be reasonably estimated; the amendment adoption date is usually the date on which the amendment is probable and estimable. For example, if board approval is needed for the plan amendment to be adopted, the curtailment loss becomes probable and estimable only upon board approval, which in turn is determined to be the amendment adoption date. [715-30-35-94, 715-60-35-21]<br>In addition, as long as the plan amendment is communicated to participants within a reasonable period of time, the curtailment gain or loss is not recognized later than the amendment adoption date, even if the effective date of the curtailment is subsequent to the date the amendment is adopted. [715-60-35-21] | Generally, yes | Yes – Curtailment loss<br>No – Curtailment gain |
| Employee terminations | A curtailment loss from employee terminations is recognized when it is probable that a curtailment will occur and its effects can be reasonably estimated. This is typically when the decision is made to terminate employees, and will usually be before the actual employee termination date. [715-30-35-94, 715-60-35-21]<br>A curtailment gain from employee terminations is not recognized until the employees are terminated. [715-30-35-94, 715-60-35-21] | No. The timing of recognition depends on whether there is a curtailment gain or loss. | Yes. |

The timing of curtailment recognition does not change regardless of whether the effects are recognized in income or OCI. The table in Question 9.4.50 explains how to determine the effect of a curtailment gain or loss on the income statement when there is a net gain/loss in AOCI pre-curtailment and also the effect of a curtailment on the benefit obligation. [715-30-35-94, 715-30-55-184, 715-60-35-171]

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Question 9.4.40#

**When there is a negative plan amendment, can negative prior service cost for a DB OPEB plan be recognized immediately?**

*This interpretive response applies to Subtopic 715-60 only.*

**Interpretive response:** No, unless there is no unrecognized prior service cost in AOCI. A reduction to the benefit obligation caused by a negative plan amendment (the prior service credit) first reduces the amount of unrecognized prior service cost in AOCI. The entity recognizes any remaining prior service credit in AOCI and amortizes it as a component of net periodic benefit cost in future periods, similar to prior service cost. Chapter 7 discusses the accounting for prior service cost. [715-60-35-20, FAS 106.BC290]

## 9.4.30 Calculating curtailment gains and losses

Question 9.4.50

**How is the gain or loss associated with a curtailment calculated?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:**

When a curtailment occurs, there are two components to consider when calculating the gain or loss associated with a curtailment.

— The first component is prior service cost in AOCI associated with years of service no longer expected to be rendered as a result of the curtailment. The amount of prior service cost to be recognized in income is prorated for the percentage of years of service that were eliminated under the curtailment. For example, if a curtailment eliminates 40% of the estimated remaining future years of service of employees employed on the date of a plan amendment, the loss associated with the curtailment is 40% of the prior service cost included in AOCI. For a full curtailment with immediate effect, the entire prior service cost is recognized because there are no future years of service to be rendered. [715-30-35-92, 715-60-35-164 – 35-167]

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— The second component is determined using the change in the benefit obligation as a result of the curtailment. The entity remeasures the benefit obligation to determine the change in the benefit obligation arising from the curtailment. See section 8.7 for guidance on remeasurements.

The following table illustrates how the second component is determined by comparing the change in the obligation to unrecognized gains or losses in AOCI. [715-30-35-93, 715-60-35-169]

| Remeasurement of obligation results in a… | Compare obligation gain/loss to gain/loss in AOCI pre-curtailment. If AOCI is a… | Curtailment calculation | Income statement recognition |
|---|---|---|---|
| Gain (decrease in the obligation) | Net loss | Gain from obligation remeasurement is recorded in AOCI to the extent of the pre-existing net loss in AOCI. The excess, if any, is recognized as a curtailment gain in the income statement. | Recognize excess, if any, as a gain |
| | Net gain | No impact on AOCI. Gain from obligation remeasurement recognized as a curtailment gain in the income statement. | Recognize entire gain |
| Loss (increase in the obligation) | Net loss | No impact on AOCI. Loss from obligation remeasurement recognized as a curtailment loss in the income statement. | Recognize entire loss |
| | Net gain | Loss from obligation remeasurement is recorded in AOCI to the extent of the pre-existing net gain in AOCI. The excess, if any, is recognized as a curtailment loss in the income statement. | Recognize excess, if any, as a loss |

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## Question 9.4.60
**Over what period are gains and losses amortized for a delayed hard freeze?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Determining when employees will become inactive (see Question 7.3.40) is important to determining when to switch amortization periods from an 'average remaining service period' to a 'remaining life expectancy'; this determines the period over which to recognize the gains and losses in AOCI. When there is a delayed hard freeze, we believe an entity should determine the amortization period between the adoption of a delayed hard freeze and its effective date based on when it considers its employees to become inactive. Question 9.4.20 discusses delayed hard freezes. [715-30-35-24, 715-30-35-92, 715-60-35-29, 715-60-35-164]

The following table illustrates how an entity determines the amortization period for gains and losses depending on how its policy defines an inactive employee – i.e. when employment ends or when participants are no longer accruing additional benefits.

| Policy | Gain/loss amortization period |
|---|---|
| Inactive when not accruing benefits (Policy 1) | (a) Average remaining service (i.e. employment) period of the employees<br>**OR**<br>(b) Over the period of the delayed freeze (from the date of adoption to the effective date of the freeze) |
| Inactive when employment ends (Policy 2) | Average remaining service (i.e. employment) period of the employees |

If an entity's accounting policy is to consider employees inactive when they stop accruing additional benefits (Policy 1), we believe Policies 1(a) and 1(b) are both acceptable. When there is a delayed hard freeze, our experience is that it is more common for entities to elect Policy 1(a) or Policy 2; entities that elect Policy 1(a) or Policy 2 believe that the remaining service period of active employees (for purposes of amortization) ends when employment ends, not when the employees stop accruing benefits. Therefore, there is no basis to change the existing amortization period while employees remain in active status during the delayed hard freeze period. This is because the employees are still employed and rendering service to the entity until the hard freeze takes effect.

Entities that choose Policy 1(b) believe that, once the delayed hard freeze is adopted, the period between the adoption of a delayed hard freeze and its effective date represents the 'average remaining service period' for the employees

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because they will become 'inactive' on the effective date of the hard freeze. Policy 1(b) would usually shorten the amortization period because of the relatively short duration of the delayed hard freeze period (e.g. to 2 years) and result in the accelerated recognition of gains and losses during that period. No matter which policy election is chosen, we generally expect the same policy to be applied to all DB plans sponsored by an entity. [715-30-35-24, 35-92, 715-60-35-29, 35-164]

The length of time of the plan freeze is important. The accounting described above does not apply to relatively short implementation periods (e.g. such as the 45-day period that ERISA requires before plan changes can take effect). If the implementation period is relatively short (e.g. 30 to 90 days) an entity does not change its amortization period until the effective date of the freeze.

## Example 9.4.30
### Delayed hard freeze of plan benefits

ABC Corp. sponsors a pension plan for its employees and, on February 1, Year 1, ABC approves a permanent freeze of plan benefits that will take effect on January 31, Year 3. It announces the plan freeze to its employees on February 10, Year 1.

- Before the plan freeze, the average remaining service period for participants was 10 years.
- ABC determines that the plan freeze results in a curtailment.
- ABC has a policy that participants are considered 'inactive' when they no longer accrue benefits (see Question 9.4.60).
- ABC has a policy that, following a hard freeze, the average remaining service period is based on the expected remaining period of employment; this is Policy 1(a) in Question 9.4.60.

The following are ABC's considerations for the accounting for the curtailment and the unrecognized amounts in AOCI.

**Status of participants active during the delayed hard freeze period for purposes of determining the amortization period**

The delayed hard freeze period in this example is two years before the freeze takes effect. During the two-year period, the employees are active for the purpose of amortizing gains or losses included in AOCI. This is because during that time they remain employed while providing services and accruing additional benefits under the plan. ABC continues to recognize service cost related to those services. Even though this plan change will ultimately result in a hard freeze, there is no basis to consider the employees inactive until the freeze takes effect.

Because the participants are considered active, ABC amortizes the gains and losses out of AOCI over their average remaining service period (see Question 9.4.60).

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**Participants become inactive and ABC switches to a life expectancy amortization period to recognize net gains and losses**

ABC follows its accounting policy choice to determine when to consider participants inactive. ABC considers participants active until January 31, Year 3, after which date they no longer accrue additional benefits under the plan. Beginning on the next measurement date following January 31, Year 3, ABC switches to an amortization period based on life expectancy as all participants are inactive. See Question 9.4.60.

**Impact on unrecognized prior service cost in AOCI**

The curtailment guidance requires ABC to immediately recognize the portion of the prior service cost included in AOCI associated with the years of service no longer expected to be rendered as a result of the curtailment. [715-30-35-92]

ABC curtailed benefits beginning in Year 3, shortening the 10-year remaining service period by 8 years or 80%. Therefore, ABC includes 80% of the prior service cost in AOCI in determining the net gain or loss to be recognized for the curtailment. ABC amortizes the remaining 20% of the prior service cost over the remaining service period.

ABC's accounting policy choice about when employees become inactive is not relevant for the purpose of recognizing prior service cost at the time the plan is frozen. ABC's recognition of 80% of the prior service cost as an immediate loss is appropriate based on the implementation guidance on curtailment measurement issues in Subtopic 715-30 (see Question 9.3.70): when a plan is terminated or suspended associated prior service cost should be eliminated – even if the employees continue to work for the entity. Implicit in the guidance about curtailment measurement issues is that the plan freeze is immediate. Because ABC's plan freeze is delayed by two years, we believe it is acceptable to continue to amortize the portion of the prior service cost not written off in the curtailment accounting over the remaining service period during the two year delayed freeze period.

Question 7.3.130 discusses when to recognize a plan amendment.

## Example 9.4.40

**Timing of a curtailment gain when employees are paid after termination date under local law**

**Background**

On December 21, Year 1, ABC Corp. announced it was terminating a significant portion of its employees in France with immediate effect. Each employee was covered under ABC's DB pension plan based on years of service. According to French employment law, a standard notification period is required for terminated employees. According to termination agreements with the employees, they are not required to provide services after December 21, Year 1. However, ABC is

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legally obligated to pay each employee through January, Year 2. The employees cannot refuse the termination agreement.

**Analysis**

ABC records the curtailment gain in Year 1 because it has fulfilled its legal obligation under French employment law and adopted a plan to terminate employees that will significantly reduce the expected years of future service of the employees covered by the plan. This is so even if the standard notification period extends into the next fiscal year. Because the employees are no longer required to provide services to ABC and cannot refuse the termination agreement, they are effectively terminated on the date of the notification.

## 9.5 Events that cause both a settlement and curtailment

### Excerpt from ASC 715-30

**35 Subsequent Measurement**

**> Relationship of Settlements and Curtailments to Other Events**

**35-74** A **settlement** and a **curtailment** may occur separately or together.

**35-75** This Subsection does not establish a proper sequence of events to follow in measuring the effects of a settlement and a curtailment that are to be recognized at the same time. Although the sequence selected can affect the determination of the aggregate **gain or loss** recognized, the selection of the event to be measured first (settlement or curtailment) is an arbitrary decision and neither order is demonstrably superior to the other. However, an employer shall consistently apply the same sequence of events in determining the effects of all settlements and curtailments that are to be recognized at the same time.

### Excerpt from ASC 715-60

**35 Subsequent Measurement**

**> Relationship of Settlements or Curtailments to Other Events**

**35-172** A settlement and a curtailment may occur separately or together.

**35-173** If benefits expected to be paid in future periods are eliminated for some plan participants (for example, because a significant portion of the work force is dismissed or a plant is closed) but the plan remains in existence and continues to pay benefits, to invest assets, and to receive contributions, a curtailment has occurred but not a settlement.

**35-174** If an employer purchases nonparticipating insurance contracts for the accumulated postretirement benefit obligation and continues to provide defined benefits for future service, either in the same plan or in a successor plan, a settlement has occurred but not a curtailment.

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**35-76** If **benefits** to be accumulated in future periods are reduced (for example, because half of a work force is dismissed or a plant is closed) but the plan remains in existence and continues to pay benefits, to invest assets, and to receive contributions, a curtailment has occurred but not a settlement.

**35-77** If an employer purchases nonparticipating annuity contracts for **vested benefits** and continues to provide defined benefits for future **service**, either in the same plan or in a successor plan, a settlement has occurred but not a curtailment.

**35-78** If a plan is terminated (that is, the obligation is settled and the plan ceases to exist) and not replaced by a successor defined benefit plan, both a settlement and a curtailment have occurred (whether or not the employees continue to work for the employer). See Example 1 (paragraph 715-30-55-198) for an illustration of this situation.

**55 Implementation Guidance and Illustrations**

**> Implementation Guidance**

**>> Relationship of Settlements and Curtailments to Other Events**

**55-135** As part of the sale of a component of an entity there may be a transfer of a pension benefit obligation to the purchaser (that is, the purchaser assumes the pension benefit obligation for specific employees. Whether both a settlement and a curtailment occur depends on the facts and circumstances.

**35-175** If a **plan termination** occurs (that is, the obligation is settled and the plan ceases to exist) and the plan is not replaced by a successor defined benefit plan, both a settlement and a curtailment have occurred (whether or not the employees continue to work for the employer).

**35-176** The settlement or the termination of one plan and the adoption of a substantially equivalent replacement plan does not trigger recognition in income of prior service cost. Neither of those events, absent a curtailment, raises sufficient doubt as to the existence of future economic benefits to trigger that recognition in income.

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## Question 9.5.10

### Can the same event cause both a settlement and curtailment?

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Yes. A plan settlement and a curtailment may occur separately, or together. [715-30-35-74 – 35-78, 715-60-35-172 – 35-175]

- A curtailment (but not a settlement) occurs when future benefits are reduced (e.g. because half the work force is dismissed, or a plant is closed), but the plan remains in existence and continues to pay benefits, invest assets and receive contributions.
- A settlement (but not a curtailment) occurs when an entity purchases nonparticipating annuity contracts for vested benefits and continues to provide defined benefits for future service, either in the same plan or in a successor plan.
- Both a curtailment and settlement occur when a plan is terminated (the obligation is settled and the plan ceases to exist) and is not replaced by a successor DB plan, regardless of whether the employees continue to work for the entity.

## Question 9.5.20

### What is the sequence for measuring settlements and curtailments?

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Because a settlement, curtailment or termination event may occur at the same time or in proximity to one another, there are often questions about how to account for these concurrent events. This is because the order in which they are accounted for can affect the total gain or loss to be recognized. Topic 715 does not specify the appropriate sequencing when measuring the effects of a settlement and curtailment that are to be recognized at the same time. It does state, however, that the selection of the event to be measured first (settlement or curtailment) is a subjective decision and neither order is demonstrably superior to the other, and that the approach selected should be consistently applied.

For certain events such as a series of related decisions or transactions, the curtailment decision may be made before the settlement decision. In these cases, it may be appropriate to measure the effects of the curtailment before

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settlement accounting is applied. An entity should apply its approach consistently to similar transactions as required under Subtopics 715-30 and 715-60. [715-30-35-75, 715-60-35-172, 715-60-55-131]

## Example 9.5.10

**Partial settlement and full curtailment from sale of a line of business**

This example provides detailed journal entries related to the following FASB example.

### Excerpt from ASC 715-60

**55 Implementation Guidance and Illustrations**

**>> Example 3: Accounting for a Partial Settlement and a Full Curtailment that Occur as a Direct Result of a Sale of a Line of Business**

**55-130** Entity S sells a line of business on December 31, 20X4; before that date, the entity had no formal plan for disposal of those operations. Entity S has a separate postretirement benefit plan that provides health care benefits to retirees of the division that is sold. In connection with that sale, all of the employees of that division are terminated by Entity S resulting in no further accumulation of benefits under the postretirement benefit plan (a full curtailment), most of the terminated employees are hired by the acquiring entity (some terminated employees fully eligible for benefits elect to retire immediately), an accumulated postretirement benefit obligation of $80,000 for postretirement benefits related to the hired employees is assumed by the acquiring entity (a partial settlement, since the obligation for current retirees is retained by Entity S), and plan assets of $100,000, representing $80,000 for the settlement of the accumulated postretirement benefit obligation and $20,000 as an excess contribution, are transferred from the plan to the acquiring entity. A $300,000 gain from the sale is calculated before considering the related effects on the plan.

**55-131** The employer's accounting policy is to determine the effects of a curtailment before determining the effects of a settlement when both events occur simultaneously.

**55-132** The effect of the curtailment is determined as follows.

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| | December 31, 20X4 | | | |
|---|---|---|---|---|
| | Before Curtailment | Curtailment-Related Effects Resulting from Sale | | After Curtailment |
| Accumulated postretirement benefit obligation | $ (257,000) | $ (10,000) | (a) | $ (267,000) |
| Plan assets at fair value | 110,000 | | | 110,000 |
| Funded status and recognized liability | $ (147,000) | $ (10,000) | | $ (157,000) |
| Accumulated other comprehensive income: | | | | |
| Net gain | $ (49,575) | $ 10,000 | (a) | $ (39,575) |
| Prior service cost | 33,000 | (33,000) | (b) | - |
| Transition obligation | 195,000 | (195,000) | (c) | - |
| Total accumulated other comprehensive income | $ 178,425 | (218,000) | | $ (39,575) |
| Curtailment loss | | $ 228,000 | | |

(a) The increase in the accumulated postretirement benefit obligation as a result of the fully eligible employees retiring earlier than expected is a loss of $10,000. That loss reduces the net gain included in accumulated other comprehensive income of $49,575; any excess (none in this Example) would be recognized in income as the effect of a curtailment (see paragraphs 715-60-35-169 through 35-170).

(b) Measured as 100% (reduction in the remaining years of service before full eligibility for benefits associated with those terminated employees who were plan participants at the date of a prior plan amendment) of the prior service cost included in accumulated other comprehensive income of $33,000 related to that amendment (see paragraphs 715-60-35-164 through 35-166).

(c) Measured as 100% (reduction in the remaining years of expected service associated with those terminated employees who were plan participants at the date of transition) of the transition obligation remaining in accumulated other comprehensive income of $195,000 (see paragraphs 715-60-35-164 through 35-166).

**55-133** The $8,128 loss related to the settlement and transfer of plan assets that is recognized in income with the gain from the sale is determined as follows.

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| | December 31, 20X4 | | | |
|---|---|---|---|---|
| | After Curtailment | Settlement and Transfer of Plan Assets | | After Settlement |
| Accumulated postretirement benefit obligation | $ (267,000) | $ 80,000 | [a] | $ (187,000) |
| Plan assets at fair value | 110,000 | (100,000) | [a] | 10,000 |
| Funded status and recognized liability | $ (157,000) | $ (20,000) | | $ (177,000) |
| Accumulated other comprehensive income: | | | | |
| Net gain | $ (39,575) | $ 11,872 | [b] | $ (27,703) |
| Prior service cost | - | | | - |
| Transition obligation | - | | | - |
| Total accumulated other comprehensive income | $ (39,575) | $ 11,872 | | $ (27,703) |
| Settlement loss | | $ 8,128 | | |

(a) The accumulated postretirement benefit obligation for the employees hired by the purchaser is determined to be $80,000 and is settled when Entity S transfers plan assets of an equal amount to the purchaser. In connection with the purchase agreement, Entity S transfers an additional $20,000 of plan assets.

(b) Represents a pro rata amount of the maximum gain based on the relationship of the accumulated postretirement benefit obligation settled to the total accumulated postretirement benefit obligation ($80,000 / $267,000 or 30%). The maximum gain is measured as the net gain included in accumulated other comprehensive income after transition plus any transition asset remaining in accumulated other comprehensive income ($39,575 + $0 = $39,575). The settlement gain is, therefore, 30% of $39,575, or $11,872; recognition in income of that gain is subject to first reducing any transition obligation remaining in accumulated other comprehensive income. As there is no transition obligation remaining in accumulated other comprehensive income (the remainder was recognized in income in connection with the curtailment), the gain of $11,872 is recognized in income together with the excess $20,000 transfer of plan assets as part of the net gain from the sale (see paragraphs 715-60-35-151 through 35-155).

**55-134** The sum of the effects related to postretirement benefits resulting from the sale is a loss of $236,128, the components of which are as follows.

| | |
|---|---|
| Curtailment loss (paragraph 715-60-55-132) | $ 228,000 |
| Net settlement loss (see the table in the preceding paragraph) | 8,128 |
| Effects of sale | $ 236,128 |

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Based on the detail provided in the above FASB example, Entity S records the following journal entries related to the curtailment and settlement.

| | *Debit* | *Credit* |
|---|---|---|
| Curtailment loss | 228,000 | |
| AOCI-Net gain | 10,000 | |
| APBO | | 10,000 |
| AOCI-Prior service cost | | 33,000 |
| AOCI-Transition obligation | | 195,000 |
| *To recognize curtailment of retirement benefit plan from employee terminations.* | | |
| Settlement loss | 8,128 | |
| AOCI-Net gain | 11,872 | |
| Net APBO | | 20,000 |
| *To recognize partial settlement of APBO assumed by acquiring entity.* | | |

## 9.6 Accounting for certain termination benefits

### Excerpt from ASC 715-30

**20 Glossary**

**Termination Benefits –** Benefits provided by an employer to employees in connection with their termination of employment. They may be either special termination benefits offered only for a short period of time or contractual benefits required by the terms of a plan only if a specified event, such as a plant closing, occurs.

### Excerpt from ASC 715-60

**20 Glossary**

**Termination Benefits –** Benefits provided by an employer to employees in connection with their termination of employment. They may be either special termination benefits offered only for a short period of time or contractual benefits required by the terms of a plan only if a specified event, such as a plant closing, occurs.

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**15 Scope and Scope Exceptions**

**> Transactions**

**15-3** The guidance in this Subtopic applies to **defined benefit pension plans**, including but not limited to the following types of arrangements: …

b. **Benefits** provided in the event of a voluntary or involuntary severance of employment (also called **termination indemnities**) if such an arrangement is in substance a pension plan (for example, if the benefits are paid for virtually all terminations).

**25 Recognition**

**> Certain Termination Benefits**

**25-8** This Subsection addresses the accounting for **termination benefits** that are not otherwise addressed in the Subtopic and Topics indicated in paragraph 715-30-15-6c.

**25-9** An employer may provide benefits to employees in connection with their termination of employment. Those benefits may be either special termination benefits offered only for a short period of time or contractual termination benefits required by the terms of a plan only if a specified event, such as a plant closing, causes employees' services to be terminated involuntarily.

**25-10** Termination benefits may take various forms including lump-sum payments, periodic future payments, or both. They may be paid directly from an employer's assets, an existing pension plan, a new employee benefit plan, or a combination of those means. An employer that offers special termination benefits to employees shall recognize a liability and a **loss** when the employees accept the offer and the amount can be reasonably estimated. An employer that provides contractual termination benefits shall recognize a liability and a loss when it is probable that

**25 Recognition**

**25-4** The Settlements, Curtailments, and Certain Termination Benefits Subsections provide recognition guidance for the postretirement benefit incentive to be received by employees in exchange for early termination. **Postretirement benefits** offered as special or contractual termination benefits shall be recognized in accordance with paragraph 715-30-25-10.

**25-5** Situations involving special or contractual **termination benefits** may also result in a curtailment to be accounted for under paragraphs 715-60-35-161 through 35-171.

**25-6** The liability and loss recognized for employees who accept an offer of special termination benefits to be provided by a **postretirement benefit plan** shall be the difference between:

a. The **accumulated postretirement benefit obligation** for those employees, assuming that those employees (**active plan participants**) not yet fully eligible for **benefits** would terminate at their **full eligibility date** and that **fully eligible plan participants** would retire immediately, without considering any special termination benefits
b. The accumulated postretirement benefit obligation as

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employees will be entitled to benefits and the amount can be reasonably estimated.

**25-11** The cost of termination benefits within the scope of this Subsection recognized as a liability and a loss shall include the amount of any lump-sum payments and the present value of any expected future payments. The liability and the loss from the acceptance of the offer of special termination benefits is the difference as of the date the employees accept the offer between the **actuarial present value** of the respective employees' accumulated **pension benefits** without considering the special termination benefits and the actuarial present value of their accumulated pension benefits considering the special termination benefits.

**25-12** See Example 6 (paragraph 715-30-55-226) for an illustration of the determination of the liability and the losses from employees' acceptance of an offer of special termination benefits.

**25-13** A situation involving termination benefits may also involve a **curtailment** to be accounted for under paragraphs 715-30-35-92 through 35-95.

**55 Implementation Guidance and Illustrations**

**>> Certain Termination Benefits**

**55-185** Paragraphs 715-30-25-9 through 25-13 provide general guidance on special termination benefits and contractual termination benefits.

**55-186** An employer that offers, for a short period of time, special termination benefits to employees, shall not recognize a loss at the date the offer is made based on the estimated acceptance rate. Paragraph 715-30-25-10 requires offers of special termination benefits to be recognized when the employees accept the offer and the amount can be reasonably estimated.

measured in (a) adjusted to reflect the special termination benefits.

See Example 4 (paragraphs715-60-55-135 through 55-139) and Example 7 (paragraphs 715-60-55-161 through 55-175).

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**55-187** An employer may offer special termination benefits that result in a curtailment. It is possible that the offer of termination benefits could be recognized in a reporting period different from the period in which the curtailment is recognized because a net loss from a curtailment (as defined in paragraph 715-30-35-94) is recognized when it is probable that a curtailment will occur and the effects are reasonably estimable, while as indicated in paragraph 715-30-25-10, the cost of special termination benefits is not recognized until employees accept the offer and the amount can be reasonably estimated.

**55-188** An employer may sponsor a pension plan that provides supplemental early retirement benefits. Such pension benefits shall not be accounted for as contractual termination benefits, rather, supplemental early retirement benefits shall be accounted for as part of net periodic pension cost pursuant to the **attribution** approach described in paragraphs 715-30-35-36 through 35-38.

**55-189** Plans providing **termination indemnities** that are associated with preretirement termination of employment shall be assessed on a case-by-case basis. If benefits are paid only for involuntary termination of employment due to the occurrence of a specific event, they qualify as contractual termination benefits, and a liability and a loss shall be recognized when it is probable that employees will receive benefits and the amount can be reasonably estimated. However, if a plan is, in substance, a pension plan (for example, if benefits are paid for virtually all terminations), the plan is subject to the provisions of the General Subsections of this Subtopic. See paragraphs 420-10-55-1 and 420-10-55-16 for additional guidance in making this determination. However, if payment of the benefits results directly from a sale or disposal of a component of an entity, the cost of those benefits shall be recorded and recognized pursuant to paragraph 205-20-45-3.

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Chapter 4 clarifies how to determine whether *special* or *contractual* termination benefits are in the scope of Topic 712 or Topic 715 and addresses accounting for those in the scope of Topic 712 (see Question 4.2.10). This section examines accounting for special and contractual termination benefits in the scope of Topic 715 because they are provided through a pension or OPEB plan.

## Question 9.6.10

### What termination benefits are in the scope of Topic 715?

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Special or contractual termination benefits provided to employees under an ongoing DB pension or OPEB plan are accounted for under Topic 715.

The following table summarizes the termination benefits for pension plans in the scope of Topic 715 and how they are accounted for.

| Description | Definition | Form | Recognition | Measurement | Subtopic |
|---|---|---|---|---|---|
| Special termination benefits | Termination benefits offered under a DB pension plan only for a short period of time [715-30-25-9] | — Lump-sum payment; and/or<br>— periodic future payment. [715-30-25-10] | Liability and loss when employees accept the offer and the amount can be reasonably estimated. [715-30-25-10] | Amount of any lump-sum payments and present value of any expected future payments.<br>Liability and loss measured at the acceptance date as the difference between:<br>— actuarial present value of employees' accumulated pension benefits *without* special termination benefits, and<br>— actuarial present value of accumulated pension benefits *with* special termination benefits. [715-30-25-11] | 715-30 |
| Contractual termination benefits | Termination benefits contractually required under a | | Liability and a loss when it is probable that employees will | Amount of any lump-sum payments and present value of any expected future payments. [715-30-25-11] | 715-30 |

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| Description | Definition | Form | Recognition | Measurement | Subtopic |
|---|---|---|---|---|---|
| | DB pension plan when a specified event (e.g. plan closing) causes employees to be terminated involuntarily [715-30-25-9] | | be entitled to benefits and the amount can be reasonably estimated. [715-30-25-10] | | |

Special or contractual termination benefits pursuant to an OPEB plan can include healthcare and life insurance. Subtopic 715-60 requires entities to follow the recognition guidance in Subtopic 715-30 when accounting for these OPEB special and contractual termination benefits. Additionally, under Subtopic 715-60, the loss and liability related to OPEB benefits that are offered as special termination benefits are measured as the difference between: [715-60-25-4 – 25-6]

- APBO for affected employees without special termination benefits; and
- Actuarial present value of APBO for affected employees *with* special termination benefits.

In both cases, this assumes that active participants who are not fully eligible would terminate at full eligibility date and fully eligible participants would retire immediately.

Termination benefits provided outside a DB plan are outside the scope of Topic 715. Question 4.2.10 discusses these benefits under Topics 420 and 712. [715-30-15-7, 715-60-15-18]

## Question 9.6.20

**When are termination benefits recognized under Topic 715?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** It depends on whether they are special termination benefits or contractual termination benefits.

### Special termination benefits

A liability and a loss are recognized for special termination benefits when the employees accept the offer and the amount can be reasonably estimated. An entity does not accrue an estimate of special termination benefit expense (above and beyond contractual termination benefits) before irrevocable acceptance. Section 4.2 discusses termination benefits under Topics 420 and 712. [715-30-25-10]

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### Contractual termination benefits

A liability and a loss are recognized when it is probable that employees will be entitled to benefits and the amount can be reasonably estimated. [715-30-25-10]

## Example 9.6.10#
**Accrual for involuntary severance when combined with a voluntary severance plan**

### Background

ABC Corp. has a voluntary severance plan (VSP) that is not part of a pension/OPEB benefit and which it periodically extends to certain groups of employees. On November 1, Year 1 ABC initiates an offer under the VSP to a group of its employees. The VSP is being offered as part of a broader severance plan that includes involuntary terminations that meet the requirements of Topic 715. If the target number of employees do not accept the VSP offer, ABC will involuntarily terminate employees to reach the targeted headcount reduction.

The timeline for the terminations is as follows.

| | |
|---|---|
| ABC communicates the VSP offer to employees: | November 1, Year 1 |
| Employee decides whether to participate: | December 1, Year 1 |
| ABC decides to accept (or reject) the VSP employees electing to participate: | December 31, Year 1 |
| Accepted employees decide whether to retract their offer to participate: | January 31, Year 2 |
| ABC severs employees who do not retract their participation: | February 1, Year 2 |
| If necessary, ABC involuntarily terminates additional employees to reach target: | February 15, Year 2 |

### Analysis

Because ABC has an involuntary termination plan that meets the recognition requirements of Topic 715, it records the liability and loss related to any contractual termination benefits (i.e. involuntary) in Year 1, as ABC knows which employees will be entitled to receive benefits and can reasonably estimate the amount of the liability for the involuntary termination benefits. ABC then recognizes any incremental voluntary termination benefits on January 31, Year 2, when the legal retraction period expires for the employees who accepted the offer.

If ABC had not had in place an involuntarily termination plan to be accounted for under Topic 715, it would have accounted for the VSP entirely under Topic 712 because it was not part of a pension/OPEB benefit. Without the

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involuntary termination plan in place, ABC could not record a liability for the voluntary severance benefits in Year 1 because employees could withdraw from the plan after the reporting date. In that case, ABC would record the entire liability on January 31, Year 2, when the legal retraction period expires, the participation is irrevocable, and the amount can be reasonably estimated.

Chapter 4 discusses accounting for termination benefits, and Question 4.3.10 discusses determining whether termination benefits are accounted for under Topic 712 or Topic 715.

## Question 9.6.30

### How are special termination benefits measured under Topic 715?

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** As summarized in the table in Question 9.6.10, special termination benefits recognized under Topic 715 are measured as the incremental increase in the entity's obligation from the increase in benefits provided under the DB plan to the terminated employees. [715-30-25-11, 715-60-25-6]

For example, an entity may determine that it will terminate 2,000 employees (i.e. a curtailment) and offer special (higher) pension termination benefits (to be paid from plan assets) to the first 1,000 employees who volunteer for termination. When the 1,000 employees or fewer irrevocably accept the offer of higher voluntary (special termination) benefits for termination, the entity immediately recognizes an incremental obligation associated with those acceptances.

The incremental liability and the loss from the acceptance of the offer of special termination benefits is the difference (as of the date the employees accept the offer) between:

— The respective employees' accumulated benefits *without considering* the special termination benefits; and
— the actuarial present value of their accumulated pension benefits *considering* the special termination benefits. [715-30-25-11, 715-60-25-6]

Active employees who did not accept the offer should not be included when calculating the loss and liability related to the special termination benefits.

If the effect of the probable curtailment is a loss, the entity recognizes that curtailment loss for the anticipated termination of 2,000 employees on the date it becomes probable and estimable. [715-30-15-6(b), 715-30-25-11, 715-30-55-186 – 55-187]

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### Guidance specific to Subtopic 715-60

Assume the same facts as above except that the special termination benefits are offered pursuant to an OPEB plan. For those who have accepted the offer of special termination benefits, ABC calculates the incremental liability and loss as the difference between:

— the APBO for those employees, assuming that active plan participants not yet fully eligible for benefits would terminate at their full eligibility date and that fully eligible participants would retire immediately, *without* considering any special termination benefits; and
— the APBO as measured in the first bullet adjusted to *include* the effects of the special termination benefits.

Active employees who did not accept the offer should not be included in the APBO when calculating the loss and liability related to the retirement benefits offered as special termination benefits. [715-60-25-6]

## Example 9.6.20
### Accounting for special termination benefits

ABC Corp. negotiates an early retirement arrangement with several executives.

— ABC agrees to provide an additional two-years' service credit when calculating the benefits to be paid under the DB pension plan. ABC is not obligated by contract to offer these benefits.
— The early retirement of the executives is not considered significant under Subtopic 715-30 to qualify as a plan curtailment; this is because only a few employees are affected. [715-30 Glossary]

For special termination benefits that are under Topic 715, ABC recognizes a liability and loss when the employee accepts the offer (similar to when they are recognized if under Topic 712). ABC measures the incremental liability and the loss of special termination benefits as the difference between (1) the actuarial present value of the respective employees' accumulated pension benefits *without considering* the special termination benefits and (2) the actuarial present value of their accumulated pension benefits *considering* the special termination benefits. This liability is separate from any effect the early retirements have on the plan PBO (e.g. through the reduction in future salary increases). [715-30-25-9]

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## Question 9.6.40

**How are termination benefits involving a curtailment accounted for?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** The loss on a curtailment is calculated separately from any related special termination benefits. If a curtailment also involves termination benefits, the change in the benefit obligation from the curtailment is the difference between the benefit obligation for the respective employees excluding the termination benefits and the benefit obligation for those employees under the normal pension plan formula and assuming no future service because of their termination. [715-30-25-13, 715-30-35-95, 715-30-55-224, 715-30-55-226 – 55-230, 715-60-25-5, 715-60-35-170]

The special termination benefits are calculated separately under Topic 715 as described in Example 5 and Example 6 of Section 715-30-55.

# 9.7 Presentation

## Excerpt from ASC 715-30

**55 Implementation Guidance and Illustrations**

**>> Presentation Matters**

**55-190** In connection with terminating its pension plan, an employer may settle the pension benefit obligation and withdraw excess plan assets and then contribute and allocate those assets to participants' accounts in a new defined contribution pension plan. In this situation, an employer shall not combine any net gain or loss from the settlement and curtailment of the terminated plan with the net periodic pension cost from the contribution to the defined contribution pension plan and thereby report both on a net basis for purposes of classification in the income statement or disclosure in accompanying notes to financial statements. Because the following two separate events have occurred that require separate accounting recognition, netting the results of the separate events is inappropriate:

a. A pension plan termination resulting in recognition in earnings of all net pension amounts included in accumulated other comprehensive income
b. A contribution of assets to a defined contribution pension plan resulting in recognition of net periodic pension cost

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equal to the amount contributed and allocated.

**55-193** An employer may sell a **component of an entity** and may settle a pension benefit obligation related to the employees affected by the sale. The separate classification of the settlement gain or loss, recognized pursuant to paragraphs 715-30-35-79 through 35-83, in discontinued operations requires an evaluation of the facts and circumstances.

**55-194** Paragraph 205-20-45-5(c) indicates that a settlement is directly related to the disposal transaction if there is a demonstrated cause-and-effect relationship and the settlement occurs no later than one year following the disposal transactions, unless it is delayed by events or circumstances beyond an entity's control. In a disposal of a component of an entity, the timing of a settlement may be at the discretion of the employer. If the employer simply chooses to settle a pension benefit obligation at the time of the sale, the resulting coincidence of events is not, in and of itself, an indication of a cause-and-effect relationship and, therefore, paragraphs 715-30-35-79 through 35-83 apply. However, a direct cause-and-effect relationship can be demonstrated if, for example, settlement of a pension benefit obligation for those employees affected by the sale is a necessary condition of the sale.

**55-195** A settlement or a curtailment may occur as a direct result of a disposal of a component of an entity or a business or nonprofit activity. Paragraph 715-30-35-94 requires that a curtailment loss be recognized in earnings when it is probable that the curtailment will occur and related amounts are reasonably estimable. Therefore, although a reporting entity may not have satisfied all the criteria in paragraphs 205-20-45-1A through 45-1D necessary to classify the operations of the component or business or nonprofit activity as discontinued operations, a curtailment loss (determined in accordance with paragraphs 715-30-35-92 through 35-93) shall be recognized if it is probable that the disposal will occur and the amount of the curtailment loss is reasonably estimable. Furthermore, paragraph 715-30-35-94 requires that a curtailment gain be recognized in earnings when the related employees terminate or the plan suspension or amendment is adopted. The curtailment gain or loss shall be classified in income from continuing operations until the reporting entity satisfies those criteria in paragraphs 205-20-45-1A through 45-1D for reporting discontinued operations.

**55-196** A settlement gain or loss is recognized in earnings at the time that the settlement occurs. If a pension obligation associated with the disposal group is settled upon or after meeting the criteria for reporting discontinued operations in paragraphs 205-20-45-1A through 45-1D, the related gain or loss (determined in accordance with paragraph 715-30-35-79) shall be recognized in earnings in the period in which the settlement occurs and classified in discontinued operations provided that the settlement is directly related to the disposal transaction.

**55-197** If a curtailment loss results from the disposal of a component of an entity, it is likely that the curtailment loss will be recognized earlier than the settlement gain or loss, if any, is recognized. As indicated in paragraph 715-30-55-195, the curtailment loss, if reasonably estimable, shall be recognized when the disposal is probable. The settlement gain or loss, if any, however, shall be recognized when the settlement occurs. See Example 9, Case A (paragraph 715-30-55-247) for an illustration in which the curtailment loss is recognized earlier than the settlement gain. See also

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Example 9, Case B (paragraph 715-30-55-250), which demonstrates the less likely scenario in which the effects of the curtailment and the settlement are recognized in the same reporting period.

## Question 9.7.10

**How are termination benefits, settlements and curtailments related to a restructuring presented?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Because restructuring plans often involve activities in both the scope of Topic 420 (exit or disposal costs) and Topic 715, an entity needs to use judgment when presenting these costs in the income statement. The following classification generally applies. [715-20-45-3A]

| Presenting termination benefits, settlement and curtailment costs related to a restructuring | | |
|---|---|---|
| **If the activity is…** | **And is accounted for under…** | **Then classify…** |
| One-time termination benefit costs | Topic 420 | In operating income, with restructuring costs |
| Gain or loss from a plan settlement or curtailment and costs of certain termination benefits | Topic 715 | Outside operating income, if such a subtotal is presented |

Section 4.8 discusses the presentation of termination benefits under Topic 712.

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# 10. Retirement plans: Special topics, including multiemployer plans

## Detailed contents

**New item added in this edition ****



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### Questions



### Examples



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## 10.1 How the standard works

In addition to the guidance for DB plans and OPEB plans covered in previous chapters of this book, this chapter covers certain narrowly applicable accounting guidance in Subtopics 715-30 and 715-60 for the following situations.

| | |
|---|---|
| **Annuity contracts and insurance contracts** | Section 10.2 |
| **Employers with two or more plans** | Section 10.3 |
| **Multiple-employer plans** | Section 10.4 |
| **Multiemployer plans** | Section 10.5 |
| **Other OPEB-specific topics** | Section 10.6 |

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## 10.2 Annuity contracts and insurance contracts

Sponsors of DB and OPEB plans are generally exposed to changes in market conditions and/or demographic conditions that could have a direct impact on their future obligations. To mitigate material risks, sponsors may as part of their de-risking strategy decide to transfer elements of the DB plan or OPEB plan risks to a third party (e.g. an insurance company) by purchasing annuity or insurance contracts. These types of contracts may be purchased either at initiation of the plan or at any time thereafter. Depending on the timing and the relationship between the sponsor and the insurance company underwriting such contracts, different accounting considerations arise.

This section examines the recognition and measurement criteria under Subtopics 715-30 and 715-60 that address the accounting for the purchase of annuity and insurance contracts with and without participating rights by a plan sponsor to cover employee benefits under DB plans and OPEB plans.

### 10.2.10 Recognition and measurement of purchased insurance contracts

| Excerpt from ASC 715-30 | Excerpt from ASC 715-60 |
| --- | --- |
| **20 Glossary** | **20 Glossary** |
| **Nonparticipating Annuity Contract –** An annuity contract that does not provide for the purchaser to participate in the investment performance or in other experience of the insurance entity. | **Nonparticipating Insurance Contract –** An insurance contract that does not provide for the purchaser to participate in the investment performance or in other experience of the insurance entity. See Insurance Contract. |
| **Participating Annuity Contract –** An annuity contract that provides for the purchaser to participate in the investment performance and possibly other experience (for example, mortality experience) of the insurance entity. Under a participating annuity contract, the insurance entity ordinarily pays dividends to the purchaser. | |
| **Participating Insurance –** Insurance in which the policyholder is entitled to participate in the earnings or surplus of the insurance entity. The participation occurs through the distribution of dividends to policyholders. | **Participating Insurance –** Insurance in which the policyholder is entitled to participate in the earnings or surplus of the insurance entity. The participation occurs through the distribution of dividends to policyholders. |

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| | |
|---|---|
| **Participation Right –** A purchaser's right under a participating insurance contract to receive future dividends or retroactive rate credits from the insurance entity. | **Participation Right –** A purchaser's right under a participating insurance contract to receive future dividends or retroactive rate credits from the insurance entity. |
| **25 Recognition** | **25 Recognition** |
| **> Participation Rights** | **> Participation Rights** |
| **25-7** If an **annuity contract** with a **participation right** is purchased, the cost of the participation right shall be recognized at the date of purchase as an asset. To the extent that benefits currently earned are covered by annuity contracts, the cost of those benefits shall be the cost of purchasing the contracts, except for the cost of the participation right. | **25-3** To the extent that **insurance contracts** meeting the conditions for treatment as insurance contracts in paragraph 715-60-35-110 are purchased during the current period to cover **postretirement benefits** attributed to service in that period (such as life insurance **benefits**), the cost of those benefits shall be the cost of purchasing the coverage under the contracts, except the cost of the **participation right**, which shall be recognized at the date of purchase as an asset. |
| **35 Subsequent Measurement** | **35 Subsequent Measurement** |
| **> Annuity and Other Contracts** | **> Insurance Contracts** |
| **35-53** Paragraph 715-30-25-7 provides that to the extent that benefits currently earned are covered by annuity contracts, the cost of those benefits shall be the cost of purchasing the contracts, except for the cost of the **participation right** when participating annuity contracts are used (see paragraph 715-30-35-57). That is, if all the benefits attributed by the plan's benefit formula to service in the current period are covered by nonparticipating annuity contracts, the cost of the contracts determines the service cost component of net pension cost for that period. Benefits covered by annuity contracts shall be excluded from the projected benefit obligation and the accumulated benefit obligation. Except for participation rights, annuity contracts shall be excluded from plan assets.<br><br>**35-54** If the insurance entity obligated under an annuity contract is a **captive insurer**, or if there is any reasonable doubt that the insurance entity will meet its obligations | **35-109** Benefits covered by insurance contracts shall be excluded from the accumulated postretirement benefit obligation. Insurance contracts shall be excluded from plan assets, except as provided in paragraphs 715-60-25-3 and 715-60-35-115 through 35-116 for the cost of participation rights.<br><br>**35-110** If the insurance entity providing the contract does business primarily with the employer and related parties (a **captive insurer**) or if there is any reasonable doubt that the insurance entity will meet its obligations under the contract, the contract is not an **insurance contract** for purposes of this Subtopic.<br><br>**35-111** An insurance contract with a captive insurer generally does not qualify as a **plan asset** unless it meets the criteria in the definition of the term plan assets. To qualify as a plan asset, an investment contract with a |

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under the contract, the contract is not an annuity contract for purposes of this Subsection.

**35-55** Benefits provided by the pension benefit formula beyond benefits provided by annuity contracts (for example, benefits related to future compensation levels) shall be accounted for according to the provisions of this Subtopic applicable to plans not involving insurance contracts.

**35-56** Some contracts provide for a refund of premiums if an employee for whom an annuity is purchased does not render sufficient service for the benefit to vest under the terms of the plan. Such a provision shall not by itself preclude a contract from being treated as an annuity contract for purposes of this Subtopic.

**35-57** Participating annuity contracts provide that the purchaser (either the plan or the employer) may participate in the experience of the insurance entity. Under those contracts, the insurance entity ordinarily pays dividends to the purchaser, the effect of which is to reduce the cost of the plan. The purchase price of a **participating annuity contract** ordinarily is higher than the price of an equivalent contract without participation rights. The difference is the cost of the participation right.

**35-58** In subsequent periods, the participation right shall be measured at its fair value if the contract is such that fair value is reasonably estimable. Otherwise, the participation right shall be measured at its amortized cost (not in excess of its net realizable value), and the cost shall be amortized systematically over the expected dividend period under the contract.

**35-59** If the substance of a **participating insurance** contract is such that the employer remains subject to all or most of the risks and rewards associated with the benefit obligation covered and the assets transferred to the captive insurer shall be segregated and restricted for the payment of postretirement benefits. Note that whether a funding vehicle can be restricted solely for the payment of retirees' benefits is subject to legal, not accounting, interpretation.

**35-112** In addition, because a plan's investment contract with a captive insurance entity represents an obligation of the employer to pay cash to be used to pay benefits and because amounts accrued by the employer to pay benefits are not plan assets, that contract shall be considered an employer debt security for purposes of this Subtopic and, therefore, must be currently transferable to be included in plan assets. (See paragraphs 715-60-55-26 through 55-28 for guidance on employer entities.)

**35-113** See paragraphs 944-20-15-16 through 15-19 for a description of investment contracts.

**35-114** Some insurance contracts (participating insurance contracts) provide that the purchaser (either the plan or the employer) may participate in the experience of the insurance entity. Under those contracts, if the insurance entity has favorable experience, the insurance entity will pay dividends to the purchaser, the effect of which is to reduce the cost of the plan. For example, if the insurance entity's investment return is better than anticipated, or perhaps if actual experience related to mortality or other assumptions is favorable, the purchaser will receive dividends that reduce the cost of the contract.

**35-115** The purchase price of a **participating insurance** contract ordinarily is higher than the price of an equivalent contract without a **participation right**. The difference is the cost of the participation right.

**35-116** In subsequent periods, the participation right shall be measured at its fair value if the contract is such that fair value is reasonably estimable. Otherwise the participation

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insurance entity, that contract is not an annuity contract for purposes of this Subtopic.

**35-60** Insurance contracts that are in substance equivalent to the purchase of annuities shall be accounted for as such. Other contracts with insurance entities shall be accounted for as investments and measured at fair value. For some contracts, the best available evidence of fair value may be contract value. If a contract has a determinable cash surrender value or conversion value, that is presumed to be its fair value.

**35-61** Paragraph 715-30-35-54 identifies attributes related to the issuers of annuity contracts that preclude accounting for the contracts as annuity contracts. The Settlements, Curtailments, and Certain Termination Benefits Subsections of this Subtopic define attributes related to annuity contracts differently for purposes of accounting for them as annuity contracts. The effect of the difference is that paragraph 715-30-35-85 excludes from settlement accounting those annuity contracts purchased from an entity that is controlled by the employer, whereas this Subsection excludes from annuity contracts those purchased from a captive insurer.

right shall be measured at its amortized cost (not in excess of its net realizable value), and the cost shall be amortized systematically over the expected dividend period under the contract.

**35-117** If the participating insurance contract causes the employer to remain subject to all or most of the risks and rewards associated with the benefit obligation covered or the assets transferred to the insurance entity, that contract is not an insurance contract for purposes of this Subtopic, and the purchase of that contract does not constitute a settlement pursuant to paragraphs 715-60-35-150 through 35-155 and 715-60-35-157 through 35-159.

**35-118** To the extent that insurance contracts are purchased during the period to cover postretirement benefits attributed to service in the current period (such as life insurance benefits), the cost of those benefits shall be the cost of purchasing the coverage under the contracts, except as provided in paragraphs 715-60-25-3 and 715-60-35-115 through 35-116 for the cost of a participation right. If all the postretirement benefits attributed to service in the current period are covered by **nonparticipating insurance contracts** purchased during that period, the cost of the contracts determines the service cost component of net postretirement benefit cost for that period.

**35-119** Benefits attributed to current service in excess of benefits provided by nonparticipating insurance contracts purchased during the current period shall be accounted for according to the provisions of this Subtopic applicable to plans not involving insurance contracts.

**35-120** Other contracts with insurance entities may not meet the definition of an insurance contract because the insurance entity does not unconditionally undertake a legal obligation to provide specified benefits to specified individuals. Those contracts shall be accounted for as investments and measured at fair value. If a contract has a

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**55 Implementation Guidance and Illustrations**

**>> Insurance Contracts**

**55-41** Paragraph 715-30-35-60 provides guidance on accounting for insurance contracts and distinguishes between insurance contracts that are in substance the equivalent purchases of annuities and other contracts. Paragraph 715-30-35-61 explains that certain attributes of annuity contracts result in accounting that is different in this Subsection from the accounting specified in the Settlements, Curtailments, and Certain Termination Benefits Subsections in this Subtopic.

**55-42** 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. For a guaranteed investment contract with a specified maturity date and for which there is no intent to liquidate the contract before that date, evidence of the fair value of the guaranteed investment contract might be obtained by looking to current yields on fixed-maturity securities having similar risk characteristics and duration.

**55-43** In an immediate participation guarantee investment contract, the market value adjustment should be considered in determining its fair value because, in effect, the contract value adjusted for any such market value adjustment represents the cash surrender value referred to in paragraph 715-30-35-60. 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 determinable cash surrender value or conversion value, that is presumed to be its fair value. For some contracts, the best available estimate of fair value may be contract value.

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| | |
|---|---|
| evidence of fair value noted for guaranteed investment contracts in the preceding paragraph should also be considered for immediate participation guarantee investment contracts. | |

Annuity contracts (sometimes called allocated contracts) and insurance contracts are further categorized as participating annuity contracts, participating insurance contracts, nonparticipating annuity contracts and nonparticipating insurance contracts. [715-30 Glossary, 715-60 Glossary]

## Question 10.2.10
**How are contracts between plan sponsors and insurance companies accounted for?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** The following decision tree summarizes the guidance in Subtopics 715-30 and 715-60 for contracts with insurance companies.

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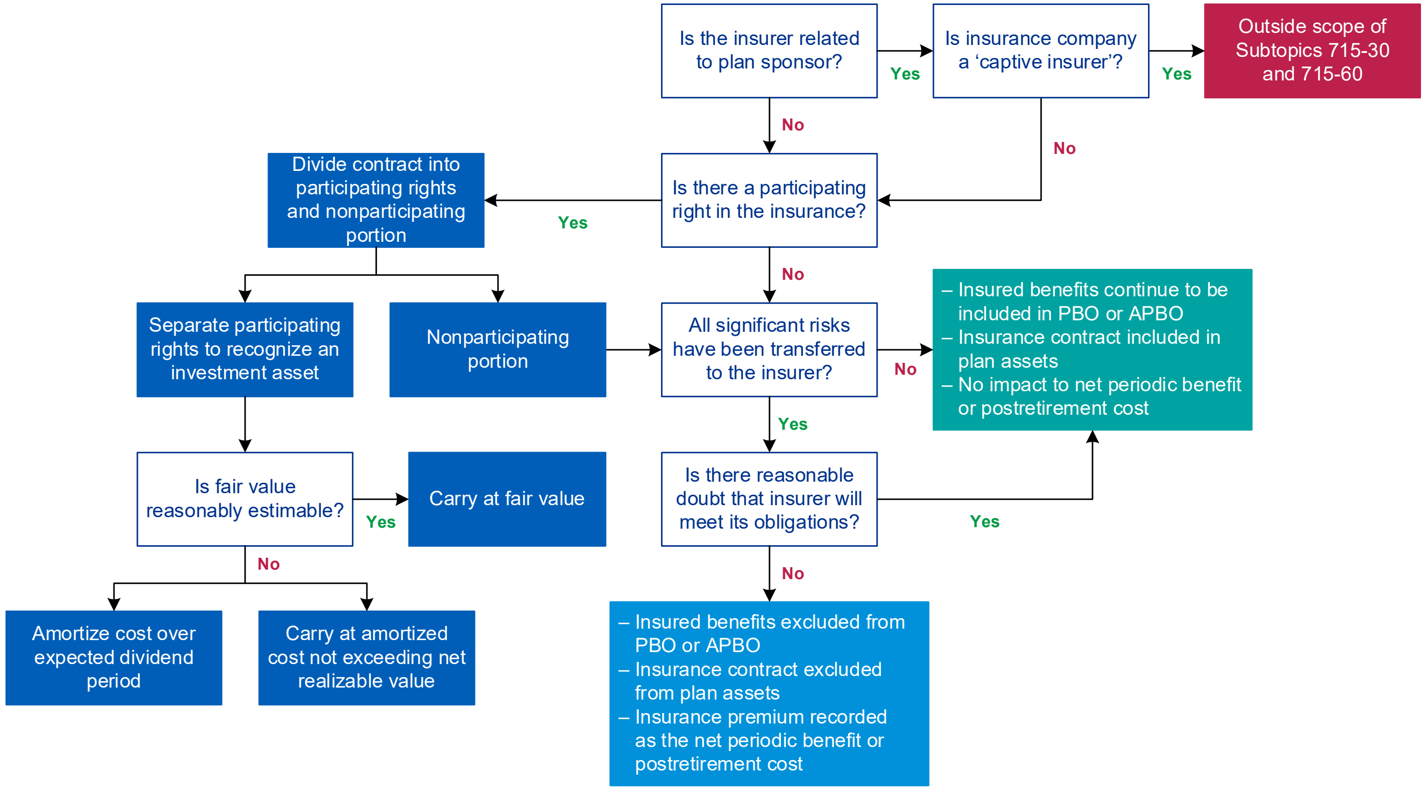


Note:

1. Annuity contracts relate to insurance coverage for DB plans and insurance contracts relate to coverage for OPEB plans for Subtopics 715-30 and 715-60, respectively.

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## Question 10.2.20
### What are annuity and insurance contracts and how are they accounted for?

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Annuity and insurance contracts are contracts purchased by a plan sponsor (which is typically the entity) from an insurance company to cover the pension benefits earned by employees each year under a DB plan or to cover OPEB benefits, such as life insurance benefits under a OPEB plan or to cover benefits earned for past years' service by settling the APBO. Such contracts cannot be entered into with a captive insurer (see Question 10.2.30).

Generally, annuity and insurance contracts are irrevocable contracts in which the plan sponsor transfers all significant risks to the underwriting insurance company and the insurance company unconditionally undertakes a legal obligation to pay specified benefits to specific participants of the DB plan or OPEB plan as and when due in return for a fixed consideration or premium. [715-30 Glossary, 715-60 Glossary]

To determine how to account for *any* contract that a plan sponsor purchases from an insurance company associated with a DB plan or OPEB plan, the sponsor needs to evaluate both the substance and form of the arrangement to assess whether the transfer of significant risk and the contract's irrevocability is similar to the purchase of an annuity contract or insurance contract. Further, if there is a reasonable doubt that the insurance company will meet its obligation under the annuity or insurance contract, there is a presumption that significant risks of the plan have not been transferred by the plan sponsor to the insurance company and therefore such contracts do not qualify as either annuity or insurance contracts under Subtopics 715-30 or 715-60. [715-30-35-54, 715-60-35-110]

#### Accounting for contracts that qualify as annuity or insurance contracts

Contracts that qualify as annuity or insurance contracts result in the transfer of significant risks associated with the DB plan and OPEB plan from the plan sponsor to the insurance company. In most cases, upon payment of the premium, the insurance company irrevocably assumes the legal obligation to pay the covered benefits to the plan participants on behalf of the plan sponsor.

When an annuity contract or insurance contract covers all benefits pursuant to the DB plan benefit formula and OPEB plan, the premium paid to the insurance company is treated as the service cost component of the net periodic benefit cost for the period. Further, the benefits covered by these contracts are excluded from the PBO and APBO because the insurance company has assumed the obligation and the risks associated with the DB plan and the OPEB plan. Correspondingly, these contracts are excluded from the determination of the plan assets. [715-30-35-53, 715-60-35-109, 715-60-35-118]

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## Question 10.2.30

**Can contracts underwritten by a related party qualify as annuity or insurance contracts?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** No. Contracts purchased from an insurance company that does business primarily with the plan sponsor (and therefore, generally the entity) do not qualify as annuity and insurance contracts for the purpose of applying Subtopics 715-30 and 715-60. The insurance company underwriting these contracts is a 'captive insurer' under Topic 715. [715-30 Glossary, 715-30-35-54, 715-60 Glossary, 715-60-35-110]

The definition of 'captive insurer' focuses on the significance of the business dealings between the plan sponsor and the insurance company. Topic 850 (related parties) defines an affiliate as a party that, directly or indirectly through one or more intermediaries, controls, is controlled by or is under common control with an enterprise. This definition focuses on 'control' and is broader than how 'captive insurer' is defined for Topic 715 purposes. Because Topic 715 does not refer to affiliates, but instead 'captive insurers' only, we believe only annuity and insurance contracts purchased from captive insurers (versus those purchased from non-captive insurers but affiliates) do not qualify for the accounting treatment under Subtopics 715-30 and 715-60. [850-10 Glossary]

In the stand-alone financial statements of the plan sponsor, purchased insurance contracts from an affiliate (that is not a captive insurance company) are accounted for similarly to purchased annuity and insurance contracts underwritten by a third-party insurance company, if the significant risks have irrevocably transferred from the plan sponsor to the insurer.

## Question 10.2.40

**How are contracts that do not qualify as annuity or insurance contracts accounted for?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Contracts (other than those underwritten by a captive insurer) that do not transfer significant risks of a DB plan or OPEB plan from the entity to the insurance company are treated as plan investments and are accounted for as plan assets. [715-30-35-60, 715-60-35-120]

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### Incremental guidance for Subtopic 715-60

Although contracts underwritten by captive insurance companies do not qualify as insurance contracts, if the entity has an investment contract with a captive insurance company, the investment could qualify as a plan asset. Treatment as a plan asset requires that the contract be clearly segregated, currently transferrable, and have restrictions limited to only retirement benefits, making the payment of retirement benefits similar to other trust assets. Evaluating the investment contract's usage restriction requires careful legal analysis and depends on the specific facts and circumstances. [715-60-35-111]

## Question 10.2.50

**How are contracts that do not qualify as annuity or insurance contracts measured?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Contracts that do not qualify as annuity or insurance contracts are measured at fair value based on the guidance in Topic 820 (fair value measurement). In some cases, the contract value may be the best available evidence of fair value. However, if the annuity or insurance contract has a determinable CSV (as may occur with a life insurance policy), as a practical expedient the entity may use the CSV as the fair value. [715-30-35-60, 715-60-35-120]

CSV may not always approximate fair value, such as when a significant termination penalty exists. In those cases, it may be appropriate to consider the contract's conversion value, if applicable, to measure fair value. In all instances, the fair value of the contract is the amount at which it could be sold to a third-party purchaser. The fair value measurement considers any other factors a market participant purchaser would consider (e.g. changes in expected mortality in life insurance contracts). See KPMG Handbook, Fair value measurement.

The fair value of a contract with an insurance company (i.e. annuity or insurance contract) for the entity's financial reporting purposes may differ from its value in the pension plan's own financial statements. This is due to differences when measuring those contracts under Topic 960 (plan accounting) for the pension plan's own financial statements.

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## Question 10.2.60

**What is a participating right in an annuity or insurance contract?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Some annuity and insurance contracts provide the entity with the right to participate in the investment performance and experiences of the insurance company subsequent to purchasing the contract. Participation may be in the form of a future dividend right or a right to claim a retrospective rate credit from the insurance company where the amount receivable by the entity depends on the insurance company's experiences, which may be favorable or unfavorable. Therefore, the participating right results in variability in the amount of return, resulting in exposure to the same risks and rewards related to future experiences. Careful analysis is required in determining if and how participating rights affect the transfer of significant risks under the DB pension or OPEB plan to the insurance company. [715-30-35-57, 715-60-35-114]

If a contract does not have a participating right, it is called a nonparticipating annuity contract or nonparticipating insurance contract. [715-30 Glossary, 715-60 Glossary]

## Question 10.2.70

**How are participating rights in participating annuity and insurance contracts recognized and measured?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** As discussed in Question 10.2.60, participating rights are in substance an investment asset symbolizing the future dividend rights subsumed within an annuity contract or insurance contract. Accordingly, on the date of purchase, the entity recognizes the cost of the participation right as an asset on the balance sheet. [715-30-25-7, 715-60-25-3]

Annuity or insurance contracts that include participating rights are generally more expensive than comparable contracts providing the same benefit value to the insured party without a participating right. The difference in cost represents the participating right on the date of purchase. [715-30-35-57, 715-60-35-115]

In subsequent periods, the participating right is measured at fair value if reasonably estimable. If not, the cost of the participating right is: [715-30-35-58, 715-60-35-116]

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- amortized over the expected dividend period, generally covering the period from the purchase date through the period over which the benefits under the annuity or insurance contract is expected to be paid (which in most cases will be the expected remaining life span of the plan participants); and
- carried at amortized cost, not to exceed the net realizable value of the participating right, on an ongoing basis.

Dividends or other returns when received by the plan sponsor from participating annuity and insurance contracts are treated like a return on plan assets and are accounted for similarly to any other return on plan assets.

## Question 10.2.75**

**What are buy-in and buy-out contracts and how does an entity account for buy-in and buy-out contracts?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:**

### Buy-in contracts

A buy-in contract is a group annuity (insurance) contract (investment product) where an insurance company reimburses the employer (or covers the costs) for benefits paid to covered participants in exchange for the employer making an upfront payment to the insurance company. The annuity contract is designed to generate returns equal to all future designated benefit payments to covered participants of the plan. Under a buy-in contract, most of the investment and longevity risk associated with covered participants and beneficiaries is transferred to the insurance company, but the employer remains legally responsible for paying the benefits.

The buy-in contract is accounted for as a plan asset (if it meets the requirements in Subtopic 715-30) or an asset of the employer's financial statements. Execution of a buy-in contract does not meet the criteria for settlement accounting because the employer's benefit obligation is not transferred to the insurance company.

### Buy-out contracts

A buy-out contract is a nonparticipating annuity (insurance) contract with an insurance company under which the employer transfers the legal responsibility for future payments to participants to the insurance company in exchange for the employer making an upfront payment to the insurance company. In a buy-out contract, the employer's benefit obligation and related risks and rewards are transferred to the insurance company. Therefore, the execution of a buy-out contract does meet the criteria for settlement accounting. An employer recognizes the settlement gain or loss when the buy-out is complete, which is typically when the employer makes all payments and the insurance company assumes the benefit obligation.

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In some cases, an employer may enter into a buy-in contract with a plan to convert it to a buy-out contract at a later date. An employer waits until the buy-out contract has been completed before derecognizing the obligation and related plan asset and recognizing any settlement gain or loss.

See Question 9.3.40 and Example 9.3.10 for guidance on how purchase price or premium adjustments affect when to recognize a settlement.

## Example 10.2.05**

### Timing of settlement recognition for a group annuity contract with buy-in and buy-out phases

ABC Corp. sponsors a DB pension plan for all of its employees in a UK subsidiary. ABC executed a group annuity contract with a regulated insurance company to settle its benefit obligation. The annuity contract is a single contract with two phases: a buy-in phase followed by a buy-out phase. The time it takes to move from the buy-in phase to the buy-out phase can take up to a year based on review by the insurance company. The annuity contract has certain features that will make the move to the buy-out phase a near certainty.

A settlement occurs when three criteria are met: [715-30 Glossary]

— the action is irrevocable;
— the employer (or the plan) is relieved of primary responsibility for a pension obligation; and
— the transaction eliminates significant risks related to the obligation and the assets used to effect the settlement.

ABC evaluates these criteria at the initial contract phase (buy-in) to determine whether a settlement should be recognized at this time. Although the contract includes features that make the move to the buy-out phase a near certainty, ABC is not relieved of primary responsibility for the pension obligation until entering into the buy-out phase of the contract. Therefore, ABC does not meet the criteria to recognize a settlement at the buy-in phase of the contract. Instead, ABC will recognize a settlement when the insurance company assumes the primary responsibility for the pension obligation at the buy-out phase of the contract.

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## 10.2.20 Settlement accounting using annuity and insurance contracts

### Excerpt from ASC 715-30

**35 Subsequent Measurement**

**>> Using Annuity Contracts in Settlement Transactions**

**35-84** The intent of the guidance in this Subsection is that if the substance of an insurance contract is such that the employer remains subject to all or most of the risks and rewards associated with the covered pension benefit obligation or the assets transferred to the insurance entity, the purchase of the contract does not constitute a settlement. The circumstances under which an employer shall recognize in earnings the net gain or loss included in accumulated other comprehensive income are limited and such recognition shall not occur if the settlement transaction is between an employer and an entity that it controls because such a transaction merely shifts the risks from one part of the entity to another part of the same entity.

**35-85 Annuity contracts** purchased from an entity that is controlled by the employer are excluded from settlement accounting. Therefore, an employer that purchases annuity contracts from an insurance entity that it controls shall not recognize any settlement gain or loss associated with the transaction (that is, the transaction does not qualify for settlement accounting).

**35-86** If there is any reasonable doubt that the insurance entity will meet its obligations under the annuity contract, the purchase of the contract does not constitute a settlement.

**35-87** If the substance of a **participating annuity contract** is such that the employer remains subject to all or most of

### Excerpt from ASC 715-60

**35 Subsequent Measurement**

**>> Insurance Contracts**

**35-160** If an **insurance contract** is purchased from an insurance entity controlled by the employer, or if a participating insurance contract causes the employer to remain subject to all or most of the risks and rewards associated with the benefit obligation covered or the assets transferred to the insurance entity, that contract is not an insurance contract and the purchase of that contract does not constitute a settlement pursuant to paragraphs 715-60-35-150 through 35-160.

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the risks and rewards associated with the benefit obligation covered or the assets transferred to the insurance entity, the purchase of the contract does not constitute a settlement.

**35-88** It may be difficult to determine the extent to which a participating annuity contract exposes the purchaser to the risk of unfavorable experience, which would be reflected in lower than expected future dividends. Additionally, under some annuity contracts described as participating, the purchaser might remain subject to all or most of the same risks and rewards related to future experience that would have existed had the contract not been purchased. Some **participating insurance** contracts may require or permit payment of additional premiums if experience is unfavorable. Accordingly, if a participating insurance contract requires or permits payment of additional premiums because of experience losses, or if the substance of the contract is such that the purchaser retains all or most of the related risks and rewards, the purchase of that contract does not constitute a settlement.

**35-89** An employer may decide to make up a deficiency in annuity contract payments following a settlement and subsequent insolvency by the insurance entity. The following guidance addresses how the employer shall account for the cost of making up the deficiency in annuity payments to the retirees.

**35-90** The following circumstances identify the fact pattern to which the required accounting would apply. An employer sponsors a **defined benefit pension plan**. The employer settles its pension obligation through the purchase of insurance annuity contracts from an insurance entity. The employer may or may not terminate the defined benefit pension plan. The employer appropriately applies the guidance in this Subsection. Subsequently, the insurance entity becomes insolvent and is unable to meet

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all of its obligations under the annuity contracts. The employer decides to make up some portion or all of any deficiency in annuity payments to the retirees.

**35-91** The employer shall recognize a loss in the circumstances described in the preceding paragraph at the time the deficiency is assumed by the employer if any gain was recognized on the original settlement. The loss recognized would be the lesser of any gain recognized on the original settlement or the amount of the benefit obligation assumed by the employer. The excess of the obligation assumed by the employer over the loss recognized shall be accounted for as a **plan amendment** or plan initiation in accordance with paragraphs 715-30-35-10 through 35-17. Subsequent accounting shall be in accordance with the provisions of this Subtopic.

**55 Implementation Guidance and Illustrations**

**>>> Meeting the Criteria for Settlement**

**55-146** If individual nonparticipating annuity contracts are to be used to settle a pension benefit obligation, payment of the premium for the purchase of the individual annuity contracts may be necessary before a settlement gain or loss should be recognized. The timing of the payment of the premium is relevant in assessing the critical issue, which is whether a transaction has occurred that irrevocably relieves the employer or the pension plan of primary responsibility for a pension benefit obligation and eliminates significant risks related to the pension benefit obligation and the plan assets used to effect the settlement. For a settlement gain or loss to be recognized, the insurance entity must have unconditionally undertaken a legal obligation to provide the specified pension benefits. If the premium has not been paid, the purchase of the annuity contracts may be revocable. Further, if plan assets have not been transferred by the pension plan to effect the settlement, they may be at risk. If significant risks related

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to the pension benefit obligation and the plan assets to be used to effect the settlement have not been eliminated, no gain or loss should be recognized.

**55-147** If individual nonparticipating annuity contracts are to be used to settle a pension benefit obligation, issuance of the individual annuity contracts may be necessary before a settlement gain or loss should be recognized. The issuance of individual annuity contracts is not the critical event but is relevant in assessing the critical issue, as stated in the preceding paragraph. However, the absence of individual annuity contracts together with an assessment of other relevant information, for example, payment of the premium as in the preceding paragraph, may indicate that only a commitment has been made to purchase annuity contracts. A commitment does not satisfy the criteria for a settlement and does not result in a settlement gain or loss.

**55-148** If plan participants have agreed to accept lump-sum cash payments in exchange for their rights to receive specified pension benefits and the amounts of the payments have been fixed, payment of the cash to plan participants may be necessary before a settlement gain or loss should be recognized. As noted in paragraph 715-30-55-146, the timing of the payment is relevant in assessing whether the criteria for a settlement have been met. If the cash payments have not been made, the agreement may be revocable. Further, if plan assets have not been transferred by the pension plan to effect the settlement, they may be at risk. If significant risks related to the pension benefit obligation and the plan assets to be used to effect the settlement have not been eliminated, no gain or loss shall be recognized.

**55-149** A settlement does not occur if a contract is entered into with an insurance entity that requires the insurance entity to pay only a portion of specific participants' pension

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benefits, for example, payments due retirees for the next five years. The contract should provide life annuities, not limited-term annuities, for a settlement to occur. A contract for limited-term annuities does not eliminate significant risks related to the pension benefit obligation for the participants, for example, the duration of their pension benefit payments, and, therefore, it does not satisfy the criteria for a settlement.

**55-150** Another example of a transaction that does not constitute a settlement involves a situation in which all of the following occur:

a. An employer (or the pension plan) irrevocably purchases an insurance contract that guarantees payment of those pension benefits vested as of the date of the purchase.
b. The purchase price of the insurance contract significantly exceeds the purchase price of a nonparticipating annuity contract covering the same pension benefits.
c. The insurance entity receives an annual fee based on a percentage of the **actuarial present value** of the covered pension benefits to compensate it for the risk of guaranteeing those pension benefits.
d. If a specified ratio of assets to the covered pension benefit obligation is maintained, the employer (or the pension plan) continues to manage the assets used to effect the purchase; however, the insurance contract requires that a certain percentage of the assets be invested in high-quality bonds or a dedicated bond portfolio, depending on the ratio of assets to the covered pension benefit obligation.
e. Upon final satisfaction of all of the pension benefit obligation covered by the insurance contract and payment of all of the contract's administrative fees due to the insurance entity, the insurance entity will remit to the employer (or the pension plan) any amounts

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remaining in the insurance contract's account balance. Interim withdrawals from the account by the employer (or the pension plan) are also permitted with prior notification to the insurance entity unless a withdrawal causes the ratio of assets to the covered pension benefit obligation to drop below a specified percentage.

**55-151** Under the terms of the contract described in the preceding paragraph, the employer remains subject to those risks and rewards described in paragraph 715-30-35-84. Accordingly, the insurance contract is a **participating annuity contract** that does not satisfy the criteria in paragraphs 715-30-35-84 through 35-88 for a settlement.

**55-152** Delayed recognition of gains or losses in **net periodic pension cost** is permitted under the General Subsections of this Subtopic, because, in part, past gains or losses may be offset by future losses or gains. The Settlements, Curtailments, and Certain Termination Benefits Subsections of this Subtopic require recognition in earnings of gains or losses included in accumulated other comprehensive income when a settlement of a pension benefit obligation occurs because the basis for generating offsetting losses or gains has been altered, that is, a pension benefit obligation and the plan assets used to effect the settlement are eliminated.

**55-153** The transaction in paragraph 715-30-55-150 is structured so that the plan assets and the pension benefit obligation have substantially the same ability to generate gains (or losses to the extent of the purchase price for the **participation right** and the annual fees paid to the insurance entity for the guarantee of the pension benefit obligation) both before and after the insurance contract is purchased. The employer remains subject to significant risks and rewards related to the pension benefit obligation and the plan assets and, therefore, the purchase does not

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qualify for settlement accounting. That transaction creates, in substance, a deposit administration contract with a guarantee from the insurance entity to provide for certain pension benefits from the insurance entity's general assets, if necessary. Transactions such as those in this example are addressed in the paragraph 715-30-35-87 guidance that prohibits settlement accounting for those transactions for which the basis of generating offsetting losses or gains has not been substantially altered.

**55-154** Paragraph 715-30-35-79 provides accounting guidance on the use of participating annuity contracts in settlement transactions. Under that guidance, settlement accounting is required for only certain participating annuity contracts as determined under the guidance in paragraphs 715-30-35-84 through 35-88.

**55-155** One reason for requiring settlement accounting for certain participating annuity contracts is to preclude a potential abuse. If settlement accounting was required for only nonparticipating annuity contracts, then an employer could avoid settlement accounting by purchasing what was essentially a nonparticipating annuity contract and paying a small premium for a de minimis participation right.

**55-156** Another reason is that paying a premium for a contract including a participation right rather than purchasing a nonparticipating annuity contract might be a sound economic decision that should not otherwise disqualify a transaction from settlement accounting, providing the transaction transferred the requisite level of risks and rewards from the employer to the insurance entity. However, if the terms of the participating annuity contract are such that the employer has the same or much of the same exposure to gains or losses with regard to the pension benefit obligation or the plan assets before and after the transaction, then settlement accounting is not permitted.

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**55-157** Example 2, Case C (see paragraph 715-30-55-209) presents an illustration of a settlement in which participating annuities were concluded to qualify for settlement accounting. The relative cost of the participation right (10 percent) used in that Case is not intended to be an indication of a criterion that could be used to determine whether the purchase of a participating annuity contract qualifies for settlement accounting. Rather, the facts assumed in the Case were selected only to illustrate the application of paragraph 715-30-35-79. No other purpose was intended. There are no quantitative criteria that can be used to determine whether the purchase of a participating annuity contract qualifies for settlement accounting. Whether the purchase of a participating annuity contract qualifies for settlement accounting depends on the particular facts and circumstances. There are no generic, quantitative criteria that can be used. Each transaction shall be evaluated on its own merits given the general criteria provided in paragraphs 715-30-35-84 through 35-88.

**55-158** A transaction may qualify for settlement accounting in the separately issued financial statements of a subsidiary, yet not qualify in the parent entity's consolidated financial statements. For example, if a parent entity's wholly owned subsidiaries, Subsidiaries A and B, have separate pension plans and Subsidiary B purchases nonparticipating annuity contracts from Subsidiary A (which is an insurance entity) to provide the vested pension benefits under Subsidiary B's pension plan, that transaction does not constitute a settlement in the parent entity's consolidated financial statements. It does not qualify because the guidance in paragraph 715-30-35-84 excludes annuity contracts purchased from an entity that is controlled by the employer from settlement accounting as such a transaction merely shifts the risk from one part of the entity to another part of the same entity. Since significant risks related to a pension benefit obligation and

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the plan assets remain with the employer, which is the economic entity comprising the parent entity and its subsidiaries, a settlement does not occur.

**55-159** Assuming the other criteria for a settlement are satisfied, the purchase of the nonparticipating annuity contracts discussed in the preceding paragraph does constitute a settlement in the separately issued financial statements of Subsidiary B, because significant risks related to a pension benefit obligation and the plan assets used to effect the settlement have been assumed by another entity that is not controlled by Subsidiary B. Disclosure of the related party nature of the settlement should be made pursuant to Section 850-10-50.

**>>> Settlement Measurement Issues**

**55-162** If nonparticipating annuity contracts are purchased from a less-than-majority-owned investee that is not controlled by the employer and the criteria for a settlement are satisfied, the resulting settlement gain or loss is not subject to partial recognition (that is, it should not be reduced to reflect the employer's ownership). The employer's noncontrolling ownership interest in the insurance entity that issues the nonparticipating annuity contracts does not affect the accounting for the settlement. Therefore, the entire settlement gain or loss should be recognized in earnings. The treatment of this intra-entity transaction is acknowledged to be a departure from traditional accounting under the equity method and is not intended to be a precedent for nonpension intra-entity transactions.

If the annuity or insurance contract (participating or nonparticipating) is purchased from an unrelated insurer at any time after a DB plan or OPEB plan is put in place – with an intention to settle any portion of the accrued DB or OPEB obligation – the entity assesses whether a settlement event has occurred and if so when settlement accounting is to be applied. If the purchased annuity or insurance contract does not result in a settlement event, the contract is accounted

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for as part of the plan assets. In practice, entities commonly purchase annuity contracts to settle DB plan obligations and non-healthcare related OPEB benefits such as life insurance benefits.

## Question 10.2.80

### Does settlement automatically occur when an annuity or insurance contract is purchased?

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Not necessarily. Topic 715 mentions purchasing a nonparticipating annuity or insurance contract to cover vested benefits as an example that meets the settlement criteria described in Question 9.3.10. However, in practice, identifying if and when the settlement criteria are met requires judgment and careful analysis of the substance of the transaction. [715-30-35-84, 715-60-35-160]

The analysis focuses on determining whether: [715-30-35-87 – 35-88, 55-146 – 55-151, 715-60-35-160]

- the entity has transferred (and therefore has not retained) the plan-related significant risks;
- the insurance company has unconditionally agreed to assume the obligation; and
- the contract is fully executed and is no longer subject to any additional actions making it irrevocable.

Further, the entity evaluates whether: [715-30-35-85]

- it controls (as defined in Topic 810) the insurance company from which it purchased the annuity or insurance contract. If control exists, settlement accounting does not apply. This is because Topic 715 specifically prohibits settlement accounting when there is merely a shift of plan-related risks from one part of the entity to another part of the same entity. [715-30-35-84 – 35-85, 715-60-35-160]
- there is any reasonable doubt that the insurance company will meet its obligations under the annuity contract. If yes, settlement accounting does not apply.

See Question 9.3.40 and Example 9.3.10 for guidance on how a purchase price or premium adjustment may affect the timing of settlement recognition.

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## Question 10.2.90

**How does a participating right affect settlement accounting?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** Differentiating between participating and nonparticipating annuity contracts affects whether and when settlement accounting applies. As discussed in Question 10.2.60, a participating annuity contract conveys to the plan sponsor certain future dividend entitlements. The amount of such dividend entitlement may be variable and depend directly on the insurer's favorable or unfavorable experience with respect to the investment return or other actuarial experience, including mortalities.

Such variations due to participating rights in an annuity or insurance contract are likely to indicate that the entity is exposed to some of the risks and rewards associated with future experiences that existed before purchasing the contract. Evaluating the extent of exposure to significant risks retained by the entity requires careful analysis of both the substance and the form of the transaction, including evaluating contractual terms that may require or permit payment of additional premiums if experience is unfavorable or because of experience losses. After considering all relevant facts and circumstances, if it is determined that the substance of the participating right causes the entity to remain subject to significant risks and rewards associated with the DB plan obligation, OPEB obligation or plan assets, the purchase of the participating annuity contract does not result in settlement. [715-30-35-87 – 35-88, 715-60-35-160]

There is no bright line or quantitative threshold level to consider when assessing whether a participating annuity contract qualifies for settlement accounting. However, in our experience, many sponsors do not apply settlement accounting if the value ascribed to the participating right (see Question 10.2.70) exceeds 10% of the premium that would have been paid to settle the same obligation by a nonparticipating annuity contract. In this situation, we believe that significant risks related to the assets used to effect the settlement are generally not considered to have been transferred to the insurance company given the level of participation right retained. Therefore, the purchase of annuity contract or insurance contract would be accounted for as part of the plan assets.

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## Question 10.2.100

**How are deficiency payments by the entity due to the insurer's insolvency accounted for?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** The entity may assume responsibility to pay the plan participants for any deficiency in the annuity contract because of the insurance company's failure to fully satisfy the assumed obligation under the annuity insurance contracts. In this situation, the entity recognizes a loss when it assumes the liability if it previously recognized a settlement gain when it purchased the annuity contract.

The loss to be recognized is measured at the lesser of:

— any settlement gain originally recognized; and
— the amount of obligation assumed.

If the obligation assumed exceeds the loss recognized, the excess obligation is accounted for as a plan amendment or plan initiation under Topic 715. See chapter 9 for further discussion. [715-30-35-89 – 35-91]

## Question 10.2.110

**How are rights to participate in mortality experience recognized?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** An annuity or insurance contract may give the entity the right to participate in positive but not negative mortality experience of the plan participants. In this situation, the entity recognizes a settlement and the cost of the participating right as an asset – either a plan asset or an asset of the entity, depending on which entity is the designated beneficiary of the participating right.

If the entity is still subject to any negative mortality experience of the plan participants, it does not recognize a settlement, and instead it treats the annuity or insurance contract as a plan asset because it retains the risks and rewards associated with the benefit obligation. [715-30-35-59 – 35-60, 715-60-35-117, 715-60-35-120]

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## Example 10.2.10
**Accounting for purchase of annuity when annuity payments begin in the future**

### Background

ABC Corp. purchased and paid the premium for a nonparticipating single premium group annuity contract (Contract) from Insurer on December 2, Year 1 (Contract Effective Date). The parties intend to irrevocably transfer ABC's obligations from its DB pension plan (frozen four years earlier) to Insurer.

Key components of Contract include the following.

- The Census Effective Date (the date Insurer assumes liability for all annuities purchased under Contract – i.e. the earliest date the Insurer could begin making the monthly benefit payments to individual beneficiaries) is February 1, Year 2 (60 days after Contract Effective Date). Insurer requires complete and accurate data at least six weeks before the date it makes the first payment.
- The final payment amounts are adjusted to reflect changes in the data submitted. These changes are limited to corrections in dates of birth, sex, type of annuity, amount of benefit payable, spouse's information, participant status, and the addition or deletion of lives. The final payment amounts are not adjusted for deaths that occur on or after the Census Effective Date.

### Analysis

ABC accounts for the purchase of an annuity as a settlement at December 2, Year 1 even though the annuity payments begin 60 days in the future and Insurer would adjust the premium if retirees die during that period.

When considering whether to apply settlement accounting, ABC considers whether it remains subject to all or most of the risk and rewards associated with the pension obligation by considering the criteria for settlement under Subtopic 715-30 (see Question 10.2.80 and 10.2.90).

ABC determines that its participation in the obligation's mortality experience from December 2, Year 1 through February 1, Year 2 does not preclude it from settlement accounting as of December 2, Year 1; this is because substantially all of the risks were transferred to Insurer at the Contract Effective Date (December 2, Year 1). Any potential mortality experience during the 60-day window is similar to a positive participating annuity, and settlement accounting is not precluded when a sponsor has positive participation exposure.

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# 10.3 Employers with two or more plans

## Excerpt from ASC 715-30

**35 Subsequent Measurement**

**> Employers with Two or More Plans**

**35-69** Net periodic pension cost, liabilities, and assets are determined on a plan-by-plan basis. Paragraph 715-30-25-6 requires that an employer that sponsors two or more separate defined benefit pension plans determine net periodic pension cost, liabilities, and assets by separately applying the provisions of this Subtopic to each plan.

## Excerpt from ASC 715-60

**35 Subsequent Measurement**

**> Employers with Two or More Plans**

**35-128** An employer may have separate medical care, dental care, and eye care plans that provide benefit coverage to all retirees of the entity. Similarly, an employer may combine two or more unfunded plans that provide the same benefits to different groups of plan participants. For example, an employer may have identical postretirement medical care plans at each of its operating locations. This Subtopic permits combining plans in those situations because the differences in the plans are not substantive. Combining information in those cases results in combined measurements for accounting and disclosure purposes.

**35-128A** As required by paragraph 715-60-25-2, upon remeasurement, a business entity shall adjust its statement of financial position in a subsequent interim period to reflect the overfunded or underfunded status of the plan consistent with that measurement date.

**35-129** Postretirement benefits offered by an employer may vary in nature and may be provided to different groups of employees. As discussed in the following paragraph, in some cases an employer may aggregate data from unfunded plans for measurement purposes in lieu of performing separate measurements for each unfunded plan (including plans whose designated assets are not appropriately segregated and restricted and thus have no plan assets as that term is used in this Subtopic). Net periodic postretirement benefit cost, the accumulated postretirement benefit obligation, and plan assets shall be

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determined for each separately measured plan or aggregation of plans by applying the provisions of this Subtopic to each such plan or aggregation of plans.

**35-130** The data from all unfunded postretirement health care plans may be aggregated for measurement purposes if those plans provide different benefits to the same group of employees or those plans provide the same benefits to different groups of employees. Data from other unfunded postretirement welfare benefit plans may be aggregated for measurement purposes in similar circumstances, such as when an employer has a variety of welfare benefit plans that provide benefits to the same group of employees. However, a plan that has plan assets (as defined herein) shall not be aggregated with other plans but shall be measured separately.

**55 Implementation Guidance and Illustrations**

**>> Combining and Dividing Plans**

**55-87** The following implementation guidance addresses issues relating to either the combination of two or more of an employer's pension plans into one plan, or the division of one pension plan into two or more separate pension plans.

**>>> Combining Pension Plans**

**55-88** An employer may combine several of its pension plans resulting in the assets of each predecessor pension plan being available to satisfy the previously existing obligations of the other. Except for prior service costs included in accumulated other comprehensive income, similar amounts of the predecessor pension plans shall be aggregated, and a single amortization schedule for each of the combined amounts shall be used in this situation. That is, the amortization of the transition asset or obligation remaining in accumulated other comprehensive income shall reflect a reasonably weighted average of the

**55 Implementation Guidance and Illustrations**

**>> Employers with More than One Plan**

**55-29** An employer has two legally separate postretirement benefit plans. Both plans are unfunded defined benefit plans covering the same employees. One plan provides postretirement medical care and the other provides postretirement dental care. An employer that has two or more such plans is permitted, but not required, to account for those plans as a single plan. The last sentence of paragraph 715-60-35-130 reinforces the criterion that the plans must be unfunded.

**55-30** It would be appropriate for the employer in the preceding paragraph to change from one-plan accounting to two-plan accounting; that is, to accounting for each plan separately if the conditions of paragraph 715-60-35-130 are no longer satisfied. If the change is elective (that is, it is made even though the conditions of that paragraph are still satisfied), the employer would have to demonstrate the preferability of the change in accounting to satisfy the

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remaining amortization periods used by the separate pension plans for that item and the minimum amortization of the aggregate net gain or loss included in accumulated other comprehensive income shall reflect the average remaining service period of the combined employee group. The prior service cost included in accumulated other comprehensive income of each pension plan at the time of the combination shall continue to be amortized as previously determined based on specific employee groups covered.

**55-89** See Example 6 (paragraph 715-30-55-122) for an illustration of the accounting when two plans are combined.

**>>> Dividing Pension Plans**

**55-90** An employer may divide a pension plan into two or more separate pension plans. Using paragraph 715-30-35-79 as guidance, an employer shall allocate the transition asset or obligation remaining in accumulated other comprehensive income and the net gain or loss included in accumulated other comprehensive income, in proportion to the projected benefit obligations of the two surviving plans. Prior service cost included in accumulated other comprehensive income shall be allocated to the surviving plans based on the applicable individuals included in the employee groups covered.

**55-91** See Example 7 (paragraph 715-30-55-124) for an illustration of the division of one pension plan into separate pension plans.

**55-92** An employer may incorporate a division of its operations, subsequently spin it off to owners of the entity, and transfer to the new entity's pension plan either a pension benefit obligation related to the employees transferred as part of the spinoff or plan assets. Paragraph

requirements of Subtopic 250-10, and its effects would be accounted for in accordance with that Subtopic.

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| 845-10-55-1 provides guidance on the accounting for such a transaction in a spinoff of nonmonetary assets to owners. | |

Entities may sometimes combine two or more of their sponsored DB plans (or OPEB plans) into a single plan, or divide a single plan into two or more separate plans. There could be many reasons to combine or divide DB or OPEB plans, but the reason usually relates to a contemplated corporate restructuring or a planned business disposal. This section discusses the recognition and measurement criteria in Subtopics 715-30 and 715-60 for such events.

## Question 10.3.10

### What is the ongoing accounting treatment for the combination of two or more DB plans not pursuant to a business combination?

*This interpretive response applies to Subtopic 715-30 only.*

**Interpretive response:** When two or more DB plans are combined into one plan, the accounting analysis focuses on assessing whether each plan is accounted for separately or whether they are combined and accounted for as one DB plan. An entity combines the plans into one DB plan for accounting purposes only if the assets of each of the predecessor DB plans are made available to satisfy the preexisting obligations of the other DB plan once the combination is effected. If this condition is not satisfied, each plan is accounted for separately.

If two or more of the combined DB plans qualify to be accounted for as one plan, the following is the appropriate accounting. [715-30-55-88]

— **Funded status.** The PBOs and fair value of plan assets of each of the combined plans are aggregated and a new funded status for the combined single plan is determined.

— **Gain or loss included in AOCI.** Amounts accumulated in gains/losses in AOCI of the predecessor plans are aggregated and a single amortization schedule is established for the combined single plan on the date of the combination. This requires calculating (1) the corridor for the combined plan using the aggregated PBO and MRV of plan assets to measure the amortization amount and (2) the average remaining service period for the combined employee plan participants.

— **Preexisting prior service cost or credit.** The predecessor amortization schedule for preexisting (i.e. those that existed pre-combination) prior service cost or credit is carried forward following the combination.

— **New prior service cost or credit, if applicable.** If, as part of the combination, the entity amends one or more predecessor plans to increase the benefits to match those offered by another predecessor plan to make the plan

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participants whole as part of the combined plan, a new prior service cost is likely to originate. In such cases, the entity computes a new amortization period for such newly established prior service cost, which is based on the average remaining years of service of the predecessor plan that was amended.

## Question 10.3.20

**What is the ongoing accounting treatment for the division of a single DB plan into two or more DB plans?**

*This interpretive response applies to Subtopic 715-30 only.*

**Interpretive response:** DB plan divisions generally occur in conjunction with either a corporate reorganization or a planned disposal of a component of the business in which the buyer is assuming the related benefit obligation of the DB plan. Effective separation of a DB plan is determined based on both legal analysis and an evaluation of whether there is a clear separation of assets of the DB plan in a manner that would restrict the use of the divided assets of one DB plan from being used to pay the benefits of another DB plan following the division.

Once the DB plan is determined to be effectively divided into multiple DB plans, the following is the appropriate accounting. [715-30-55-90, 715-30-55-92]

— **PBOs.** Using the applicable benefit formula and the best-estimate assumptions at the date of division, the PBOs for the new plans are measured based on each plan's participants.

— **Plan Assets.** Each of the divided assets among the plans is considered separately.

— **Gain or loss included in AOCI, including any transition asset or obligation.** Because the accumulated amounts in AOCI are likely from different sources, making it difficult to specifically identify amounts with respect to each of the divided plans, the accumulated amount in AOCI is allocated among the divided plans based on the ratio of each divided plan's PBO to the total PBO of the plan before the division.

— **Prior service cost or credit in AOCI.** Prior service cost included in AOCI is allocated to the surviving plans based on the applicable individuals included in the employee groups covered.

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## Question 10.3.30
### Can an entity combine two or more OPEB plans in applying Subtopic 715-60?

*This interpretive response applies to Subtopic 715-60 only.*

**Interpretive response:** Yes. An entity may have more than one unfunded OPEB healthcare plan (e.g. a separate medical care plan, dental care plan and an eye care plan) through which it may provide either:

- different retirement benefits to the same group of retiring employees – e.g. medical, dental and eye care plans coverage provided to all retiring employees; or
- the same retirement benefits to different groups of retiring employees – e.g. an identical medical care plan covering employees at each of its multiple operating locations.

Subtopic 715-60 permits, but does not require, the entity to combine two or more unfunded OPEB plans as a single OPEB plan for accounting and financial reporting purposes. Combining is permitted as long as the benefits covered by each of the OPEB plans do not vary (i.e. healthcare plans are not being combined with non-healthcare plans), each of the OPEB plans are unfunded (i.e. plans have no plan assets) and there are no substantive differences between the benefits covered under each of the OPEB plans. [715-60-35-128, 715-60-35-130, 715-60-55-29]

Combining each OPEB plan's information into a single OPEB plan for measurement purposes results in the net periodic postretirement benefit cost, the APBO and the plan assets being determined on an aggregate basis under Subtopic 715-60. Net periodic postretirement benefit cost, the APBO and plan assets for other OPEB plans (including those with plan assets), which are ineligible to be combined, will continue to be accounted for separately. [715-60-35-129]

## Question 10.3.40
### Can OPEB plans previously combined into a single OPEB plan be disaggregated and separately measured?

*This interpretive response applies to Subtopic 715-60 only.*

**Interpretive response:** It depends. An entity that aggregated two or more unfunded OPEB plans into a single OPEB plan for measurement purposes can subsequently disaggregate and measure each of the OPEB plans separately only if the conditions in paragraph 715-60-35-130 are no longer satisfied (see Question 10.3.30). If these conditions continue to be satisfied, disaggregating and separately measuring OPEB plans that were previously combined is permitted only if

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the entity can demonstrate the preferability of the change in accounting by following the requirements of Topic 250. See section 3.3.20 in KPMG Handbook, Accounting changes and error corrections. [715-60-55-30]

## Question 10.3.50

**How is the elimination of one OPEB benefit (for employees with multiple OPEB plans previously accounted for as one OPEB plan) accounted for?**

*This interpretive response applies to Subtopic 715-60 only.*

**Background:** ABC Corp. has two separate retirement plans, a health benefit plan and a life benefit plan. Both plans are unfunded and available to the same group of employees. ABC measures the two plans in the aggregate. It plans to eliminate the health benefit plan and retain the life benefit plan provided to employees.

**Interpretive response:** Because ABC accounts for the two plans as one, it considers the removal of the health benefits as a negative plan amendment because the removal reduces the benefits attributed to prior service. A negative plan amendment and the resulting gain is amortized after first reducing the existing prior service cost and any transition obligation included in AOCI.

Further, because the conditions of Topic 715 are still satisfied, accounting for the two plans separately is not required and therefore ABC continues to measure the plans as one. If ABC decides to change from one-plan to two-plan accounting, it must satisfy the preferability requirements of Topic 250. See section 3.3.20 in KPMG Handbook, Accounting changes and error corrections.

Conversely, if ABC accounts for these two plans separately, the elimination of the health benefit plan is considered a curtailment because it eliminates the accrual of defined benefits for the plan participants. The effect of the curtailment is immediately recognized in ABC's income statement. See section 9.4 for further discussion.

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# 10.4 Multiple-employer plans

## Excerpt from ASC 715-30

**35 Subsequent Measurement**

**> Multiple-Employer Plans**

**35-70** Some pension plans to which two or more unrelated employers contribute are not multiemployer plans. Rather, they are in substance aggregations of **single-employer plans** combined to allow participating employers to pool their assets for investment purposes and to reduce the costs of plan administration. Those **multiple-employer plans** ordinarily do not involve collective-bargaining agreements. They may also have features that allow participating employers to have different benefit formulas, with the employer's contributions to the plan based on the benefit formula selected by the employer. Such plans shall be considered single-employer plans rather than multiemployer plans for purposes of this Subtopic, and each employer's accounting shall be based on its respective interest in the plan.

**55 Implementation Guidance and Illustrations**

**>> Multiemployer, Multiple-Employer, and Single-Employer Plans**

**55-62** Subtopic 715-80 provides guidance on multiemployer plans. Paragraph 715-30-35-70 provides guidance on **multiple-employer plans** that distinguishes multiemployer from multiple-employer plans and requires that multiple-employer plans be viewed as in-substance aggregations of **single-employer plans**. The following example illustrates the guidance in that paragraph.

## Excerpt from ASC 715-60

**35 Subsequent Measurement**

**> Multiple-Employer Plans**

**35-131** Some postretirement benefit plans to which two or more unrelated employers contribute are not multiemployer plans. Rather, those **multiple-employer plans** are in substance aggregations of single-employer plans, combined to allow participating employers to pool plan assets for investment purposes or to reduce the costs of plan administration. Those plans ordinarily do not involve collective-bargaining agreements. They may also have features that allow participating employers to have different benefit formulas, with the employer's contributions to the plan based on the benefit formula selected by the employer. Those plans shall be considered single-employer plans rather than multiemployer plans for purposes of this Subtopic, and each employer's accounting shall be based on its respective interest in the plan.

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**55-63** Assume a not-for-profit entity (NFP) has a defined benefit pension plan that covers employees at the national and all local chapters and each chapter is required to contribute to the pension plan based on a predetermined formula (for example, on a percentage-of-salary basis), plan assets are not segregated or restricted on a chapter-by-chapter basis, and 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. This arrangement should be accounted for as a single-employer pension plan in the NFP's financial statements. However, in each chapter's separate financial statements (if issued) the arrangement should be accounted for as a multiemployer pension plan. It is unclear how an allocation of net periodic pension cost or the overfunded or underfunded status of the defined benefit pension plan 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. The disclosures required by Section 715-80-50 do not apply in this situation. Instead, each chapter should disclose the name of the plan in which it participates and the amount of contributions it made in each annual period for which a statement of income (statement of activities for **not-for-profit entities**) is presented, as well as any related-party disclosures required by Subtopic 850-10.

**55-64** The conclusions in the preceding paragraph would also be true in a similar parent-subsidiary arrangement if

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| the subsidiaries issue separate financial statements. In a similar arrangement, each subsidiary should account for its participation in the overall single-employer pension plan as a participation in a multiemployer pension plan. The disclosures required by Section 715-80-50 do not apply in this situation. Instead, each subsidiary should disclose the name of the plan in which it participates and the amount of contributions the subsidiary made in each period for which a statement of income or statement of activities is presented. The parent entity should, of course, account for the pension plan as a single-employer pension plan in its consolidated financial statements. | |

Topic 715 defines multiple-employer plans as an aggregation of different single-employer plans sponsored by unrelated entities that are combined to allow participating entities to pool their pension fund assets for investment purposes and to reduce the cost of plan administration. Generally, participation is not governed by collective bargaining agreements. Such plans may allow participating entities to have different benefit formulas, allowing entities to contribute amounts based on their elected benefit formula. A separate account for each participating entity is maintained to ensure that contributions are made available only to provide benefits to the contributing entity's employees. Plans with such features are likely to be in substance single-employer plans and are accounted for as such. [715-30-35-70, 715-60-35-131]

In a multiple-employer plan, each participating entity accounts for its respective interest in the pooled assets (which are tracked separately) and the separately determined DB/OPEB actuarial obligation and related cost under Subtopics 715-30 or 715-60.

## Question 10.4.10

**What is the difference between multiple-employer plans and multiemployer plans?**

*This interpretive response applies to both Subtopics 715-30 and 715-60.*

**Interpretive response:** When an entity participates in a plan that includes unrelated entities, careful evaluation of the plan's substance and characteristics is required to determine if it is a multiple-employer plan or a multiemployer plan. Typically, plans with multiple employers participating may use these terms interchangeably to define the plan and in

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some cases, if the participation is driven by law, the definition as used in the legal statute may differ from that used for accounting purposes.

Regardless of how the plan is defined in commerce or law, an entity considers key features of the plan to characterize the plan for accounting purposes. The distinctive feature in a multiple-employer plan is the ability to elect different benefit formulas by each participating entity such that each participant's contribution to the plan is solely based on the selected benefit formula applicable to that entity's employees. Further, if the purpose the plan is limited to reducing administrative cost of the plan assets (which is achieved by pooling resources of each participating entity), the plan is likely a multiple-employer plan. [715-30 Glossary, 715-60 Glossary]

In contrast, a multiemployer plan is defined in Subtopic 715-80 as a DB plan or OPEB plan in which two or more unrelated entities participate pursuant to a collective-bargaining agreement with a plan sponsor. Section 10.5 and Question 10.5.10 discuss specific characteristics of a multiemployer plan. The distinctive feature in a multiemployer plan is the existence of a collective bargaining agreement that defines each participating entity's contribution to the plan and allows for the plan to commingle funds received and pay benefits to any eligible employee – i.e. funds received from one entity can be used to pay benefits of another entity's employees.

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## 10.5 Multiemployer plans

### Excerpt from ASC 715-80

**05 Overview and Background**

**05-1** This Subtopic provides guidance on the accounting and reporting of multiemployer pension and other postretirement benefit plans. For purposes of this Subtopic, a **multiemployer plan** is a pension plan or other postretirement benefit plan to which two or more unrelated employers contribute, usually pursuant to one or more collective-bargaining agreements.

**05-2** In a multiemployer setting, eligibility for benefits is defined by the plan; retired employees continue to receive benefits whether or not their former employers continue to contribute to the plan.

**05-3** However, in a multiemployer postretirement benefit plan, plan participants not yet eligible for benefits may lose accumulated postretirement benefits if their current or former employer withdraws from a plan unless they take or have a job with other employers who participate in the plan.

**05-4** While the postretirement benefit plan may have the option of canceling the accrued service credits that apply toward the required service, within the bargaining unit, of plan participants who were employed by a withdrawing employer and who become or are employed by another participating employer, that rarely occurs because of the difficulty of matching employees to specific employers. For example, in certain industries, an employee may work for more than one employer in a single day and different employers on different days, making it difficult to associate any portion of that employee's past service with a specific employer.

**15 Scope and Scope Exceptions**

**> Overall Guidance**

**15-1** This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic, see Section 715-10-15, with specific exceptions and qualifications noted below.

**> Transactions**

**15-2** The guidance in this Subtopic applies to all multiemployer pension or other postretirement benefit plans.

**15-3** The guidance in this Subtopic does not apply to multiple-employer plans – as distinguished from multiemployer plans. Multiple-employer plans are in substance aggregations of single-employer plans, combined to allow participating employers to pool plan assets for investment purposes or to reduce the costs of plan administration. Those plans ordinarily do not involve collective-bargaining agreements. They may also have features that allow participating employers to have different benefit formulas, with the employer's contributions to the plan based on the benefit formula selected by the employer.

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**35 Subsequent Measurement**

**35-1** An employer participating in a **multiemployer plan** shall recognize as net pension cost or net periodic postretirement benefit cost the required contribution for the period, which shall include both cash and the fair value of noncash contributions, and shall recognize as a liability any unpaid contributions required for the period.

**35-2** In some situations, withdrawal from a multiemployer plan may result in an employer having an obligation to the plan for a portion of the unfunded benefit obligation of the pension or other postretirement benefit plans. If withdrawal under circumstances that would give rise to an obligation is either probable or reasonably possible, the provisions of Topic 450 shall apply.

This section discusses the recognition and measurement criteria under Subtopic 715-80, which addresses the accounting for an entity's participation in multiemployer DB plans and OPEB plans under a collective-bargaining arrangement between the employer and the plan sponsor (e.g. a trade union or labor union).

An entity accounts for its ongoing participation in plans that qualify as a multiemployer DB plan or a multiemployer OPEB plan similar to a DC plan. Therefore, the entity recognizes: [715-80-35-1]

— its required contribution for the period as the net pension cost for DB multiemployer plans and net periodic postretirement cost for OPEB multiemployer plans; and

— a corresponding liability for any accrued and unpaid current period contributions.

Further, the entity recognizes neither an accrual for future contributions nor the funded status of the multiemployer plan because it is not the plan sponsor. This accounting continues until the entity withdraws from the multiemployer plan.

## Question 10.5.10

### What are multiemployer plans?

**Interpretive response:** Multiemployer plans are DB plans or OPEB plans in which two or more unrelated entities participate pursuant to a collective-bargaining agreement with a plan sponsor. Collective-bargaining agreements are contracts negotiated between an employer and a trade union or labor union, which generally include the terms and conditions of employment (e.g. hours of work, benefits, compensation).

Usually, a multiemployer plan is administered by a board of trustees comprising management and labor representatives; for this reason, such a plan is also known as a joint trust or union plan.

Many entities participate in multiemployer plans, and an entity may participate in more than one plan. Entities participating in multiemployer plans usually have a common industry bond, but some plans may include employers in different

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industries, with the labor union being the only common bond. Further, some multiemployer plans do not involve a union. For example, local chapters of a not-for-profit organization may participate in a plan established by the related national organization. [715-80 Glossary]

The following features are required for a DB plan or OPEB plan to meet the definition of a multiemployer plan. [715-80 Glossary, 715-80-05-2]

— Assets contributed by one participating entity may be used to provide benefits to employees of other participating entities because assets are not segregated separately or restricted to provide benefits only to the employees of the contributing entity.

— Each entity's required contribution is predefined by the plan, which could be based on factors such as number of employees, working hours or production units.

— Benefits are paid to eligible individuals by the plan and not the individual's participating entity.

— A participating entity's withdrawal from the plan does not absolve the plan of its obligation to eligible employees.

## Question 10.5.20

### When is a withdrawal liability from a multiemployer plan recognized?

**Interpretive response:** In some situations, entities may withdraw or consider withdrawing from their current participation in a multiemployer plan. Potential consequences of withdrawing from such plans are generally covered by the plan's governing documents, which may require the withdrawing entity to complete the required funding for vested benefits on the date of withdrawal. Therefore, on the date of withdrawal, a liability to fund the required amount of vested benefits is recognized immediately. [715-80-35-1]

Entities contemplating withdrawal from multiemployer plans apply Topic 450 (contingencies) to evaluate the likelihood of the occurrence of events that would give rise to an obligation for the possible withdrawal liability in reporting periods before the actual date of withdrawal. [715-80-35-2]

Applying Topic 450 in periods before the actual date of withdrawal entails the following. [450-20-25-2, 450-20-50-3 – 50-6]

— If the likelihood of occurrence of an event giving rise to an obligation for withdrawal is probable and the loss is reasonably estimable, a withdrawal liability is recognized. However, if the withdrawal liability cannot be reasonably estimated, the entity discloses either an estimate of the possible loss or a range of loss or the fact that a reasonable estimate cannot be made.

— If the likelihood of occurrence of an event giving rise to an obligation for withdrawal is reasonably possible, no withdrawal liability is recognized. However, the entity discloses a contingent liability along with an estimate

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of the possible loss or a range of loss or the fact that a reasonable estimate cannot be made.

— If the likelihood of occurrence of an event giving rise to an obligation for withdrawal is remote, neither a withdrawal liability nor disclosure is required.

## Question 10.5.30

### How is a multiemployer plan accounted for upon withdrawal of other plan participants?

**Background:** The entity is one of two significant participants in a multiemployer DB plan. The other participant filed for bankruptcy and may withdraw from the multiemployer plan.

**Interpretive response:** We believe, the entity remaining in the multiemployer plan continues to account for its plan as a multiemployer plan unless the conditions for termination of the plan (generally included in the governing documents) are met or formal actions are taken to convert the plan from a multiemployer plan to a single-employer plan.

In this case, although the entity is the only remaining employer in the multiemployer plan, the plan itself is not terminated and employees of the withdrawing entity continue to earn service credits. Therefore, the remaining entity in the plan continues to apply multiemployer plan accounting.

An entity that withdraws from a multiemployer pension plan is liable on the date of withdrawal for its proportionate share of the plan's unfunded vested liability. Therefore, a withdrawal liability for such portion of the unfunded liability is recognized immediately by the bankrupt entity.

However, the withdrawal of other participants in a multiemployer plan may result in a risk that the plan is underfunded if the withdrawing entity does not fulfill its obligation to contribute to the plan (e.g. due to bankruptcy). The continuing entity may become aware of such risk earlier than the actual date of withdrawal by others. In such cases, the remaining entity considers whether it has assumed a liability as soon it becomes aware of the other entity's withdrawal and potential shortfall in the plan's unfunded vested liability. Assessing whether an obligating event has occurred is facts and circumstances dependent and requires careful evaluation. Topic 450 (contingencies) is relevant when determining whether a potential loss contingency exists and needs to be accrued in the period the entity becomes aware of the other participant's withdrawal (see Question 10.5.20).

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# 10.6 Other OPEB-specific topics

Subtopic 715-60 includes guidance about accounting areas specific to OPEB plans. This section addresses the following accounting issues:

- Medicare Prescription Drug, Improvement and Modernization Act (MMA) enacted in 2003
- split-dollar life insurance arrangements.

Chapter 7 discusses assumptions that are unique to postretirement healthcare plans.

## 10.6.10 Medicare Prescription Drug, Improvement and Modernization Act

### Excerpt from ASC 715-60

**05 Overview and Background**

**05-8** The Medicare Prescription Drug, Improvement, and Modernization Act Subsections provide guidance on the accounting for the effects of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 for employers that sponsor postretirement health care plans that provide prescription drug **benefits**.

**05-11** The Medicare Prescription Drug, Improvement, and Modernization Act Subsections make reference to various provisions of the Act and, in many cases, paraphrase those provisions. However, nothing in these Subsections should be considered a definitive interpretation of any provision of the Act for any purpose.

**15 Scope and Scope Exceptions**

**> Overall Guidance**

**15-10** The Medicare Prescription Drug, Improvement, and Modernization Act Subsections follow the same Scope and Scope Exceptions as outlined in the General Subsection of this Subtopic, see paragraph 715-60-15-1, with specific exceptions noted below.

**> Transactions**

**15-11** The guidance in the Medicare Prescription Drug, Improvement, and Modernization Act Subsections applies to the following plans and **benefits**:

a. A single-employer defined benefit postretirement health care **plan** that has both of the following characteristics:

   1. The employer has concluded that prescription drug benefits available under the plan to some or all participants for some or all future years are "actuarially equivalent" to Medicare Part D and thus qualify for the subsidy under the Medicare Prescription Drug, Improvement, and Modernization Act.
   2. The expected subsidy will offset or reduce the employer's share of the

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cost of the underlying postretirement prescription drug coverage on which the subsidy is based.

**15-12** The guidance in the Medicare Prescription Drug, Improvement, and Modernization Act Subsections does not address the following:

a. Situations that may arise in which the expected subsidy exceeds the employer's share of the cost of the underlying postretirement prescription drug coverage on which the subsidy is based
b. Multiemployer health and welfare benefit plans.

**> Other Considerations**

**15-13** Although the Medicare Prescription Drug, Improvement, and Modernization Act Subsections provide limited guidance on certain other related aspects of accounting and disclosure necessitated by the Act (for example, changes in assumed participation rates and **health care cost trend rates**, as well as income tax accounting), that guidance is not intended to supersede or in any way limit the application of other relevant authoritative literature.

**35 Subsequent Measurement**

**35-133** Changes in coverage provided by governmental programs (see paragraph 715-60-35-102) shall be considered in the period that the law is changed. However, the Medicare Prescription Drug, Improvement, and Modernization Act introduces the following two new features to Medicare that an employer needs to consider in determining those measurements:

a. A subsidy that is based on 28 percent of an individual beneficiary's annual prescription drug costs between $250 and $5,000 (subject to indexation and the provisions of the Act as to allowable retiree costs)
b. The opportunity for a retiree to obtain a prescription drug benefit under Medicare.

**35-134** Regardless of the impact of the subsidy, the existence of prescription drug coverage under Medicare Part D may have an effect on an employer's per capita claims cost for a **plan** that currently provides a prescription drug benefit. That effect depends on whether current and future **retirees** (or their beneficiaries under the employer-sponsored plan) enroll in the voluntary Medicare Part D plan and on the Act's macrosocioeconomic effects on health care cost trends and consumers' behavior.

**35-135** In response to the Act, or for other reasons, an employer may amend an existing plan (or establish a new one). To the extent that an employer amends a plan (positively or negatively), the **accumulated postretirement benefit obligation** will be affected by the direct effects of the change in **benefits** attributed to employee services already rendered. If an amendment changes the determination as to the actuarial equivalency of benefits available under the plan, the expected subsidy to the employer also will change.

**35-136** Therefore, under that guidance, measures of the accumulated postretirement benefit obligation and net periodic other postretirement benefit cost on or after the date of enactment shall reflect the effects of the Act.

**35-137** When an employer initially accounts for the subsidy its effect on the accumulated postretirement benefit obligation shall be accounted for as an

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actuarial experience gain pursuant to paragraphs 715-60-35-23 and 715-60-35-29 through 35-33.

**35-138** Because the subsidy affects the employer's share of its plan's costs, the subsidy is included in measuring the costs of benefits attributable to current service. Therefore, the subsidy reduces service cost when it is recognized as a component of net periodic other postretirement benefit cost.

**35-139** If an estimate of the expected subsidy subsequently changes—as a result of changes in regulations or legislation, changes in the underlying estimates of other postretirement prescription drug costs, or for reasons other than a **plan amendment**—the effect of the change in estimate is an actuarial experience **gain or loss** pursuant to paragraph 715-60-35-23.

**35-140** If prescription drug benefits currently available under an existing plan are deemed not actuarially equivalent as of the date of enactment of the Act, but the plan is subsequently amended to provide actuarially equivalent benefits, the direct effect of the plan amendment on the accumulated postretirement benefit obligation (that is, the effect of only the change in prescription drug coverage) and the effect on the accumulated postretirement benefit obligation from any resulting subsidy to which the employer is expected to be entitled as a result of the amendment shall be combined. If that combined effect reduces the accumulated postretirement benefit obligation, it is deemed to be an actuarial experience gain pursuant to paragraph 715-60-35-23. If the combined effect increases the accumulated postretirement benefit obligation, it is deemed to be **prior service cost** that shall be accounted for pursuant to paragraphs 715-60-35-13 through 35-19.

**35-141** A plan that provides prescription drug benefits that previously were deemed actuarially equivalent under the Act may be subsequently amended to reduce its prescription drug coverage and that reduced coverage may not be considered actuarially equivalent. In that circumstance, any actuarial experience gain related to the subsidy previously recognized is unaffected. However, the combined net effect on the accumulated postretirement benefit obligation of the subsequent plan amendment that reduces benefits under the plan and thus disqualifies the benefits as actuarially equivalent and the elimination of the subsidy shall be accounted for as prior service cost (credit) as of the date the amendment is adopted.

**35-142** When first determining the effects of the Act, an employer and its actuarial consultants may have been unable to determine the extent to which the benefits provided by a plan are actuarially equivalent as of the date of the initial measurement applying the guidance in the Medicare Prescription Drug, Improvement, and Modernization Act Subsections.

**35-143** If additional clarifying regulations related to the Act or new information about the interpretation or determination of actuarial equivalency under the Act becomes available, the employer shall reconsider whether the benefits provided under its plan, as presently constructed, are actuarially equivalent. If that reconsideration results in a conclusion that benefits provided by the plan are actuarially equivalent (or that additional benefits provided by the plan are actuarially equivalent in the case of a plan under which an employer previously had determined that some benefits were actuarially equivalent), that conclusion could be a significant event pursuant to paragraphs 715-60-35-125

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through 35-128.

**35-144** However, the guidance in the preceding paragraph does not apply if a plan amendment is the event that gives rise to the employer's reconsideration of actuarial equivalency. The guidance in paragraphs 715-60-35-140 through 35-141 applies to plan amendments.

**35-145** If the effects of the subsidy on the plan are significant, a measurement of **plan assets** and obligations shall be performed as of the date that actuarial equivalency is determined.

**35-146** Any effect on the accumulated postretirement benefit obligation due to the subsidy shall be reflected as an actuarial gain consistent with the guidance in paragraph 715-60-35-137.

**35-147** Measures of net periodic postretirement benefit cost for subsequent periods would reflect the effects of those measurements.

**35-148** Prior financial statements shall not be retroactively adjusted nor shall a cumulative effect for prior periods be recognized in income.

**55 Implementation Guidance and Illustrations**

**> Implementation Guidance**

**55-103** The following flowchart illustrates the application of certain aspects of the accounting for the effects of the Medicare Prescription Drug, Improvement, and Modernization Act.

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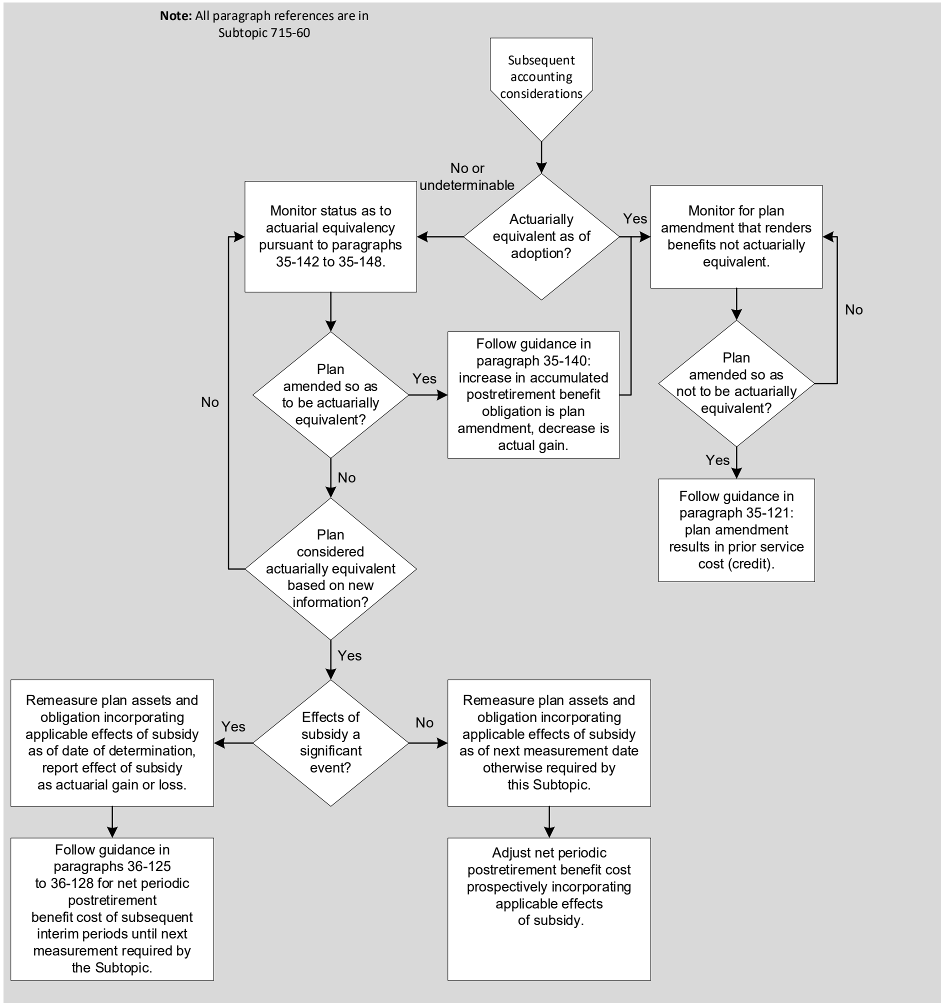


## Question 10.6.10

### How are subsidies and reimbursements under government programs considered in measuring OPEB benefits?

**Interpretive response:** Reimbursements (or subsidies) from government programs (e.g. Medicare in the US) could have a material effect on an entity's present and future share of healthcare costs for its OPEB plan.

In measuring the cost and actuarial obligation, an entity includes the effect of Medicare reimbursements using only the provisions of the currently effective law. Anticipated future changes to the government programs, which are likely to be effected through a proposed change in law, are not considered. Only reimbursements that apply under present law, including enacted changes in law, are assumed to continue in measuring the OPEB benefit obligation. [715-60-35-102]

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Many of the laws that govern reimbursements will include various provisions and measures (e.g. formulas) to increase future reimbursement amounts from the government to counter the inflationary effects of medical costs. However, only the currently effective formulas are used in determining actuarial assumptions about future reimbursements.

Subtopic 715-60 includes specific guidance on accounting for the Medicare Part D prescription drug benefit, which was introduced by the MMA. This federal subsidy (drug subsidy) program was introduced in the form of a reimbursement to entities who have eligible OPEB benefits. Any drug subsidy received is reflected in measuring the OPEB benefit obligation as a reduction in service cost, when recognized as a component of net periodic postretirement benefit cost. [715-60-35-136]

### Question 10.6.20

**Is the MMA subsidy considered when calculating plan-related temporary differences for income taxes?**

**Interpretive response:** No. Under the MMA, for federal income tax purposes, an entity excludes from its taxable income the received subsidy amount. Because the subsidy is exempt from federal taxation, it has no effect on plan-related temporary differences accounted for under Topic 740 (income taxes) for the periods that the subsidy affects the entity's accounting for the plan. The entity measures a temporary difference under Topic 740 as if the subsidy did not exist. [715-60-35-148]

## 10.6.20 Split-dollar life insurance arrangements

### Excerpt from ASC 715-60

**05 Overview and Background**

**Split-Dollar Life Insurance Arrangements**

**05-13** The Split-Dollar Life Insurance Arrangements Subsections provide guidance on accounting and reporting for split-dollar life insurance arrangements.

**05-14** Entities purchase life insurance for various reasons that may include protecting against the loss of key employees, funding deferred compensation and postretirement benefit obligations, and providing an investment return. One form of this insurance is split-dollar life insurance. The structure of split-dollar life insurance arrangements can be complex and varied.

**05-15** The two most common types of arrangements are **endorsement split-dollar life insurance** arrangements and **collateral assignment split-dollar life insurance** arrangements. Generally, the difference between these

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arrangements is dependent on the ownership and control of the life insurance policy.

**15 Scope and Scope Exceptions**

**Split-Dollar Life Insurance Arrangements**

**> Overall Guidance**

**15-19** The Split-Dollar Life Insurance Arrangements Subsections follow the same Scope and Scope Exceptions as outlined in the General Subsection of this Subtopic, see paragraph 715-60-15-1, with specific exceptions noted below.

**> Transactions**

**15-20** The guidance in the Split-Dollar Life Insurance Arrangements Subsections applies to the following plans and **benefits**:

a. **Endorsement split-dollar life insurance** arrangements that provide a benefit to an employee that extends to postretirement periods.
b. **Collateral split-dollar life insurance** arrangements that provide a benefit to an employee that extends to postretirement periods.

**15-21** The guidance in the Split-Dollar Life Insurance Arrangements Subsections does not apply to the following plans and benefits:

a. A split-dollar life insurance arrangement that provides a specified benefit to an employee that is limited to the employee's active service period with an employer.

**20 Glossary**

**Collateral Split-Dollar Life Insurance –** A split-dollar life insurance arrangement in which the employee (or the employee's estate or a trust controlled by the employee, referred to as the employee) owns and controls the insurance policy.

**Endorsement Split-Dollar Life Insurance –** A split-dollar life insurance arrangement in which the entity owns and controls the insurance policy. The employer enters into a separate agreement that splits the policy benefits between the employer and the employee. The employer owns the policy, controls all rights of ownership, and may terminate the insurance policy (and, in turn, the policy benefits promised to the employee). To effect the split-dollar arrangement, the employer endorses a portion of the death benefits to the employee (the employee designates a beneficiary for this portion of the death benefits). Upon the death of the employee, the employee's beneficiary typically receives the designated portion of the death benefits directly from the insurance entity and the employer receives the remainder of the death benefits.

**35 Subsequent Measurement**

**Split-Dollar Life Insurance Arrangements**

**35-177** For an **endorsement split-dollar life insurance** arrangement within the scope of the Split-Dollar Life Insurance Arrangements Subsections, an employer shall recognize a liability for future **benefits** in accordance with this Subtopic (if, in substance, a **postretirement benefit plan** exists) or Subtopic

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710-10 (if the arrangement is, in substance, an individual deferred compensation contract) based on the substantive agreement with the employee. A liability for the benefit obligation under this Subtopic or Subtopic 710-10 has not been settled through the purchase of a typical endorsement split-dollar life insurance arrangement.

**35-178** For example, if the employer has effectively agreed to maintain a life insurance policy during the employee's retirement, the cost of the insurance policy during postretirement periods shall be accrued in accordance with either this Subtopic or Subtopic 710-10.

**35-179** Similarly, if the employer has effectively agreed to provide the employee with a death benefit, the employer shall accrue, over the service period, a liability for the **actuarial present value** of the future death benefit as of the employee's expected retirement date, in accordance with either this Subtopic or Subtopic 710-10.

**35-180** An employer shall recognize a liability for the postretirement benefit related to a collateral assignment split-dollar life insurance arrangement in accordance with either this Subtopic (if, in substance, a postretirement benefit plan exists) or Subtopic 710-10 (if the arrangement is, in substance, an individual deferred compensation contract) if the employer has agreed to maintain a life insurance policy during the employee's retirement or provide the employee with a death benefit based on the substantive agreement with the employee.

**35-181** For example, if the employer has effectively agreed to maintain life insurance policy during the employee's retirement, the estimated cost of maintaining the insurance policy during the postretirement period shall be accrued in accordance with either this Subtopic or Subtopic 710-10.

**35-182** Similarly, if the employer has effectively agreed to provide the employee with a death benefit, the employer shall accrue a liability for the actuarial present value of the future death benefit as of the employee's expected retirement date, in accordance with either this Subtopic or Subtopic 710-10.

**35-183** For purposes of the Split-Dollar Life Insurance Arrangements Subsections, an employer has agreed to maintain a life insurance policy if the employer has stated or implied commitment to provide loans to an employee to fund premium payments on the underlying insurance policy during the postretirement period. Absent evidence to the contrary, it shall be presumed that an employer will provide loans to an employee to fund premium payments on the underlying insurance policy in the postretirement period if the employer has provided loans in the past or if the employer is currently promising to provide loans in the future.

**35-184** In periods following the inception of the collateral assignment split-dollar life insurance arrangement, employers shall continue to evaluate (pursuant to the guidance in the Split-Dollar Life Insurance Arrangements Subsections) whether a change in facts and circumstances (for example, an amendment to the arrangement or change from the employer's past practice) has altered the substance of the collateral assignment split-dollar life insurance arrangement, which could result in a liability or an adjustment to a previously recognized liability, for a postretirement benefit.

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**35-185** In addition, an employer shall recognize and measure an asset based on the nature and substance of the collateral assignment split-dollar life insurance arrangement.

**55 Implementation Guidance and Illustrations**

**Split-Dollar Life Insurance Arrangements**

**> Implementation Guidance**

**55-176** A typical **endorsement split-dollar life insurance** arrangement may have the following terms:

a. An employer purchases a life insurance policy to insure the life of an employee and pays a single premium at inception of the policy. Based on the insurance carrier's experience (for example, mortality) it can either charge or credit the policyholder for the negative or positive experience, respectively. The additional premium or credit is typically effectuated through an adjustment to the cash surrender value of the policy.
b. The employer enters into a separate agreement that splits the policy **benefits** between the employer and the employee. The employer owns the policy, controls all rights of ownership, and may terminate the insurance policy (and, in turn, the policy benefits promised to the employee). To effect the split-dollar arrangement, the employer endorses a portion of the death benefits to the employee (the employee designates a beneficiary for this portion of the death benefits). Upon the death of the employee, the employee's beneficiary typically receives the designated portion of the death benefits directly from the insurance entity and the employer receives the remainder of the death benefits.

**55-177** The employee's portion of the death benefits is commonly based on one of the following:

a. Amounts that exceed the gross premiums paid by the employer
b. Amounts that exceed the sum of the gross premiums paid by the employer and an additional fixed or variable investment return on those premiums
c. The net insurance at the date of death (that is, the face amount of the death benefit under the policy, less the cash surrender value)
d. Amounts equal to a multiple of the employee's base salary at retirement or death (for example, twice the employee's base salary).

**55-178** All available evidence should be considered in determining the substance of the arrangement, such as explicit written terms of the arrangement, communications made by the employer to the employee, the employer's past practices in administering the same or similar arrangements, and whether the employer is the primary obligor for the postretirement benefit.

**55-179** For example, if the employer agrees to provide a death benefit to the employee even in the event of default by the insurance entity, that would provide an indication that the promise made to the employee is to provide a postretirement death benefit. If the amount of the death benefit is not explicitly tied to an insurance policy, then the amount of the postretirement benefit should also be the amount of the death benefit promised to the employee. Conversely, if the terms of the arrangement are such that the employer has no obligation to the employee upon default of the insurance entity, that would

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provide an indication that the postretirement benefit is a promise to maintain a life insurance policy during the employee's retirement. In determining the appropriate measurement and **attribution** of the cost and obligation under any particular arrangement, employers should refer to the guidance in this Subtopic, as applicable.

**55-180** For example, if the terms of the arrangement are such that the employer has no obligation, either stated or implied, to provide loans to an employee to cover insurance policy premiums in the postretirement period, that may be an indication that there is no postretirement obligation. However, if the employer through the collateral assignment arrangement with the employee has an obligation, either stated or implied, to provide loans to an employee to cover the experience gains and losses of the insurance entity, that may indicate that an employer has a postretirement benefit obligation. In determining the appropriate measurement and attribution of the cost and obligation under any particular arrangement, employers should refer to the guidance in this Subtopic, as applicable.

**55-181** In determining the nature and substance of the arrangement, the employer should assess what future cash flows the employer is entitled to, if any, as well as the employee's obligation and ability to repay the employer. For example, if the arrangement limited the amount the employer could recover to the amount of the cash surrender value of the insurance policy held by the employee (or retiree), and if the employer's loan to the employee (or retiree) is greater than the cash surrender value of the insurance policy, at the balance sheet date the employer's asset would be limited to the amount of the cash surrender value of the insurance policy. Conversely, if the arrangement required the employee to repay the employer irrespective of the collateral assigned and the employer has determined that the employee loan is collectible and intends to seek recovery beyond the cash surrender value of the life insurance policy, the employer should recognize the value of the loan (including accrued interest, if applicable) considering the guidance in Subtopic 835-30. An employer should evaluate all available information in determining the nature and substance of the collateral assignment split-dollar life insurance arrangement.

Life insurance contracts are purchased for various reasons; most commonly to either protect against the loss of key employees or to earn a return on investment. Split-dollar life insurance contracts are one such vehicle. While the structure and terms vary, there are generally two types of split-dollar life insurance contracts:

— endorsement split-dollar life insurance arrangements – owned and controlled by the entity; and
— collateral assignment split-dollar life insurance arrangements – owned and controlled by the employee or a trust controlled by the employee.

## Observation
### Income statement presentation

EITF 06-4, Accounting for Deferred Compensation and Postretirement Benefits Aspects of Endorsement Split-Dollar Life Insurance Arrangements, is the

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primary source for paragraphs 715-60-05-14 – 05-15, 715-60-05-20 – 05-21, 715-60-35-177 – 35-179, 715-60-55-176 – 55-177 and 715-60-55-179. Further, EITF 06-10, Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements, is the primary source for paragraphs 715-60-05-15, 715-60-35-180 – 35-185, 715-60-55-178 and 715-60-55-180 – 55-181 is.

The EITF did not reach a consensus on the income statement presentation of a gain resulting from settlement of the OPEB obligation, and therefore that presentation issue is not addressed in the Codification. We have observed diversity in practice for the income statement presentation for such a gain.

## Question 10.6.30

**How are split-dollar life insurance arrangements accounted for?**

*This interpretive response applies only to Subtopic 715-60.*

**Interpretive response:** An entity accrues a liability for the present value of the postretirement benefit obligation over the service period. If the postretirement benefit obligation is a death benefit, the obligation accretes interest during the retirement period until the death benefit is paid to the employee's beneficiary. The postretirement benefit obligation is settled upon payment of the death benefit to the employee's beneficiary.

If the postretirement benefit obligation is a promise to maintain an insurance policy in force during the employee's retirement, the obligation accretes interest during the retirement period. However, the entity settles a portion of the obligation in each retirement reporting period as it incurs the cost of maintaining the life insurance policy. If the insured dies at the expected mortality date, receipt of the death benefit from the insurer and payment of the death benefit to the beneficiary would be equal. [715-60-35-185]

## Example 10.6.10

**Key employee life insurance**

### Background

ABC Corp. purchases a life insurance contract for a key employee that has an increased CSV each period. ABC enters into an endorsement arrangement with the employee whereby the death benefit, less the CSV, will be paid to the employee’s designated beneficiary. The communications between ABC and the employee stipulate that the postretirement benefit obligation is a death benefit.

### Analysis

During the employee’s service period, ABC accrues the present value of the death benefit, net of the projected CSV at the employee’s expected mortality date. At the end of the employee’s service period (i.e. the full eligibility date), ABC has a liability recorded equal to the present value of the death benefit and an asset for the CSV of the life insurance.

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During the retirement period, ABC:

— accretes interest on the benefit obligation;
— recognizes the related interest cost; and
— records the CSV under Subtopic 325-30 (investments in insurance contracts).

If the employee dies at the expected mortality date, the APBO (which equals the death benefit provided to the employee) is settled with the excess insurance proceeds.

Using the same facts, assume the communications between ABC and the employee stipulate that the postretirement benefit obligation is a promise to maintain an insurance policy during the employee's retirement. At the end of the employee's service period, ABC should have a liability recorded equal to the actuarial present value of the cost of providing insurance during the retirement period. During the retirement period, ABC reduces the obligation each reporting period for the cost of the insurance, net of interest accretion on the remaining benefit obligation. Effectively, ABC recognizes additional interest cost in each reporting period offsetting the reduction in the accrual.

Changes in the expected mortality date and discount rate result in gains or losses recognized under Topic 715 (see chapter 8).

## Example 10.6.20

**Endorsement split-dollar arrangement to provide a death benefit**

### Background

ABC Corp. enters into an endorsement split-dollar life insurance arrangement with an employee who is 52 years old. The arrangement provides a life insurance benefit equal to the net insurance at the date of death (face amount of policy less the CSV) to the employee's beneficiary.

— To become eligible for the retirement benefit, the employee must provide 10 years of service.
— The employee's mandatory retirement age is 62.
— ABC will receive the CSV of the policy.
— Communications between ABC and the employee stipulate that the retirement benefit is a death benefit.
— The arrangement does not constitute a plan and is therefore accounted for under Topic 715.

Additional features of the policy are as follows.

— Face amount of policy is $300,000.
— ABC pays a single premium of $20,000 at inception of the arrangement.
— ABC is the owner of the policy and is entitled to 100% of the CSV.
— ABC can cancel coverage at any time.
— For simplicity, the CSV increases ratably $6,000/year: $9,000 interest credit – $3,000 cost of insurance.

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— The actuarial present value of the retirement benefit ABC recognizes each year of employee service is $6,000.
— Mortality assumptions estimate that the employee will die at age 82.
— The employee retires at age 62

## Analysis

### *Journal entry: Day 1*

| | Debit | Credit |
|---|---|---|
| Insurance asset[1] | 20,000 | |
| Cash | | 20,000 |
| *To record purchase of endorsement split-dollar life insurance arrangement.* | | |

Note:

1. Assume the CSV equals the premium payment. If the CSV is less than $20,000 when the policy is purchased, ABC expenses the difference between the premium paid and the CSV.

### *Journal entries: end of Year 1*

| | Debit | Credit |
|---|---|---|
| Deferred compensation expense[1] | 6,000 | |
| Postretirement benefit obligation | | 6,000 |
| *To record postretirement benefit obligation for year.* | | |
| Insurance asset[2] | 6,000 | |
| Investment income | | 6,000 |
| *To recognize increase in CSV of the policy.* | | |

Notes:

1. Actuarial present value of the retirement benefit ABC recognizes each year of employee service is $6,000. ABC records this entry annually until age 62, the full eligibility date.
2. Calculated as $9,000 interest credit – $3,000 cost of insurance. ABC records this entry until the earlier of the employee's death or surrender of the policy.

### *End of Year 10: Full eligibility and employee retirement*

Total postretirement benefit obligation accrued during employee' service is $60,000.

### *Journal entries: end of first year after retirement*

| | Debit | Credit |
|---|---|---|
| Interest expense [1] | 2,000 | |
| Postretirement benefit obligation | | 2,000 |
| *To record accretion of postretirement benefit obligation until settlement.* | | |

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| | Debit | Credit |
|---|---|---|
| Insurance asset[2] | 6,000 | |
| Investment income | | 6,000 |
| *To recognize increase in CSV of policy.* | | |

Notes:

1. For simplicity, this amount is assumed to accrete ratably each year until the obligation is settled.
2. $9,000 interest credit – $3,000 cost of insurance. ABC records this entry until the earlier of the employee's death or surrender of the policy.

### *Journal entry: employee dies one day after retirement*

If the employee dies one day after retirement, the entries above for one year after retirement would not be made.

| | Debit | Credit |
|---|---|---|
| Cash[1] | 300,000 | |
| Postretirement benefit obligation[2] | 60,000 | |
| Insurance asset[3] | | 80,000 |
| Cash (paid to employee’s estate)[4] | | 220,000 |
| Gain[5] | | 60,000 |
| *To record insurance proceeds received upon employee's death and settlement of postretirement benefit obligation.* | | |

Notes:

1. The insurance company may pay the death benefit directly to the employee’s beneficiary instead of to ABC. However, ABC (as the employer) has promised to pay a death benefit to the employee; therefore, the cash is recognized as paid to ABC by the insurance company.
2. $6,000 annual retirement benefit × 10 years.
3. The insurance asset would equal the CSV computed as $20,000 from the date the policy was acquired plus the $6,000 investment income per year for 10 years.
4. The employee’s estate would receive $220,000 – i.e. the excess of the face amount of the policy of $300,000 over the CSV.
5. The $60,000 is a combination of a gain related to the insurance asset of $220,000 ($300,000 benefit amount – $80,000 insurance asset) offset by a loss from settlement of the postretirement benefit obligation of $160,000 ($220,000 settlement payment – obligation of $60,000).

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### *Journal entry: employee dies five years after retirement*

| | Debit | Credit |
|---|---|---|
| Cash[1] | 300,000 | |
| Postretirement benefit obligation[2] | 70,000 | |
| Insurance asset[3] | | 110,000 |
| Cash – paid to employee's estate[4] | | 190,000 |
| Gain[5] | | 70,000 |
| *To record insurance proceeds received upon employee's death and settlement of postretirement benefit obligation.* | | |

Notes:

1. The insurance company may pay the death benefit directly to the employee's beneficiary instead of to the employer. However, ABC (as the employer) has promised to pay a death benefit to the employee; therefore, the cash is recognized as paid to ABC by the insurance company.
2. The postretirement benefit obligation accreted of $2,000 per year after the full eligibility date for a total accretion of $10,000, which is added to the $60,000 that was recognized during the employee's service period.
3. The insurance asset would equal the CSV computed as $20,000 from the date the policy was acquired plus the $6,000 investment income per year for 15 years.
4. The employee's estate would receive $190,000 – i.e. the excess of the face amount of the policy of $300,000 over the CSV.
5. The $70,000 credit is a combination of a gain related to the insurance asset of $190,000 ($300,000 benefit amount – $110,000 insurance asset) offset by a loss from settlement of the postretirement benefit obligation of $120,000 ($190,000 settlement payment – obligation of $70,000).

### *Journal entry: employee dies at age 82 (estimated mortality date)*

| | Debit | Credit |
|---|---|---|
| Cash[1] | 300,000 | |
| Postretirement benefit obligation[2] | 100,000 | |
| Insurance asset[3] | | 200,000 |
| Cash – paid to employee's estate[4] | | 100,000 |
| Gain[5] | | 100,000 |
| *To record insurance proceeds received upon employee's death and settlement of postretirement benefit obligation.* | | |

Notes:

1. The insurance company may pay the death benefit directly to the employee's beneficiary instead of to the employer. However, ABC (as the employer) has promised to pay a death benefit to the employee; therefore, the cash is recognized as paid to ABC by the insurance company.
2. The postretirement benefit obligation accreted of $2,000 per year after the full eligibility date for a total accretion of $40,000, which is added to the $60,000 that was recognized during the employee's service period.

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3. The insurance asset would equal the CSV computed as $20,000 from the date the policy was acquired plus the $6,000 investment income per year for 30 years.
4. The employee's estate would receive $100,000 – the excess of the face amount of the policy of $300,000 over the CSV.
5. The $100,000 credit is a gain related to the insurance asset of $100,000 ($300,000 benefit amount – $200,000 insurance asset.

## Example 10.6.30

### Endorsement split-dollar arrangement to provide the cost of insurance

#### Background

ABC Corp. enters into an endorsement split-dollar life insurance arrangement with an employee who is 52 years old. The arrangement provides a life insurance benefit to the employee's beneficiary in an amount equal to the net insurance at the date of death – face amount of policy less the CSV.

Assume the same facts as in Example 10.6.20 except that:

— communications between ABC and the employee stipulate that the postretirement benefit obligation is a promise to maintain an insurance policy in force during the employee's retirement period; and
— the cost of insurance (the postretirement benefit) to be recognized per year of employee service is $6,000.

**Note:** Insurance proceeds received by the employee's beneficiary exceeding the CSV will not result in a journal entry for ABC because the excess represents the life insurance benefit paid by the insurance company directly.

#### Analysis

***Journal entry: Day 1***

| | *Debit* | *Credit* |
|---|---|---|
| Insurance asset[1] | 20,000 | |
| Cash | | 20,000 |
| *To record purchase of endorsement split-dollar life insurance arrangement.* | | |

Note:

1. Assume that the CSV equals premium payment. If the CSV is less than $20,000 at the date the policy is purchased, ABC expenses the difference between the premium paid and the CSV.

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### *Journal entries: end of Year 1*

| | Debit | Credit |
|---|---:|---:|
| Deferred compensation expense[1] | 6,000 | |
| Postretirement benefit obligation | | 6,000 |
| *To record postretirement benefit obligation for year.* | | |
| Insurance asset[2] | 6,000 | |
| Investment income | | 6,000 |
| *To recognize increase in CSV of policy.* | | |

Notes:

1. The annual cost of insurance is $6,000. ABC records this entry annually until age 62, the full eligibility date.
2. $9,000 interest credit – $3,000 cost of insurance. ABC records this entry until the earlier of the employee's death or surrender of the policy.

### *End of Year 10: Full eligibility and employee retirement*

Total postretirement benefit obligation accrued during employee's service is $60,000.

### *Journal entry: end of first year after retirement*

| | Debit | Credit |
|---|---:|---:|
| Insurance asset[1] | 9,000 | |
| Postretirement benefit obligation[2] | 3,000 | |
| Investment income | | 9,000 |
| Insurance asset – cost of insurance | | 3,000 |
| *To record interest credit and cost of insurance.* | | |

Notes:

1. The annual interest credit of $9,000.
2. The cost of insurance of $3,000 incurred during the period reduces the employer’s obligation to the employee. This journal entry would continue annually until age 82. For simplicity, this assumes that the cost of insurance is an equal amount in each year of the retirement period.

### *Journal entry: employee dies one day after retirement*

If the employee dies one day after retirement, the entries above for one year after retirement would not be made.

| | Debit | Credit |
|---|---:|---:|
| Postretirement benefit obligation | 60,000 | |
| Deferred compensation expense | | 60,000 |
| *To record settlement of postretirement benefit obligation upon death of employee.* | | |

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| | Debit | Credit |
|---|---|---|
| Cash[1,2] | 80,000 | |
| Insurance asset | | 80,000 |
| *To record insurance proceeds received upon employee's death.* | | |

Notes:

1. Insurance proceeds received equal to the CSV calculated as $20,000 from the date the policy was acquired + $6,000 investment income per year for 10 years.
2. The employee's estate receives $220,000: face amount of the policy of $300,000 – CSV of $80,000.

### *Journal entry: employee dies five years after retirement*

| | Debit | Credit |
|---|---|---|
| Postretirement benefit obligation[1] | 45,000 | |
| Deferred compensation expense | | 45,000 |
| *To record settlement of postretirement benefit obligation upon death of employee.* | | |
| Cash[2,3] | 110,000 | |
| Insurance asset | | 110,000 |
| *To record insurance proceeds received upon employee's death.* | | |

Notes:

1. $60,000 postretirement obligation reduced by $3,000 per year for each of the last five years.
2. Insurance proceeds received equal to the CSV calculated as $20,000 from the date the policy was acquired + $6,000 investment income per year for 15 years.
3. The employee's estate receives $190,000: face amount of the policy of $300,000 – CSV of $110,000.

### *Journal entry: employee dies at age 82 (estimated mortality date)*

| | Debit | Credit |
|---|---|---|
| Cash[1,2] | 200,000 | |
| Insurance asset | | 200,000 |
| *To record insurance proceeds received upon employee's death.* | | |

Notes:

1. Insurance proceeds received equal to the CSV calculated as $20,000 from the date the policy was acquired + $6,000 investment income per year for 30 years.
2. The employee's estate would receive $100,000 – the excess of the face amount of the policy of $300,000 over the CSV of $200,000.

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# 11. Retirement plans: Disclosure

## Detailed contents



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## 11.3 Defined contribution plans

### Question



## 11.4 Multiemployer plans

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## 11.1 How the standard works

Topic 715 outlines the disclosure requirements for entities that offer pension, OPEB and certain special or contractual termination benefits to employees. This chapter outlines the disclosure requirements for single-employer pension and DB pension and OPEB plans, DC plans and multiemployer plans.

The disclosure requirements outlined in Topic 715 are extensive, and public entities are required to disclose more information than nonpublic entities.

Further, the format for many of the disclosures is highly prescriptive. For example, information may be required to be disclosed as a reconciliation or in a tabular or narrative form. However, many of the requirements are also objective-based, so this chapter includes KPMG views on what to consider disclosing to meet some of the disclosure objectives outlined in Topic 715.

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# 11.2. Defined benefit plans

## 11.2.10 Annual disclosure

### Excerpt from ASC 715-20

**50 Disclosure**

**> Disclosures by Public Entities**

**50-1** An employer that sponsors one or more defined benefit pension plans or one or more defined benefit other postretirement plans shall provide the following information, separately for pension plans and other postretirement benefit plans. Amounts related to the employer's results of operations shall be disclosed for each period for which a statement of income is presented. Amounts related to the employer's statement of financial position shall be disclosed as of the date of each statement of financial position presented. All of the following shall be disclosed:

a. A reconciliation of beginning and ending balances of the benefit obligation showing separately, if applicable, the effects during the period attributable to each of the following:
   1. Service cost
   2. Interest cost
   3. Contributions by plan participants
   4. Actuarial gains and losses
   5. Foreign currency exchange rate changes (The effects of foreign currency exchange rate changes that are to be disclosed are those applicable to plans of a foreign operation whose functional currency is not the reporting currency pursuant to Section 830-10-45.)
   6. Benefits paid
   7. Plan amendments
   8. Business combinations
   9. Divestitures
   10. Curtailments, settlements, and special and contractual termination benefits.

   For defined benefit pension plans, the benefit obligation is the projected benefit obligation. For defined benefit other postretirement plans, the benefit obligation is the accumulated postretirement benefit obligation.

b. A reconciliation of beginning and ending balances of the fair value of plan assets showing separately, if applicable, the effects during the period attributable to each of the following:
   1. Actual return on plan assets
   2. Foreign currency exchange rate changes (see (a)(5))
   3. Contributions by the employer
   4. Contributions by plan participants
   5. Benefits paid
   6. Business combinations
   7. Divestitures

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8. Settlements.

c. The funded status of the plans and the amounts recognized in the statement of financial position, showing separately the assets and current and noncurrent liabilities recognized.
d. The objectives of the disclosures about postretirement benefit plan assets are to provide users of financial statements with an understanding of:

1. How investment allocation decisions are made, including the factors that are pertinent to an understanding of investment policies and strategies
2. The classes of plan assets
3. The inputs and valuation techniques used to measure the fair value of plan assets
4. The effect of fair value measurements using significant unobservable inputs (Level 3) on changes in plan assets for the period
5. Significant concentrations of risk within plan assets.

An employer shall consider those overall objectives in providing the following information about plan assets:

i. A narrative description of investment policies and strategies, including target allocation percentages or range of percentages considering the classes of plan assets disclosed pursuant to (ii) below, as of the latest statement of financial position presented (on a weighted-average basis for employers with more than one plan), and other factors that are pertinent to an understanding of those policies and strategies such as investment goals, risk management practices, permitted and prohibited investments including the use of derivatives, diversification, and the relationship between plan assets and benefit obligations. For investment funds disclosed as classes as described in (ii) below, a description of the significant investment strategies of those funds shall be provided.

ii. The fair value of each class of plan assets as of each date for which a statement of financial position is presented. For additional guidance on determining appropriate classes of plan assets, see paragraph 820-10-50-2B. Examples of classes of assets could include, but are not limited to, the following: cash and **cash equivalents**; equity securities (segregated by industry type, company size, or investment objective); debt securities issued by national, state, and local governments; corporate debt securities; asset-backed securities; structured debt; derivatives on a gross basis (segregated by type of underlying risk in the contract, for example, interest rate contracts, foreign exchange contracts, equity contracts, commodity contracts, credit contracts, and other contracts); investment funds (segregated by type of fund); and real estate. Those examples are not meant to be all inclusive. An employer should consider the overall objectives in paragraph 715-20-50-1(d)(1) through (5) in determining whether additional classes of plan assets or further disaggregation of classes should be disclosed. If an employer determines the measurement date of plan assets in accordance with paragraph 715-30-35-63A or 715-60-35-123A and the employer contributes assets to the plan between the measurement date and its fiscal year-end, the employer shall

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not adjust the fair value of each class of plan assets for the effects of the contribution. Instead, the employer shall disclose the amount of the contribution to permit reconciliation of the total fair value of all the classes of plan assets to the ending balance of the fair value of plan assets. For example, the contribution could be disclosed as follows:

| | | Fair Value Measurements at February 3, 20X5 (in thousands) | | |
|---|---|---|---|---|
| **Asset Class** | **Total** | **Quoted Prices in Active Markets for Identical Assets (Level 1)** | **Significant Observable Inputs (Level 2)** | **Significant Unobservable Inputs (Level 3)** |
| Cash | $14,770 | $14,770 | $ - | $ - |
| Equity securities: | | | | |
| U.S. companies | 41,200 | 37,000 | 1,200 | 3,000 |
| International companies | 32,900 | 24,000 | 7,600 | 1,300 |
| Mortgage-backed securities | 13,335 | - | 12,780 | 555 |
| Assets at fair value at measurement date of 1/31/20X5 | 102,205 | $75,770 | $21,580 | $4,855 |
| Contributions after measurement date | 25,000 | | | |
| Total assets reported at 2/3/20X5 | $127,205 | | | |

iii. A narrative description of the basis used to determine the overall expected long-term rate-of-return-on-assets assumption, such as the general approach used, the extent to which the overall rate-of-return-on-assets assumption was based on historical returns, the extent to which adjustments were made to those historical returns in order to reflect expectations of future returns, and how those adjustments were determined. The description should consider the classes of assets as described in (ii) above, as appropriate.

iv. Information that enables users of financial statements to assess the inputs and valuation techniques used to develop fair value measurements of plan assets at the reporting date. For fair value measurements using significant unobservable inputs, an employer shall disclose the effect of the measurements on changes in plan assets for the period. To meet those objectives, the employer shall disclose the following information for each class of plan assets disclosed pursuant to (ii) above for each annual period:

01. The level of the fair value hierarchy within which the fair value measurements are categorized in their entirety, segregating fair value measurements using quoted prices in active markets for identical assets or liabilities (Level 1), significant other observable inputs (Level 2), and significant unobservable inputs (Level 3). The guidance in paragraphs 820-10-35-37 through 35-37A is applicable. Investments for which fair value is measured using the net asset value per share (or its equivalent) practical expedient in paragraph 820-10-35-59 shall not be categorized within the fair value hierarchy, as noted by paragraph 820-10-35-54B. If an employer determines the measurement date of plan assets in accordance with paragraph 715-30-35-63A or 715-60-35-123A and the employer contributes assets to the

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plan between the measurement date and its fiscal year-end, the employer shall not adjust the fair value of each class of plan assets for the effects of the contribution. Instead, the employer shall disclose the amount of the contribution to permit reconciliation of the total fair value of all plan assets in the fair value hierarchy to the ending balance of the fair value of plan assets. For example, the contribution could be disclosed as follows:

| | | **Fair Value Measurements at February 3, 20X5 (in thousands)** | | |
|---|---|---|---|---|
| **Asset Class** | **Total** | **Quoted Prices in Active Markets for Identical Assets (Level 1)** | **Significant Observable Inputs (Level 2)** | **Significant Unobservable Inputs (Level 3)** |
| Cash | $14,770 | $14,770 | $ - | $ - |
| Equity securities: | | | | |
| U.S. companies | 41,200 | 37,000 | 1,200 | 3,000 |
| International companies | 32,900 | 24,000 | 7,600 | 1,300 |
| Mortgage-backed securities | 13,335 | - | 12,780 | 555 |
| Assets at fair value at measurement date of 1/31/20X5 | 102,205 | $75,770 | $21,580 | $4,855 |
| Contributions after measurement date | 25,000 | | | |
| Total assets reported at 2/3/20X5 | $127,205 | | | |

02. For fair value measurements of plan assets using significant unobservable inputs (Level 3), a reconciliation from the opening balances to the closing balances, disclosing separately changes during the period attributable to the following:

A. Actual Return on Plan Assets (Component of **Net Periodic Postretirement Benefit Cost**) or Actual Return on Plan Assets (Component of **Net Periodic Pension Cost**), separately identifying the amount related to assets still held at the reporting date and the amount related to assets sold during the period

B. Purchases, sales, and settlements, net

C. The amounts of any transfers into or out of Level 3 (for example, transfers due to changes in the observability of significant inputs).

03. Information about the valuation technique(s) and inputs used to measure fair value and a discussion of changes in valuation techniques and inputs, if any, during the period.

e. For defined benefit pension plans, the accumulated benefit obligation.
f. The benefits (as of the date of the latest statement of financial position presented) expected to be paid in each of the next five fiscal years, and in the aggregate for the five fiscal years thereafter. The expected benefits shall be estimated based on the same assumptions used to measure the entity's benefit obligation at the end of the year and shall include benefits attributable to estimated future employee service.
g. The employer’s best estimate, as soon as it can reasonably be determined, of contributions expected to be paid to the plan during the next fiscal year

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beginning after the date of the latest statement of financial position presented. Estimated contributions may be presented in the aggregate combining all of the following:

1. Contributions required by funding regulations or laws
2. Discretionary contributions
3. Noncash contributions.

h. The amount of net benefit cost recognized, showing separately all of the following:

1. The service cost component
2. The interest cost component
3. The expected return on plan assets for the period
4. The gain or loss component
5. The prior service cost or credit component
6. The transition asset or obligation component
7. The gain or loss recognized due to settlements or curtailments.

The line item(s) used in the income statement to present the components other than the service cost component shall be disclosed if the other components are not presented in a separate line item or items in the income statement.

i. Separately the net gain or loss and net prior service cost or credit recognized in other comprehensive income for the period pursuant to paragraphs 715-30-35-11, 715-30-35-21, 715-60-35-16, and 715-60-35-25, and reclassification adjustments of other comprehensive income for the period, as those amounts, including amortization of the net transition asset or obligation, are recognized as components of net periodic benefit cost.
j. The amounts in accumulated other comprehensive income that have not yet been recognized as components of net periodic benefit cost, showing separately the net gain or loss, net prior service cost or credit, and net transition asset or obligation.
k. On a weighted-average basis, all of the following assumptions used in the accounting for the plans, specifying in a tabular format, the assumptions used to determine the benefit obligation and the assumptions used to determine net benefit cost:

1. Discount rates (see paragraph 715-30-35-45 for a discussion of representationally faithful disclosure)
2. Rates of compensation increase (for pay-related plans)
3. Expected long-term rates of return on plan assets.
4. Interest crediting rates (for cash balance plans and other plans with promised interest crediting rates).

l. The assumed health care cost trend rate(s) for the next year used to measure the expected cost of benefits covered by the plan (gross eligible charges), and a general description of the direction and pattern of change in the assumed trend rates thereafter, together with the ultimate trend rate(s) and when that rate is expected to be achieved.
n. If applicable, the amounts and types of securities of the employer and **related parties** included in plan assets.
o. If applicable, any alternative method used to amortize prior service amounts or net gains and losses pursuant to paragraphs 715-30-35-13 and 715-30-35-25 or 715-60-35-18 and 715-60-35-31.

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p. If applicable, any substantive commitment, such as past practice or a history of regular benefit increases, used as the basis for accounting for the benefit obligation.
q. If applicable, the cost of providing special or contractual termination benefits recognized during the period and a description of the nature of the event.
r. An explanation of the following information:
   1. The reasons for significant gains and losses related to changes in the defined benefit obligation for the period
   2. Any other significant change in the benefit obligation or plan assets not otherwise apparent in the other disclosures required by this Subtopic.
u. If applicable, the accounting policy election to measure plan assets and benefit obligations using the month-end that is closest to the employer's fiscal year-end in accordance with paragraph 715-30-35-63A or 715-60-35-123A and the month-end measurement date.

**> Entities (Public and Nonpublic) with Two or More Plans**

**50-2** The disclosures required by this Subtopic shall be aggregated for all of an employer's defined benefit pension plans and for all of an employer's other defined benefit postretirement plans unless disaggregating in groups is considered to provide useful information or is otherwise required by the following paragraph and paragraph 715-20-50-4.

**50-3** If aggregate disclosures are presented, an employer shall disclose, as of the date of each statement of financial position presented, both of the following:

a. For pension plans, the projected benefit obligation and fair value of plan assets for plans with projected benefit obligations in excess of plan assets, and the accumulated benefit obligation and fair value of plan assets for plans with accumulated benefit obligations in excess of plan assets
b. For other postretirement benefit plans, the accumulated postretirement benefit obligation and fair value of plan assets for plans with accumulated postretirement benefit obligations in excess of plan assets.

**50-4** 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. A foreign reporting entity that prepares financial statements in conformity with U.S. generally accepted accounting principles (GAAP) shall apply the preceding guidance to its domestic and foreign plans.

**> Disclosures by Nonpublic Entities**

**50-5** A **nonpublic entity** is not required to disclose the information required by paragraph 715-20-50-1(a) through (c), 715-20-50-1(h), 715-20-50-1(o) through (q), and 715-20-50-1(r)(2). A nonpublic entity that sponsors one or more defined benefit pension plans or one or more other defined benefit postretirement plans shall provide all of the following information, separately for pension plans and other postretirement benefit plans. Amounts related to the employer's results of operations shall be disclosed for each period for which a statement of income is presented. Amounts related to the employer's statement of

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financial position shall be disclosed as of the date of each statement of financial position presented.

a. The benefit obligation, fair value of plan assets, and funded status of the plan.
b. Employer contributions, participant contributions, and benefits paid.
c. The objectives of the disclosures about postretirement benefit plan assets are to provide users of financial statements with an understanding of:

   1. How investment allocation decisions are made, including the factors that are pertinent to an understanding of investment policies and strategies
   2. The classes of plan assets
   3. The inputs and valuation techniques used to measure the fair value of plan assets
   4. The effect of fair value measurements using significant unobservable inputs (Level 3) on changes in plan assets for the period
   5. Significant concentrations of risk within plan assets.

   An employer shall consider those overall objectives in providing the following information about plan assets:

   i. A narrative description of investment policies and strategies, including target allocation percentages or range of percentages considering the classes of plan assets disclosed pursuant to (ii) below, as of the latest statement of financial position presented (on a weighted-average basis for employers with more than one plan), and other factors that are pertinent to an understanding of those policies and strategies such as investment goals, risk management practices, permitted and prohibited investments including the use of derivatives, diversification, and the relationship between plan assets and benefit obligations. For investment funds disclosed as classes as described in (ii) below, a description of the significant investment strategies of those funds shall be provided.

   ii. The fair value of each class of plan assets as of each date for which a statement of financial position is presented. For additional guidance on determining appropriate classes of plan assets, see paragraph 820-10-50-2B. Examples of classes of assets could include, but are not limited to, the following: cash and cash equivalents; equity securities (segregated by industry type, company size, or investment objective); debt securities issued by national, state, and local governments; corporate debt securities; asset-backed securities; structured debt; derivatives on a gross basis (segregated by type of underlying risk in the contract, for example, interest rate contracts, foreign exchange contracts, equity contracts, commodity contracts, credit contracts, and other contracts); investment funds (segregated by type of fund); and real estate. Those examples are not meant to be all inclusive. An employer should consider the overall objectives in paragraph 715-20-50-5(c)(1) through (5) in determining whether additional classes of plan assets or further disaggregation of classes should be disclosed. If an employer determines the measurement date of plan assets in accordance with paragraph 715-30-35-63A or 715-60-35-123A and the employer contributes assets to the plan between

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the measurement date and its fiscal year-end, the employer shall not adjust the fair value of each class of plan assets for the effects of the contribution. Instead, the employer shall disclose the amount of the contribution to permit reconciliation of the total fair value of all the classes of plan assets to the ending balance of the fair value of plan assets. For example, the contribution could be disclosed as follows:

| | | Fair Value Measurements at February 3, 20X5 (in thousands) | | |
|---|---|---|---|---|
| **Asset Class** | **Total** | **Quoted Prices in Active Markets for Identical Assets (Level 1)** | **Significant Observable Inputs (Level 2)** | **Significant Unobservable Inputs (Level 3)** |
| Cash | $14,770 | $14,770 | $ - | $ - |
| Equity securities: | | | | |
| U.S. companies | 41,200 | 37,000 | 1,200 | 3,000 |
| International companies | 32,900 | 24,000 | 7,600 | 1,300 |
| Mortgage-backed securities | 13,335 | - | 12,780 | 555 |
| Assets at fair value at measurement date of 1/31/20X5 | 102,205 | $75,770 | $21,580 | $4,855 |
| Contributions after measurement date | 25,000 | | | |
| Total assets reported at 2/3/20X5 | $127,205 | | | |

iii. A narrative description of the basis used to determine the overall expected long-term rate-of-return-on-assets assumption, such as the general approach used, the extent to which the overall rate-of-return-on-assets assumption was based on historical returns, the extent to which adjustments were made to those historical returns in order to reflect expectations of future returns, and how those adjustments were determined. The description should consider the classes of assets described in (ii) above, as appropriate.

iv. Information that enables users of financial statements to assess the inputs and valuation techniques used to develop fair value measurements of plan assets at the reporting date. For fair value measurements using significant unobservable inputs, an employer shall disclose the effect of the measurements on changes in plan assets for the period. To meet those objectives, the employer shall disclose the following information for each class of plan assets disclosed pursuant to (ii) above for each annual period:

01. The level of the fair value hierarchy within which the fair value measurements are categorized in their entirety, segregating fair value measurements using quoted prices in active markets for identical assets or liabilities (Level 1), significant other observable inputs (Level 2), and significant unobservable inputs (Level 3). The guidance in paragraphs 820-10-35-37 through 35-37A is applicable. Investments for which fair value is measured using the net asset value per share (or its equivalent) practical expedient in paragraph 820-10-35-59 shall not be categorized within the fair value hierarchy, as noted by paragraph 820-10-35-54B. If an employer determines the measurement date of plan assets in accordance with paragraph

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715-30-35-63A or 715-60-35-123A and the employer contributes assets to the plan between the measurement date and its fiscal year-end, the employer shall not adjust the fair value of each class of plan assets for the effects of the contribution. Instead, the employer shall disclose the amount of the contribution to permit reconciliation of the total fair value of all plan assets in the fair value hierarchy to the ending balance of the fair value of plan assets. For example, the contribution could be disclosed as follows:

| | | **Fair Value Measurements at February 3, 20X5 (in thousands)** | | |
|---|---|---|---|---|
| **Asset Class** | **Total** | **Quoted Prices in Active Markets for Identical Assets (Level 1)** | **Significant Observable Inputs (Level 2)** | **Significant Unobservable Inputs (Level 3)** |
| Cash | $14,770 | $14,770 | $ - | $ - |
| Equity securities: | | | | |
| U.S. companies | 41,200 | 37,000 | 1,200 | 3,000 |
| International companies | 32,900 | 24,000 | 7,600 | 1,300 |
| Mortgage-backed securities | 13,335 | - | 12,780 | 555 |
| Assets at fair value at measurement date of 1/31/20X5 | 102,205 | $75,770 | $21,580 | $4,855 |
| Contributions after measurement date | 25,000 | | | |
| Total assets reported at 2/3/20X5 | $127,205 | | | |

02. For fair value measurements of plan assets using significant unobservable inputs (Level 3), the amounts of purchases and any transfers into or out of Level 3 (for example, transfers due to changes in the observability of significant inputs), disclosed separately.

03. Information about the valuation technique(s) and inputs used to measure fair value and a discussion of changes in valuation techniques and inputs, if any, during the period.

d. For defined benefit pension plans, the accumulated benefit obligation.
e. The benefits (as of the date of the latest statement of financial position presented) expected to be paid in each of the next five fiscal years, and in the aggregate for the five fiscal years thereafter. The expected benefits shall be estimated based on the same assumptions used to measure the entity's benefit obligation at the end of the year and shall include benefits attributable to estimated future employee service.
f. The employer’s best estimate, as soon as it can reasonably be determined, of contributions expected to be paid to the plan during the next fiscal year beginning after the date of the latest statement of financial position presented. Estimated contributions may be presented in the aggregate combining any of the following:

1. Contributions required by funding regulations or laws
2. Discretionary contributions
3. Noncash contributions.

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g. The amounts recognized in the statements of financial position, showing separately the postretirement benefit assets and current and noncurrent postretirement benefit liabilities.
h. Separately, the net gain or loss and net prior service cost or credit recognized in other comprehensive income for the period pursuant to paragraphs 715-30-35-11, 715-30-35-21, 715-60-35-16, and 715-60-35-25 and reclassification adjustments of other comprehensive income for the period, as those amounts, including amortization of the net transition asset or obligation, are recognized as components of net periodic benefit cost.
i. The amounts in accumulated other comprehensive income that have not yet been recognized as components of net periodic benefit cost, showing separately the net gain or loss, net prior service cost or credit, and net transition asset or obligation.
j. On a weighted-average basis, all of the following assumptions used in the accounting for the plans, specifying in a tabular format, the assumptions used to determine the benefit obligation and the assumptions used to determine net benefit cost:
    1. Discount rates (see paragraph 715-30-35-45 for a discussion of representationally faithful disclosure)
    2. Rates of compensation increase (for pay-related plans)
    3. Expected long-term rates of return on plan assets.
    4. Interest crediting rates (for cash balance plans and other plans with promised interest crediting rates).
k. The assumed health care cost trend rate(s) for the next year used to measure the expected cost of benefits covered by the plan (gross eligible charges), and a general description of the direction and pattern of change in the assumed trend rates thereafter, together with the ultimate trend rate(s) and when that rate is expected to be achieved.
l. If applicable, the amounts and types of securities of the employer and related parties included in plan assets.
m. The nature and effect of significant nonroutine events, such as amendments, combinations, divestitures, curtailments, and settlements.
p. If applicable, the accounting policy election to measure plan assets and benefit obligations using the month-end that is closest to the employer's fiscal year-end in accordance with paragraph 715-30-35-63A or 715-60-35-123A and the month-end measurement date.
q. The amount of net periodic benefit cost recognized. In addition, if the components other than the service cost component are not presented in a separate line item or items in the income statement, the amount of the other components and the line item(s) used in the income statement to present them shall be disclosed.
r. An explanation of the reasons for significant gains and losses related to changes in the benefit obligation for the period.

**55 Implementation Guidance and Illustrations**

**> Implementation Guidance**

**>> Disclosure of Assumed Discount Rates for Other Postretirement Benefit Obligations**

**55-1** An employer's disclosure of the weighted average of the assumed discount rates for its other postretirement benefit obligation may not necessarily be the same as that disclosed for its pension benefit obligation.

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Even if the assumed discount rates are the same, the weighted average of those rates that is disclosed for the other postretirement benefit obligation may not be the same as that disclosed for the pension benefit obligation because the weighted average is influenced by the timing and pattern of benefits to be provided, which can differ between a pension and a postretirement benefit plan.

**55-2** For example, pension benefits are usually paid in fixed amounts throughout retirement. On the other hand, postretirement health care benefits tend to increase during retirement because retirees generally require more health care services as they age, although the net cost to employers after retirees reach age 65 is reduced by Medicare. If, as a result of the expected cost of health care, the timing or pattern of postretirement benefits differs from that for pension benefits, that difference should be reflected in the weighting of the assumed discount rates.

## 11.2.20 Overview

### Question 11.2.10
**Are the disclosure requirements for nonpublic entities the same as for public entities?**

**Interpretive response:** No. The disclosure requirements for nonpublic entities that sponsor DB pension or OPEB plans are listed in paragraph 715-20-50-5 (reproduced above). They are similar to the requirements for public entities in paragraph 715-20-50-1 (also reproduced above).

However, there are several disclosure requirements for public entities that are not required under the nonpublic entities paragraph – specifically, the requirements in paragraph 715-20-50-1(a), (b), (c), (h), (m) and (o) through (r). [715-20-55-15]

### Question 11.2.20
**Can an entity aggregate its disclosures for a DB pension plan and an OPEB plan?**

**Interpretive response**: No. Topic 715 requires the disclosures to be made separately for each category of plan – i.e. at a minimum, one disclosure for DB pension plans and one disclosure for OPEB plans. [715-20-50-1]

If an entity has more than one DB pension plan, Topic 715 permits (but does not require) aggregation of the information within the DB pension plan disclosure. This is also the case if an entity has more than one OPEB plan. [715-20-50-2 – 50-3]

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## Question 11.2.30
### What are classes of plan assets?

**Interpretive response**: Topic 715 requires the disclosure of plan assets, along with information about those assets. Topic 820 (fair value measurement) provides guidance on determining appropriate classes of plan assets.

In determining the appropriate classes of assets, an entity considers the nature, characteristics and risks of the asset (e.g. shared activities or business sectors, vintage, geographical concentration, credit quality or other economic characteristics) and the level of the fair value hierarchy within which the fair value measurement is characterized. The aggregation of classes of assets is discussed in Question N35 of KPMG Handbook, Fair value measurement.

Examples of classes of asset include, but are not limited to: [715-20-50-5]

- cash and cash equivalents;
- equity securities – segregated by industry type, company size or investment objective;
- debt securities issued by national, state and local governments;
- corporate debt securities;
- asset-backed securities;
- structured debt;
- derivatives on a gross basis – segregated by type of underlying risk in the contract, such as interest rate contracts, foreign exchange contracts, equity contracts, commodity contracts, credit contracts and other contracts;
- investment funds – segregated by type of fund; and
- real estate.

## Question 11.2.40
### Is how an entity discloses the relationship between plan assets and benefit obligations prescribed?

**Interpretive response:** No. Topic 715 does not contain specific guidance about the requirement to disclose the relationship between plan assets and benefit obligations. However, we believe an entity might disclose how it considers benefit obligation maturities in allocating its investment portfolio among and within plan asset classes.

## Question 11.2.50
### Must an entity disclose plan assets on a weighted-average basis?

**Interpretive response**: Yes, if an entity has more than one plan. [715-20-50-5(5i)]

We believe the requirement to present assets on a weighted-average basis ensures the information disclosed reflects the relative size of each plan. For

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example, a plan comprising 60% of the entity's total plans would influence the amounts that an entity discloses for the expected long-term rate of return on assets and target allocation to a greater degree than all others. Therefore, reporting on a weighted-average basis takes into account the significance of each plan.

## Question 11.2.60

**Must an entity disclose investment policies and strategies for plan assets?**

**Interpretive response**: Yes. Topic 715 requires an entity to provide a narrative description of investment policies and strategies for its plan assets. [715-20-50-5(i)]

Topic 715 does not prescribe specific information on disclosure about investment strategies and policies. However, we believe a plan sponsor should describe the considerations most significant to its investment decisions.

We believe this information may include:

— investment objectives such as optimizing returns, achieving stable earnings, maintaining relationships between plan assets and benefit obligations, or making stable contributions.

— the basis for allocating assets, frequency of rebalancing, limitations or latitude to invest in foreign markets and derivatives, and a description of other risk management practices.

The description of investment strategies should include the target asset allocation percentages, or range of percentages, unless the plan sponsor does not use target allocations to manage its portfolio.

## Question 11.2.70

**Must the weighted-average of the assumed discount rates be the same if an entity has multiple DB pension or OPEB plans?**

**Interpretive response:** No. There is a requirement to disclose the weighted-average of the assumed discount rate. However, there is no requirement for the assumed discount rates to be the same across plans. See Question 8.3.40. [250-10-55-1 – 55-2, 715-20-50-1(k)(1)]

## Question 11.2.80

**What are the disclosure requirements for a controlled subsidiary of a public entity?**

**Interpretive response:** We believe the financial statements of a subsidiary controlled by an entity whose equity securities trade in a public market must

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meet all disclosure requirements of a publicly traded entity. Therefore, such subsidiaries must comply with the disclosure requirements for public entities.

However, there are potential differences in accounting for subsidiaries whose employees participate in the parent's DB plan. See section 8.7 for further discussion.

## 11.2.30 Comprehensive example

### Excerpt from ASC 715-20

**55 Implementation Guidance and Illustrations**

**> Implementation Guidance**

**>> Example 1: Disclosures about Defined Benefit Pension and Other Postretirement Benefit Plans in the Annual Financial Statements of a Publicly Traded Entity**

**55-16** The following illustrates the fiscal 20X3 financial statement disclosures for an employer (Entity A) with multiple defined benefit pension plans and other postretirement benefit plans (dollar amounts in millions). This Example assumes that Entity A does not have cash balance plans or other plans with promised interest crediting rates. Narrative descriptions of the basis used to determine the overall expected long-term rate-of-return-on-assets assumption (see paragraph 715-20-50-1(d)(iii)) and disclosure of the valuation technique(s) and inputs used to measure the fair value of plan assets and a discussion of changes in valuation techniques and inputs (see paragraph 715-20-50-1(d)(iv)(03)), if any, are not included in this Example. The narrative description of the basis used to determine the overall expected long-term rate-of-return-on-assets assumption is meant to be entity-specific. An explanation of the reasons for significant gains and losses related to changes in the benefit obligation for the period (see paragraph 715-20-50-1(r)(1)), if any, is not provided in this Example because the reasons may vary in different reporting periods or in different entities. For purposes of this Example, the disclosures required by paragraphs 715-20-50-1(d)(ii) and 715-20-50-1(d)(iv) are provided for only the fiscal year ending December 31, 20X3. However, those paragraphs indicate that the disclosures are required to be presented as of each date for which a statement of financial position is presented.

**55-17** During 20X3, Entity A acquired FV Industries and amended its plans. Entity A would make the following disclosure.

***Notes to Financial Statements***

**Pension and Other Postretirement Benefit Plans**

Entity A has both funded and unfunded noncontributory defined benefit pension plans that together cover substantially all of its employees. The plans provide defined benefits based on years of service and final average salary.

Entity A also has both funded and unfunded other postretirement benefit plans covering substantially all of its employees. The health care plans are contributory with participants' contributions adjusted annually; the life

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insurance plans are noncontributory. The accounting for the health care plans anticipates future cost-sharing changes to the written plans that are consistent with the entity's expressed intent to increase retiree contributions each year by 50 percent of health care cost increases in excess of 6 percent. The postretirement health care plans include a limit on the entity's share of costs for recent and future retirees.

Entity A acquired FV Industries on December 27, 20X3, including its pension plans and other postretirement benefit plans. Amendments made at the end of 20X3 to Entity A's plans increased the pension benefit obligations by $70 and reduced the other postretirement benefit obligations by $75.

**Obligations and Funded Status**
**At December 31**

| | Pension Benefits | | Other Benefits | |
|---|---|---|---|---|
| | **20X3** | **20X2** | **20X3** | **20X2** |
| **Change in benefit obligation** | | | | |
| Benefit obligation at beginning of year | $1,246 | $1,200 | $742 | $712 |
| Service cost | 76 | 72 | 36 | 32 |
| Interest cost | 90 | 88 | 55 | 55 |
| Plan participants' contributions | | | 20 | 13 |
| Amendments | 70 | | (75) | |
| Actuarial loss | 20 | | 25 | |
| Acquisition | 900 | | 600 | |
| Benefits paid | (125) | (114) | (90) | (70) |
| Benefit obligation at end of year | 2,277 | 1,246 | 1,313 | 742 |
| **Change in plan assets** | | | | |
| Fair value plan assets at beginning of year | 1,068 | 894 | 206 | 87 |
| Actual return on plan assets | 29 | 188 | 5 | 24 |
| Acquisition | 1,000 | | 25 | |
| Employer contributions | 75 | 100 | 137 | 152 |
| Plan participants' contributions | | | 20 | 13 |
| Benefits paid | (125) | (114) | (90) | (70) |
| Fair value of plan assets at end of year | 2,047 | 1,068 | 303 | 206 |
| Funded status at end of year | $(230) | $(178) | $(1,010) | $(536) |

[Note: Nonpublic entities are not required to provide information in the preceding tables; they are required to disclose the employer's contributions, participants' contributions, benefit payments, and the funded status.]

Amounts recognized in the statement of financial position consist of the following.

| | Pension Benefits | | Other Benefits | |
|---|---|---|---|---|
| | **20X3** | **20X2** | **20X3** | **20X2** |
| Noncurrent assets | $227 | $127 | $ - | $ - |
| Current liabilities | (125) | (125) | (150) | (150) |
| Noncurrent liabilities | (332) | (180) | (860) | (386) |
| | $(230) | $(178) | $(1,010) | $(536) |

[Note: The sum of current liabilities and noncurrent liabilities consists of the

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amount of underfunded (including unfunded) pension benefits or other benefits.]

Amounts recognized in accumulated other comprehensive income consist of the following.

| | Pension Benefits | | Other Benefits | |
|---|---|---|---|---|
| | 20X3 | 20X2 | 20X3 | 20X2 |
| Net loss (gain) | $94 | $18 | $(11) | $(48) |
| Prior service cost (credit) | 210 | 160 | (92) | (22) |
| | $304 | $178 | $(103) | $(70) |

The accumulated benefit obligation for all defined benefit pension plans was $1,300 and $850 at December 31, 20X3, and 20X2, respectively.

**Information for pension plans with an accumulated benefit obligation in excess of plan assets**

| | December 31 | |
|---|---|---|
| | 20X3 | 20X2 |
| Accumulated benefit obligation | $237 | $222 |
| Fair value of plan assets | 84 | 95 |

**Information for pension plans with a projected benefit obligation in excess of plan assets**

| | December 31 | |
|---|---|---|
| | 20X3 | 20X2 |
| Projected benefit obligation | $1,277 | $696 |
| Fair value of plan assets | 820 | 391 |

[Note: The net amount of projected benefit obligation and plan assets for all underfunded (including unfunded) pension plans was $457 and $305 at December 31, 20X3, and 20X2, respectively, and was classified as liabilities on the statement of financial position.]

[Note: Information for other postretirement benefit plans with an accumulated postretirement benefit obligation in excess of plan assets has been disclosed in the note on "Obligations and Funded Status" because all the other postretirement benefit plans are unfunded or underfunded.]

**Components of Net Periodic Benefit Cost and Other Amounts Recognized in Other Comprehensive Income**

| | Pension Benefits | | Other Benefits | |
|---|---|---|---|---|
| **Net Periodic Benefit Cost** | 20X3 | 20X2 | 20X3 | 20X2 |
| Service cost | $76 | $72 | $36 | $32 |
| Interest cost | 90 | 88 | 55 | 55 |
| Expected return on plan assets | (85) | (76) | (17) | (8) |
| Amortization of prior service cost (credit) | 20 | 16 | (5) | (5) |
| Amortization of net (gain) loss | - | - | - | - |
| Net periodic benefit cost | $101 | $100 | $69 | $74 |
| **Other Changes in Plan Assets and Benefit Obligations Recognized in Other Comprehensive Income** | | | | |
| Net loss (gain) | $76 | $(112) | $37 | $(16) |
| Prior service cost (credit) | 70 | - | (75) | - |
| Amortization of prior service (cost) credit | (20) | (16) | 5 | 5 |
| Total recognized in other comprehensive | 126 | (128) | (33) | (11) |
| Total recognized in net periodic benefit cost and other comprehensive income | $227 | $(28) | $36 | $63 |

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The components of net periodic benefit cost other than the service cost component are included in the line item "other income/(expense)" in the income statement.

[Note: Nonpublic entities are not required to separately disclose components of net periodic benefit cost.]

[Entity-specific narrative description of the reasons for significant gains and losses related to changes in the defined benefit obligation for the period would be disclosed.]

## Assumptions

**Weighted-average assumptions used to determine benefit obligations at December 31**

| | Pension Benefits | | Other Benefits | |
|---|---|---|---|---|
| | **20X3** | **20X2** | **20X3** | **20X2** |
| Discount rate | 6.75% | 7.25% | 7.00% | 7.50% |
| Rate of compensation increase | 4.25 | 4.5 | | |

**Weighted-average assumptions used to determine net periodic benefit cost for years ended December 31**

| | Pension Benefits | | Other Benefits | |
|---|---|---|---|---|
| | **20X3** | **20X2** | **20X3** | **20X2** |
| Discount rate | 7.25% | 7.50% | 7.50% | 7.75% |
| Expected long-term return on plan assets | 8.00 | 8.50 | 8.10 | 8.75 |
| Rate of compensation increase | 4.50 | 4.75 | | |

[Entity-specific narrative description of the basis used to determine the overall expected long-term rate of return on assets, as described in paragraph 715-20-50-1(d)(iii), would be disclosed.]

[An entity with cash balance plans or other plans with promised interest crediting rates would disclose the weighted-average interest crediting rates used to determine the benefit obligation and net periodic benefit cost.]

**Assumed health care cost trend rates at December 31**

| | **20X3** | **20X2** |
|---|---|---|
| Health care cost trend rate assumed for next year | 12% | 12.5% |
| Rate to which the cost trend rate is assumed to decline (the ultimate trend rate) | 6% | 5% |
| Year that the rate reaches the ultimate trend rate | 20X9 | 20X9 |

## Plan Assets

The company’s overall investment strategy is to achieve a mix of approximately 75 percent of investments for long-term growth and 25 percent for near-term benefit payments with a wide diversification of asset types, fund strategies, and fund managers. The target allocations for plan assets are 65 percent equity securities, 20 percent corporate bonds and U.S. Treasury securities, and 15 percent to all other types of investments. Equity securities primarily include investments in large-cap and mid-cap companies primarily located in the United States. Fixed income securities include corporate bonds of companies from diversified industries, mortgage-backed securities, and U.S. Treasuries. Other types of investments include investments in hedge funds and private equity funds that follow several different strategies.

The fair value of Entity A’s pension plan assets at December 31, 20X3, by

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asset class are as follows.

[Note: The two methods for disclosing the fair value of classes of plan assets presented below are not intended to be treated as a template. While they both provide examples of disclosures that comply with the requirements of paragraph 715-20-50-1(d)(ii), the classes disclosed should be tailored to the nature and risks of assets in an employer's plan(s). Additionally, an employer should consider the overall objectives in paragraphs 715-20-50-1(d)(1), (2), and (5).]

**Method 1:**

| | | Fair Value Measurements at December 31, 20X3 (in millions) | | |
|---|---|---|---|---|
| **Asset Class** | **Total** | **Quoted Prices in Active Markets for Identical Assets (Level 1)** | **Significant Observable Inputs (Level 2)** | **Significant Unobservable Inputs (Level 3)** |
| Cash | $150 | $150 | | |
| Equity securities: | | | | |
| U.S. large-cap[a] | 550 | 550 | | |
| U.S. mid-cap growth | 100 | 100 | | |
| International large-cap value | 325 | 325 | | |
| Emerging markets growth | 75 | 25 | $50 | |
| Domestic real estate | 100 | 20 | 80 | |
| Fixed income securities: | | | | |
| U.S. Treasuries | 200 | 200 | | |
| Corporate bonds[b] | 200 | | 200 | |
| Mortgage-backed securities | 50 | | 50 | |
| Other types of investments: | | | | |
| Equity long/short hedge funds[c] | 55 | | | $55 |
| Event driven hedge funds[d] | 45 | | | 45 |
| Global opportunities hedge funds[e] | 35 | | | 35 |
| Multi-strategy hedge funds[f] | 40 | | | 40 |
| Private equity funds[g] | 47 | | | 47 |
| Real estate | 75 | | | 75 |
| Total | $2,047 | $1,370 | $380 | $297 |

(a) This class comprises low-cost equity index funds not actively managed that track the S&P 500.

(b) This class represents investment grade bonds of U.S. issuers from diverse industries.

(c) This class includes hedge funds that invest both long and short in primarily U.S. common stocks. Management of the hedge funds has the ability to shift investments from value to growth strategies, from small to large capitalization stocks, and from a net long position to a net short position.

(d) This class includes investments in approximately 60% equities and 40% bonds to profit from economic, political, and government driven events. A majority of the investments are targeted at economic policy decisions.

(e) This class includes approximately 80% investments in non-U.S. common stocks in the health care, energy, information technology, utilities, and telecommunications sectors and approximately 20% investments in diversified currencies.

(f) This class invests in multiples strategies to diversify risks and reduce volatility. It includes investments in approximately 50% U.S. common stocks, 30% global real estate projects, and 20% arbitrage investments.

(g) This class includes several private equity funds that invest primarily in U.S. commercial real estate.

[Note: Presented below is another method by which management could disclose classes of plan assets.]

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**Method 2:**

| Asset Class | Total | Fair Value Measurements at December 31, 20X3 (in millions) — Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| Cash | $150 | $150 | | |
| Equity securities: | | | | |
| U.S. companies | 400 | 400 | | |
| International companies | 300 | 300 | | |
| Mutual funds (a) | 450 | 320 | $130 | |
| U.S. Treasury securities | 200 | 200 | | |
| AA corporate bonds | 100 | | 100 | |
| A corporate bonds | 100 | | 100 | |
| Mortgage-backed securities | 50 | | 50 | |
| Equity long/short hedge funds (b) | 55 | | | $55 |
| Event driven hedge funds (c) | 45 | | | 45 |
| Global opportunities hedge funds (d) | 35 | | | 35 |
| Multi-strategy hedge funds (e) | 40 | | | 40 |
| Private equity funds (f) | 47 | | | 47 |
| Real estate | 75 | | | 75 |
| Total | $2,047 | $1,370 | $380 | $297 |

(a) 70% of mutual funds invest in common stock of large-cap U.S. companies. 30% of the company's mutual fund investments focus on emerging markets and domestic real estate common stocks.

(b) This class includes hedge funds that invest both long and short in primarily U.S. common stocks. Management of the hedge funds has the ability to shift investments from value to growth strategies, from small to large capitalization stocks, and from a net long position to a net short position.

(c) This class includes investments in approximately 60% equities and 40% bonds to profit from economic, political, and government driven events. A majority of the investments are targeted at economic policy decisions.

(d) This class includes approximately 80% investments in non-U.S. common stocks in the health care, energy, information technology, utilities, and telecommunications sectors and approximately 20% investments in diversified currencies.

(e) This class invests in multiples strategies to diversify risks and reduce volatility. It includes investments in approximately 50% U.S. common stocks, 30% global real estate projects, and 20% arbitrage investments.

(f) This class includes several private equity funds that invest primarily in U.S. commercial real estate.

[Note: An entity shall disclose the following information regardless of its method for disclosing classes of plan assets.]

| | Fair Value Measurements Using Significant Unobservable Inputs (Level 3) — Equity Long/ Short Hedge Funds | Event Driven Hedge Funds | Global Oppor-tunities Hedge Funds | Multi-Strategy Hedge Funds | Private Equity Funds | Real Estate | Total |
|---|---|---|---|---|---|---|---|
| Beginning balance at December 31, 20X2 | $40 | $35 | $39 | $35 | $40 | $10 | $199 |
| Actual return on plan assets: | | | | | | | |
| Relating to assets still held at the reporting date | (2) | 5 | (7) | 5 | 2 | 3 | 6 |
| Relating to assets sold during the period | | 3 | | | 2 | | 5 |
| Purchases, sales, and settlements | 15 | 2 | | | 3 | 62 | 82 |
| Transfers in and/or out of Level 3 | 2 | | 3 | | | | 5 |
| Ending balance at December 31, 20X3 | $55 | $45 | $35 | $40 | $47 | $75 | $297 |

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[Note: Nonpublic entities are not required to provide a reconciliation from the opening balances to the closing balances of plan assets measured on a recurring basis in Level 3 of the fair value hierarchy. However, nonpublic entities are required to disclose separately the amounts of purchases of Level 3 plan assets and transfers into and out of Level 3 of the fair value hierarchy.]

[Entity-specific narrative description of investment policies and strategies for plan assets, including weighted-average target asset allocations [if used as part of those policies and strategies] as described in paragraph 715-20-50-1(d)(ii) would be included here.]

The fair values of Entity A's other postretirement benefit plan assets at December 31, 20X3, by asset class are as follows.

| | | Fair Value Measurements at December 31, 20X3 (in millions) | | |
|---|---|---|---|---|
| **Asset Class** | **Total** | **Quoted Prices in Active Markets for Identical Assets (Level 1)** | **Significant Observable Inputs (Level 2)** | **Significant Unobservable Inputs (Level 3)** |
| Diversified equity securities | $150 | $150 | - | $ - |
| U.S. Treasury securities | 50 | 50 | - | - |
| Diversified corporate bonds | 103 | - | $103 | - |
| Total | $303 | $200 | $103 | $ - |

Diversified equity securities include Entity A common stock in the amounts of $12 at December 31, 20X3.

## Cash Flows

### Contributions

Entity A expects to contribute $125 million to its pension plan and $150 million to its other postretirement benefit plan in 20X4.

### Estimated Future Benefit Payments

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid.

| | Pension Benefits | Other Benefits |
|---|---|---|
| 20X4 | $200 | $150 |
| 20X5 | 208 | 155 |
| 20X6 | 215 | 160 |
| 20X7 | 225 | 165 |
| 20X8 | 235 | 170 |
| Years 20X9-20Y3 | 1,352 | 984 |

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## 11.2.40 Interim disclosure

### Excerpt from ASC 715-20

**50 Disclosure**

**> Interim Disclosure Requirements for Publicly Traded Entities**

**50-6** A **publicly traded entity** shall disclose the following information for its interim financial statements that include a statement of income:

a. The amount of net benefit cost recognized, for each period for which a statement of income is presented, showing separately each of the following:

   1. The service cost component
   2. The interest cost component
   3. The expected return on plan assets for the period
   4. The gain or loss component
   5. The prior service cost or credit component
   6. The transition asset or obligation component
   7. The gain or loss recognized due to a settlement or curtailment.

   The line item(s) used in the income statement to present the components other than the service cost component shall be disclosed if the other components are not presented in a separate line item or items in the income statement.

b. The total amount of the employer's contributions paid, and expected to be paid, during the current fiscal year, if significantly different from amounts previously disclosed pursuant to paragraph 715-20-50-1(g). Estimated contributions may be presented in the aggregate combining all of the following:

   1. Contributions required by funding regulations or laws
   2. Discretionary contributions
   3. Noncash contributions.

**> Interim Disclosure Requirements for Nonpublic Entities**

**50-7** A nonpublic entity shall disclose in interim periods for which a complete set of financial statements is presented the total amount of the employer's contributions paid, and expected to be paid, during the current fiscal year, if significantly different from amounts previously disclosed pursuant to paragraph 715-20-50-5(f). Estimated contributions may be presented in the aggregate combining all of the following:

a. Contributions required by funding regulations or laws
b. Discretionary contributions
c. Noncash contributions.

**> Disclosures Related to Expected Rate of Return on Plan Assets**

**50-8** The weighted-average expected long-term rate of return on plan assets is used to determine net benefit cost, and, therefore, in the absence of a subsequent interim measurement of both pension or other postretirement plan assets and obligations (see paragraph 715-30-35-68), the disclosed rate is the

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rate determined as of the beginning of the year. However, if that rate changes because of a subsequent interim measurement of both pension or other postretirement plan assets and obligations, disclosure of the beginning and more recently assumed rate, or a properly weighted combination of the two, shall be made.

## Question 11.2.90

**Must disclosures of estimated contributions to fund benefit plans be updated in a public entity's interim financial statements?**

**Interpretive response:** Topic 715 requires a public entity to update its disclosure in interim periods of estimated contributions to fund benefit plans if the estimate changes significantly during the year. This disclosure requirement focuses only on the significance of changes in estimated contributions; it does not identify or limit the factors an entity considers when deciding whether to update its disclosure. [715-20-50-6(b)]

When evaluating whether there is a significant change in estimated contributions that would require an update to previous disclosures, we believe an entity should consider:

— refinements and finalization of funding computations; typically actuaries have updated information about these computations in Q2 or Q3 of the fiscal year; and
— changes in discretionary contributions due to changes in business, regulatory changes and/or economic conditions.

Subtopic 715-20's Example 2 (reproduced below) illustrates this disclosure.

## Excerpt from ASC 715-20

**55 Implementation Guidance and Illustrations**

**> Implementation Guidance**

**>> Example 2: Interim-Period Disclosures of a Publicly Traded Entity**

**55-18** This Example illustrates the disclosures of a publicly traded entity for the first fiscal quarter beginning after December 15, 20X3.

Components of Net Periodic Benefit Cost

| **Three months ended March 31** | **Pension Benefits** | | **Other Benefits** | |
|---|---|---|---|---|
| | **20X4** | **20X3** | **20X4** | **20X3** |
| Service cost | $35 | $19 | $16 | $9 |
| Interest cost | 38 | 23 | 23 | 14 |
| Expected return on plan assets | (41) | (21) | (6) | (4) |

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| | | | | |
|---|---|---|---|---|
| Amortization of prior service cost | 7 | 5 | (3) | (1) |
| Amortization of net (gain) loss | 2 | - | - | - |
| Net periodic benefit cost | $41 | $26 | $30 | $18 |

The components of net periodic benefit cost other than the service cost component are included in the line item "other income/(expense)" in the income statement.

Employer Contributions

Entity A previously disclosed in its financial statements for the year ended December 31, 20X3, that it expected to contribute $125 million to its pension plan in 20X4. As of March 31, 20X4, $20 million of contributions have been made. Entity A presently anticipates contributing an additional $120 million to fund its pension plan in 20X4 for a total of $140 million.

## Question 11.2.100

**Must disclosures of estimated contributions to fund benefit plans be updated in a nonpublic entity's interim financial statements?**

**Interpretive response:** Similar to the public entity guidance, Topic 715 requires nonpublic entities to update their disclosure in interim periods of estimated contributions to fund benefit plans if the estimate changes significantly during the year. [715-20-50-7]

Subtopic 715-20's Example 3 (reproduced below) illustrates this disclosure.

## Excerpt from ASC 715-20

**55 Implementation Guidance and Illustrations**

**> Implementation Guidance**

**>> Example 3: Interim-Period Disclosures of a Nonpublic Entity in a Complete Set of Financial Statements**

**55-19** This Example illustrates the disclosures for a nonpublic entity (Entity A) for the first fiscal quarter beginning after December 15, 20X3.

> Entity A previously disclosed in its financial statements for the year ended December 31, 20X3, that it expected to contribute $125 million to its pension plan in 20X4. As of March 31, 20X4, $20 million of contributions have been made. Entity A presently anticipates contributing an additional $120 million to fund its pension plan in 20X4 for a total of $140 million.

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## 11.2.50 Disclosure – Other

### Excerpt from ASC 715-60

**50 Disclosure**

**50-1** See paragraphs 715-20-50-1 through 50-7 for disclosure requirements for defined benefit plans other than disclosure requirements related to the Medicare Prescription Drug, Improvement, and Modernization Act, which are provided in paragraphs 715-60-50-2 through 50-6.

**50-2** This Subsection provides guidance on disclosures regarding the effect of the Medicare subsidy. This Subsection also provides guidance on the disclosures about the effects of the subsidy for an employer that sponsors a postretirement health care benefit **plan** that provides prescription drug coverage but for which the employer has not yet been able to determine actuarial equivalency.

**50-3** In interim and annual financial statements for the first period in which an employer includes the effects of the subsidy in measuring the **accumulated postretirement benefit obligation** and the first period in which an employer includes the effects of the subsidy in measuring **net periodic postretirement benefit cost**, it shall disclose all of the following:

a. The reduction in the accumulated postretirement benefit obligation for the subsidy related to **benefits** attributed to past service.
b. The effect of the subsidy on the measurement of net periodic postretirement benefit cost for the current period. That effect includes any **amortization** of the actuarial gain in (a) of this paragraph as a component of the net amortization called for by paragraphs 715-60-35-29 through 35-30, the reduction in current period service cost due to the subsidy, and the resulting reduction in interest cost on the accumulated postretirement benefit obligation as a result of the subsidy.
c. Any other disclosures required by paragraph 715-20-50-1(r).

**50-4** For purposes of the disclosures required by paragraph 715-20-50-1(a) and 715-20-50-1(f), an employer shall disclose gross benefit payments (paid and expected, respectively), including prescription drug benefits, and separately the gross amount of the subsidy receipts (received and expected, respectively).

**50-6** Until an employer is able to determine whether benefits provided by its plan are actuarially equivalent, it shall disclose both of the following in financial statements for interim or annual periods:

a. The existence of the Medicare Prescription Drug, Improvement, and Modernization Act
b. That measures of the accumulated postretirement benefit obligation or net periodic postretirement benefit cost do not reflect any amount associated with the subsidy because the employer is unable to conclude whether the benefits provided by the plan are actuarially equivalent to Medicare Part D under the Act.

The MMA authorizes Medicare to provide prescription drug benefits to retirees covered by an employer-sponsored health plan. Medicare also provides

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subsidies to incentivize entities to continue to provide prescription drug benefits to its Medicare-eligible retirees. Subtopic 715-60 outlines the disclosure requirements for such healthcare benefit plans.

## 11.2.60 SEC considerations

### Question 11.2.110

**What are MD&A disclosure considerations related to single-employer DB pension and OPEB plans?**

**Interpretive response:** A registrant must disclose: [Reg S-K Item 303(a and b)]

— known trends, demands, commitments, events or uncertainties that result, or are reasonably likely to result, in the registrant's liquidity increasing or decreasing in any material way; and

— identify and separately describe internal and external sources of liquidity, and briefly discuss any material unused sources of liquid assets.

To the extent they are material, we believe the discussion of employee benefit plans in MD&A should provide users with information about:

— the nature of the plans;
— the character of deferred gains and losses;
— the degree to which important assumptions have coincided with actual experience; and
— the timing and amounts of future funding requirements.

To the extent they are material, we believe the discussion and analysis of employee benefits should also provide users with information about:

— the effects of accounting for the registrant's benefit plans; and
— the funding of the PBO and APBO on the registrant's financial condition and operating performance.

#### Disclosures about critical accounting estimates

The accounting for employee benefit plans typically involves numerous assumptions and estimates, and frequently the involvement of actuaries in determining the asset allocations and quantifying benefit obligations, funding requirements, and compensation expense.

To the extent that the employee benefit plans are a critical accounting estimate, a registrant must disclose [Reg S-K Item 303(b)]:

— qualitative and quantitative information necessary to understand the estimation uncertainty; and

— the impact the critical accounting estimate has had or is reasonably likely to have on financial condition or results of operations to the extent the information is material and reasonably available. This information should include why each critical accounting estimate is subject to uncertainty and, to the extent the information is material and reasonably available, how

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much each estimate and/or assumption has changed over a relevant period; and

— the sensitivity of the reported amount to the methods, assumptions and estimates underlying its calculation. We believe this could include long-term rates of return on plan assets, mortality tables, discount rates used for projecting benefit obligations, methods of deriving MRV, average remaining service period, average remaining life expectancy, and alternative methods of amortizing gains and losses.

### Attribution and amortization of gains and losses

Accounting for employee benefit plans depends largely on the assumptions concerning the periods of attribution (the process of assigning the cost of benefits to period of employee service) and the calculation and amortization of gains and losses.

Therefore, we believe MD&A should address:

— the material trends or patterns of amounts reflected in the financial statements, significant assumptions and any material variations between the results based on those assumptions, and the registrant's actual experience.

— when results of operations are materially affected by benefit plans, the material underlying assumptions and their effect to sufficiently address the quality of earnings.

— when material deviations between the actual and expected long-term rates of return on plan assets arise, those amounts and any material deferred gains or losses that result. In these circumstances, we believe the registrant should quantify the amounts, and indicate the periods reflected in the results of operations.

### Expected and actual long-term rates of return on plan assets

When addressing the expected and actual long-term rates of return on plan assets, we believe a registrant should disclose, where material:

— the various categories of investments held as plan assets;
— the relative asset allocations or holdings in each category; and
— any reasonably likely changes in the allocation of plan assets.

### Sensitivity analysis

We believe that a sensitivity analysis, demonstrating how a change in the assumed long-term rates of return would affect the results of operations, may also be necessary to sufficiently convey the quality of the registrant's earnings and the degree of uncertainty.

### Deferred gains and losses

If deferred gains and losses are material, we believe a registrant should discuss the amortization periods, and differentiate between those subject to amortization versus those that are not.

### Material funding obligations

If material funding obligations exist, we believe a registrant should:

— quantify the amounts of the funding obligations;

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- address the material known trends or uncertainties related to paying those amounts – e.g. if the registrant expects to pay them over a specified time, or if there are known material uncertainties concerning payment;
- address the material effect of future payments on future cash flows; and
- address any material uncertainty in the funding obligation itself – e.g. uncertainty introduced by significant differences between the duration of debt instruments included in plan assets, or changing demographics in the workforce, and the expected timing of future benefit payments.

### Other disclosures

We believe other disclosures in MD&A related to benefit plans, including exposure, recognition and funding obligations, should follow a similar approach. MD&A should build on and not unnecessarily repeat information disclosed in the notes to the financial statements.

We believe a registrant should disclose material assumptions and changes in assumptions, their material effect on financial condition and operating performance, material deviations between results based on the assumptions used by the registrant and actual plan performance, and the known material trends and uncertainties related to plans, including those caused by these deviations.

For example, a registrant should consider the need for disclosing the historical pattern of expense recognition and the periods over which amounts deferred in OCI are recognized in results of operations.

## Question 11.2.120

**What disclosures about assumed discount rates does the SEC staff expect?**

**Interpretive response:** We understand the SEC staff expects a registrant to disclose, either in the notes to the financial statements or in MD&A, how it determines assumed discount rates.

This disclosure should include the specific source data the registrant uses to support the discount rate. If the registrant benchmarks its assumption from published long-term bond indices, it should explain how it determined that the timing and amount of cash outflows related to the bonds included in the indices matches its estimated benefit payments.

If differences exist between the terms of the bonds in the published index and the benefit obligations, the registrant should explain how it adjusts its selected discount rate to account for the differences. It should not increase the benchmark rates unless it performed a detailed analysis that supports the specific amount of the increase. See Question 8.3.130.

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## Question 11.2.130
### What does an entity disclose about the effects of the economy on its pension and OPEB plans?

**Interpretive response:** We believe the effect of the economic environment on pension and OPEB plans, especially during low-interest rate environments that result in a decline in value of plan assets and increasing pension and OPEB obligations, should be discussed in the liquidity disclosures in MD&A.

Suggested disclosures include trends and uncertainties related to funding plan obligations, the amounts of expected future minimum statutory funding requirements, timing of those payments, and the nature of uncertainties in developing estimates. In addition, if an entity's past and current plan contributions are not indicative of estimated future minimum statutory funding requirements, we believe that an entity is encouraged to disclose past contributions, expected changes to contributions, and qualitative and quantitative terms.

## Question 11.2.140
### What does an entity disclose about changes to investment portfolios?

**Interpretive response:** We understand the SEC staff expects transparent disclosure of investment strategies, including MD&A discussion of changes to the strategy and how those changes affect assumptions of EROA and the ability to fund the plan (e.g. how bond maturities compare to the expected benefit payments).

## Question 11.2.150
### What does an entity disclose about changes to accounting policies?

**Interpretive response:** In our experience, when a change in accounting policy accelerates recognition of gains and losses, most entities recognize net asset and gains and losses in AOCI and amortize those amounts (or amounts outside a corridor) into the income statement over a period of time (see chapter 7). Some entities change to an accounting policy of recognizing these amounts (or amounts outside a corridor) in the income statement on the plan remeasurement date, which generally occurs in Q4.

We understand the SEC staff expects that registrants changing their accounting policy must obtain a preferability letter from their auditors and make required disclosures related to changes in accounting principles. See section 6.2 of KPMG Handbook, Accounting changes and error corrections. We understand the SEC staff also encourages registrants to provide clear accounting policy disclosures, including whether a corridor approach is used in identifying amounts to be recognized in the income statement.

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We understand the SEC staff expects registrants to disclose Q4 adjustments if material, and that registrants that capitalize some or all of their service costs (e.g. to inventory or property, plant and equipment) should consider how such adjustments influence capitalization. [715-30-35-7A]

### Question 11.2.160

**Are disclosures for foreign plans disaggregated from domestic plans?**

**Interpretive response:** Yes. We understand the SEC staff expects that for pension and OPEB plans, disclosures should be appropriately disaggregated when foreign plans are material and have significantly different assumptions from domestic plans.

## 11.3 Defined contribution plans

### Excerpt from ASC 715-70

**50 Disclosure**

**50-1** An employer shall disclose the amount of cost recognized for **defined contribution pension plans** and for other defined contribution postretirement benefit plans for all periods presented separately from the amount of cost recognized for defined benefit plans. The disclosures shall include a description of the nature and effect of any significant changes during the period affecting comparability, such as a change in the rate of employer contributions, a business combination, or a divestiture.

A DC plan provides an individual account for each participant and provides benefits that are based on amounts contributed to the participant's account by the entity or employee. Subtopic 715-70 outlines the required disclosures for DC plans.

### Question 11.3.10

**Can DC plan and DB plan disclosures be aggregated?**

**Interpretive response**: No. Topic 715 requires the amount of cost recognized for DC pension plans and for other DC retirement benefit plans to be presented separately from the amount of cost recognized for DB plans. [715-70-50-1]

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## 11.4 Multiemployer plans

### Excerpt from ASC 715-80

**50 Disclosure**

**50-2** An employer shall apply the provisions of Topic 450 to its participation in a **multiemployer plan** if it is either probable or reasonably possible that either of the following would occur:

a. An employer would withdraw from the plan under circumstances that would give rise to an obligation.
b. An employer's contribution to the fund would be increased during the remainder of the contract period to make up a shortfall in the funds necessary to maintain the negotiated level of benefit coverage (a maintenance of benefits clause).

**> Multiemployer Plans That Provide Pension Benefits**

**50-3** An employer shall provide the disclosures required by paragraphs 715-80-50-4 through 50-10 in annual financial statements. The disclosures of the employer's contributions made to the plan in paragraphs 715-80-50-4 through 50-10 include all items recognized as net pension costs (see paragraph 715-80-35-1). The disclosures based on the most recently available information shall be the most recently available through the date at which the employer has evaluated subsequent events.

**50-4** An employer that participates in a multiemployer plan that provides **pension benefits** shall provide a narrative description both of the general nature of the multiemployer plans that provide pension benefits and of the employer's participation in the plans that would indicate how the risks of participating in these plans are different from **single-employer plans**.

**50-5** When feasible, the information required by this paragraph shall be provided in a tabular format. Information that requires greater narrative description may be provided outside the table. For each individually significant multiemployer plan that provides pension benefits, an employer shall disclose the following:

a. Legal name of the plan.
b. The plan's Employer Identification Number and, if available, its plan number.
c. For each statement of financial position presented, the most recently available certified zone status provided by the plan, as currently defined by the Pension Protection Act of 2006 or a subsequent amendment of that Act. The disclosure shall specify the date of the plan's year-end to which the zone status relates and whether the plan has utilized any extended amortization provisions that affect the calculation of the zone status. If the zone status is not available, an employer shall disclose, as of the most recent date available, on the basis of the financial statements provided by the plan, the total plan assets and accumulated benefit obligations, whether the plan was:
    1. Less than 65 percent funded
    2. Between 65 percent and 80 percent funded

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3. At least 80 percent funded.

d. The expiration date(s) of the collective-bargaining agreement(s) requiring contributions to the plan, if any. If more than one collective-bargaining agreement applies to the plan, the employer shall provide a range of the expiration dates of those agreements, supplemented with a qualitative description that identifies the significant collective-bargaining agreements within that range as well as other information to help investors understand the significance of the collective-bargaining agreements and when they expire (for example, the portion of employees covered by each agreement or the portion of contributions required by each agreement).
e. For each period that a statement of income (statement of activities for a **not-for-profit entity**) is presented:

   1. The employer's contributions made to the plan
   2. Whether the employer's contributions represent more than 5 percent of total contributions to the plan as indicated in the plan's most recently available annual report (Form 5500 for U.S. plans). The disclosure shall specify the year-end date of the plan to which the annual report relates.

f. As of the end of the most recent annual period presented:

   1. Whether a funding improvement plan or rehabilitation plan (for example, as those terms are defined by the Employment Retirement Security Act of 1974) had been implemented or was pending
   2. Whether the employer paid a surcharge to the plan
   3. A description of any minimum contribution(s), required for future periods by the collective-bargaining agreement(s), statutory obligations, or other contractual obligations, if applicable.

Factors other than the amount of the employer's contribution to a plan, for example, the severity of the underfunded status of the plan, may need to be considered when determining whether a plan is significant.

**50-6** An employer shall provide a description of the nature and effect of any significant changes that affect comparability of total employer contributions from period to period, such as:

a. A business combination or a divestiture
b. A change in the contractual employer contribution rate
c. A change in the number of employees covered by the plan during each year.

**50-7** The requirements in paragraph 715-80-50-5 assume that the other information about the plan is available in the public domain. For example, for U.S. plans, the plan information in Form 5500 is publicly available. In circumstances in which plan level information is not available in the public domain, an employer shall disclose, in addition to the requirements of paragraphs 715-80-50-5 through 50-6, the following information about each significant plan:

a. A description of the nature of the plan benefits
b. A qualitative description of the extent to which the employer could be responsible for the obligations of the plan, including benefits earned by employees during employment with another employer
c. Other quantitative information, to the extent available, as of the most recent date available, to help users understand the financial information

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about the plan, such as total plan assets, actuarial present value of accumulated plan benefits, and total contributions received by the plan.

If the quantitative information in paragraph 715-80-50-5(c), 715-80-50-5(e)(2), or 715-80-50-7(c) cannot be obtained without undue cost and effort, that quantitative information may be omitted and the employer shall describe what information has been omitted and why. In that circumstance, the employer also shall provide any qualitative information as of the most recent date available that would help users understand the financial information that otherwise is required to be disclosed about the plan.

**50-8** Disclosures about multiemployer plans that are subject to the guidance in the preceding paragraph shall be included in a separate section of the tabular disclosure required by paragraph 715-80-50-5.

**50-9** In addition to the information about the significant multiemployer plans that provide pension benefits required by paragraphs 715-80-50-5 and 715-80-50-7, an employer shall disclose in a tabular format for each annual period for which a statement of income or statement of activities is presented, both of the following:

a. Its total contributions made to all plans that are not individually significant
b. Its total contributions made to all plans.

**50-10** See Example 1 (paragraph 715-80-55-6) for an illustration of the application of the disclosure requirements in paragraphs 715-80-50-4 through 50-9).

**> Multiemployer Plans That Provide Postretirement Benefits Other Than Pensions**

**50-11** An employer shall disclose the amount of contributions to multiemployer plans that provide **postretirement benefits other than pensions** for each annual period for which a statement of income or statement of activities is presented. The disclosures shall include a description of the nature and effect of any changes that affect comparability of total employer contributions from period to period, such as:

a. A business combination or a divestiture
b. A change in the contractual employer contribution rate
c. A change in the number of employees covered by the plan during each year.

The disclosures also shall include a description of the nature of the benefits and the types of employees covered by these benefits, such as medical benefits provided to active employees and retirees.

A multiemployer plan is a pension or retirement benefit plan to which two or more unrelated employers contribute, usually pursuant to one or more collective-bargaining agreements. [715-80 Glossary]

Subtopic 715-80 outlines the disclosure requirements for multiemployer plans.

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## Excerpt from ASC 715-80

**55 Implementation Guidance and Illustrations**

**> Illustrations**

**>> Example 1: Disclosures for Multiemployer Plans That Provide Pension Benefits**

**55-6** This Example illustrates certain, but not all, of the disclosure requirements in paragraphs 715-80-50-4 through 50-9.

**55-7** Entity A contributes to a number of multiemployer defined benefit pension plans under the terms of collective-bargaining agreements that cover its union-represented employees. The risks of participating in these multiemployer plans are different from single-employer plans in the following aspects:

a. Assets contributed to the multiemployer plan by one employer may be used to provide benefits to employees of other participating employers.
b. If a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers.
c. If Entity A chooses to stop participating in some of its multiemployer plans, Entity A may be required to pay those plans an amount based on the underfunded status of the plan, referred to as a withdrawal liability.

**55-8** Entity A's participation in these plans for the annual period ended December 31, 20X0, is outlined in the table below. The "EIN/Pension Plan Number" column provides the Employer Identification Number (EIN) and the three-digit plan number, if applicable. Unless otherwise noted, the most recent Pension Protection Act (PPA) zone status available in 20X0 and 20X9 is for the plan's year-end at December 31, 20X9, and December 31, 20X8, respectively. The zone status is based on information that Entity A received from the plan and is certified by the plan's actuary. Among other factors, plans in the red zone are generally less than 65 percent funded, plans in the yellow zone are less than 80 percent funded, and plans in the green zone are at least 80 percent funded. The "FIP/RP Status Pending/Implemented" column indicates plans for which a financial improvement plan (FIP) or a rehabilitation plan (RP) is either pending or has been implemented. The last column lists the expiration date(s) of the collective-bargaining agreement(s) to which the plans are subject. Finally, the number of employees covered by Entity A's multiemployer plans decreased by 5 percent from 20X9 to 20X0, affecting the period-to-period comparability of the contributions for years 20X9 and 20X0. The significant reduction in covered employees corresponded to a reduction in overall business. There have been no significant changes that affect the comparability of 20X8 and 20X9 contributions.

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| | | Pension Protection Act Zone Status | | | Contributions of Entity A | | | | |
|---|---|---|---|---|---|---|---|---|---|
| **Pension Fund** | **EIN/Pension Plan Number** | **20X0** | **20X9** | **FIP/RP Status Pending/Implemented** | **20X0** | **20X9** | **20X8** | **Surcharge Imposed** | **Expiration Date of Collective-Bargaining Agreement** |
| ABC Fund 34 | 32-1899999 | Red as of 9/30/2009 | Yellow as of 9/30/2008 | Pending | $ 1,883,000 | $ 2,309,000 | $2,226,000 | Yes | 12/31/20X3 |
| ABC Fund 37 | 52-5599999-002 | Green | Yellow | No | 3,342,000 | 3,609,000 | 3,586,000 | No | 12/31/20X2 to 12/31/20X3[(a)] |
| ABC Fund 40 | 92-3499999 | Yellow | Yellow | No | 5,798,000 | 6,435,000 | 6,374,000 | No | 12/31/20X5 |
| ABC Fund 43 | 82-4299999 | Red | Red | Pending | 3,539,000 | 3,234,000 | 3,218,000 | Yes | 12/31/20X4 |
| ABC Fund 46[(b)] | 82-6899999 | Green | Green | No | 778,000 | 816,000 | 833,000 | No | 12/31/20X3 |
| ABC Fund 49 | 52-6199999 | Yellow | Yellow | No | 534,000 | 547,000 | 491,000 | No | 12/31/20X2 |
| ABC Fund 52 | 72-8599999-001 | Red | Green | Implemented | 1,349,000 | 1,134,000 | 1,050,000 | No | 12/31/20X5 |
| ABC Fund 55 | 82-2999999 | Green | Green | No | 1,224,000 | 1,046,000 | 1,151,000 | No | 12/31/20X4 |
| Plans for which plan financial information is not publicly available outside Entity A's financial statements. | | | | | | | | | |
| ABC Fund 61[(c)] | N/A | N/A | N/A | N/A | 418,000 | 482,000 | 491,000 | N/A | 12/31/20X2 |
| ABC Fund 73[(d)] | N/A | N/A | N/A | N/A | 1,872,000 | 1,764,000 | 1,693,000 | N/A | 12/31/20X2 |
| **Other Funds** | | | | | 147,000 | 160,000 | 169,000 | | |
| | | | | **Total contributions:** | $ 20,884,000 | $ 21,536,000 | $ 21,282,000 | | |

(a) Entity A is party two significant collective-bargaining agreements that require contributions to ABC Fund 37. Agreements D and E expire on 12/31/20X2, and 12/31/20X3, respectively. Of the two, Agreement D is more significant because 70 percent of Entity A's employee participants in ABC Fund 37 are covered by that agreement. Agreement E also is significant because its participants are involved in multiple projects that Entity A is scheduled

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to start in 20X4.

(b) ABC Fund 46 utilized the special 30-year amortization rules provided by Public Law 111-192, Section 211 to amortize its losses from 2008. The plan recertified its zone status after using the amortization provisions of that law.

(c) Plan information for ABC Fund 61 is not publicly available. ABC Fund 61 provides fixed, monthly retirement payments on the basis of the credits earned by the participating employees. To the extent that the plan is underfunded, the future contributions to the plan may increase and may be used to fund retirement benefits for employees related to other employers who have ceased operations. Entity A could be assessed a withdrawal liability in the event that it decides to cease participating in the plan. ABC Fund 61's financial statements for the years ended June 30, 20X0 and 20X9 indicated total assets of $62,000,000 and $51,000,000, respectively; total actuarial present value of accumulated plan benefits of $120,000,000 and $110,000,000, respectively; and total contributions for all participating employers of $9,000,000 and $8,000,000, respectively. The plan's financial statements for the plan years ended June 30, 20X0 and 20X9 indicate that the plan was less than 65 percent funded in both years.

(d) Plan information for ABC Fund 73 is not publicly available. ABC Fund 73 provides fixed retirement payments on the basis of the credits earned by the participating employees. However, in the event that the plan is underfunded, the monthly benefit amount can be reduced by the trustees of the plan. Entity A is not responsible for the underfunded status of the plan because ABC Fund 73 operates in a jurisdiction that does not require withdrawing participants to pay a withdrawal liability or other penalty. Entity A is unable to provide additional quantitative information on the plan because Entity A is unable to obtain that information without undue cost and effort. The collective-bargaining agreement of ABC Fund 73 requires contributions on the basis of hours worked. The agreement also has a minimum contribution requirement of $1,000,000 each year.

Entity A was listed in its plans' Forms 5500 as providing more than 5 percent of the total contributions for the following plans and plan years:

| **Pension Fund** | **Year Contributions to Plan Exceeded More Than 5 Percent of Total Contributions (as of December 31 of the Plan's Year-End)** |
|---|---|
| ABC Fund 34 | 20X9 and 20X8 |
| ABC Fund 43 | 20X8 |
| ABC Fund 52 | 20X8 |
| ABC Fund 61 | 20X9 |

At the date the financial statements were issued, Forms 5500 were not available for the plan years ending in 20X0.

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# 12. Employee Stock Ownership Plans (ESOPs)

## Detailed contents



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## 12.1 How the standard works

Subtopic 718-40 outlines the measurement, recognition, presentation and disclosure requirements for ESOPs. These accounting requirements relate to the entity (i.e. the employer sponsoring the ESOP) and not the ESOP reporting. All other Subtopics of Topic 718 (stock compensation) are included in KPMG Handbook, Share-based payment.

An ESOP is a nondiscriminatory benefit plan established by an entity for the purpose of compensating its employees (the ESOP participants) through shares and an ownership interest. An ESOP enables participation in any changes in stock price while also obtaining certain tax benefits.

An ESOP invests primarily in employer stock and meets certain requirements of the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code of 1986 (IRC); therefore, most ESOPs are considered qualified compensation arrangements. There may be other types of employee stock ownership plans, but the discussion in this chapter focuses on ESOPs that meet these requirements, which are the most common.

An ESOP has an account for each participating employee. Shares in the ESOP are allocated to participants based on a formula described in the plan document.

ESOPs are either leveraged (the ESOP shares are purchased by the ESOP with borrowed funds) or nonleveraged (the ESOP shares are contributed by the sponsor entity without borrowed funds). There are a variety of compensation structures that fall within these two types of ESOPs. For example, some ESOPs may involve a convertible preferred stock with either a put option or guaranteed redemption rather than common stock.

This chapter is organized as follows.

| | |
|---|---|
| **Initial concepts** | Section 12.2 |
| **Leveraged ESOPs** | Section 12.3 |
| **Nonleveraged ESOPs** | Section 12.4 |
| **General guidance applied to both leveraged and nonleveraged ESOPs** | Section 12.5 |
| **Presentation and disclosure** | Section 12.6 |

The effect of an ESOP on an entity's EPS calculation is discussed in section 6.19 of KPMG Handbook, Earnings per share. Section 6.19 includes EPS-related interpretive analysis and examples for the varying ESOP structures discussed throughout this chapter.

See discussion about scope and classification considerations for ESOPs under Topic 480 (debt vs equity) in chapter 6 of KPMG Handbook, Debt and equity financing and consider related discussion about classifying mandatorily redeemable financial instruments in section 3 of KPMG Handbook, Share-based payment.

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## 12.2 Initial concepts

### Excerpt from ASC 718-40

**05 Overview and Background**

**General**

**05-1** This Subtopic provides guidance to entities that utilize **employee stock ownership plans**. It includes the following Subsections:

a. General
b. Leveraged employee stock ownership plans
c. Nonleveraged employee stock ownership plans

**05-2** Employee stock ownership plans are used for many purposes in addition to furthering employee ownership. These include the following:

a. To fund a matching program for a sponsor's 401(k) saving plan, formula-based profit-sharing plan, and other employee benefits
b. To raise new capital or to create a marketplace for the existing stock
c. To replace lost benefits from the termination of other retirement plans or provide benefits under postretirement benefit plans, particularly medical benefits
d. To be part of the financing package in leveraged buy-outs
e. To provide a tax-advantaged means for owners to terminate their ownership
f. To be part of a long-term program to restructure the equity section of a plan sponsor's balance sheet
g. To defend the entity against hostile takeovers.

**Leveraged Employee Stock Ownership Plans**

**05-3** A leveraged **employee stock ownership plan** borrows money to acquire shares of the employer stock. The money can be borrowed by the employee stock ownership plan from the sponsor, with or without a related outside loan, or directly from an outside lender. Outside loans to the employee stock ownership plan are generally guaranteed by the sponsor. Unlike other kinds of employee benefit plans, an employee stock ownership plan is permitted by Employee Retirement Income Security Act of 1974 to borrow from a related party or with the assistance of a related party. The debt usually is collateralized by the employer's shares.

**Nonleveraged Employee Stock Ownership Plans**

**05-4** As indicated in paragraph 718-40-25-21, an employer with a nonleveraged **employee stock ownership plan** periodically contributes its shares or cash to its employee stock ownership plan on behalf of employees. In the case of cash contributions the entity acquires shares. The shares are allocated to participant accounts and held by the employee stock ownership plan until distributed to the employees at a future date, such as on the date of termination or retirement. The shares of employer stock obtained by the nonleveraged employee stock ownership plan shall be allocated to individual participant accounts as of the end of the employee stock ownership plan's fiscal year.

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Allocating shares by year end is mandated by the tax code in 2008. The Codification does not keep up with changes in the tax code.

**15 Scope and Scope Exceptions**

**General**

**> Entities**

**15-2** The guidance in this Subtopic applies to all employers with **employee stock ownership plans**, both leveraged and nonleveraged.

**> Transactions**

**15-3** This Subtopic provides guidance on an employer's accounting for employee stock ownership plans. There are two basic forms of employee stock ownership plan: leveraged and nonleveraged. This Subtopic addresses the financial reporting for each separately.

**> Other Considerations**

**15-4** The guidance in this Subtopic does not address the following:

a. Financial reporting by employee stock ownership plans.

**20 Glossary**

**Employee –** An individual over whom the grantor of a share-based compensation award exercises or has the right to exercise sufficient control to establish an employer-employee relationship based on common law as illustrated in case law and currently under U.S. Internal Revenue Service (IRS) Revenue Ruling 87-41. A reporting entity based in a foreign jurisdiction would determine whether an employee-employer relationship exists based on the pertinent laws of that jurisdiction. Accordingly, a grantee meets the definition of an employee if the grantor consistently represents that individual to be an employee under common law. The definition of an employee for payroll tax purposes under the U.S. Internal Revenue Code includes common law employees. Accordingly, a grantor that classifies a grantee potentially subject to U.S. payroll taxes as an employee also must represent that individual as an employee for payroll tax purposes (unless the grantee is a leased employee as described below). A grantee does not meet the definition of an employee solely because the grantor represents that individual as an employee for some, but not all, purposes. For example, a requirement or decision to classify a grantee as an employee for U.S. payroll tax purposes does not, by itself, indicate that the grantee is an employee because the grantee also must be an employee of the grantor under common law.

A leased individual is deemed to be an employee of the lessee if all of the following requirements are met:

a. The leased individual qualifies as a common law employee of the lessee, and the lessor is contractually required to remit payroll taxes on the compensation paid to the leased individual for the services provided to the lessee.
b. The lessor and lessee agree in writing to all of the following conditions related to the leased individual:
    1. The lessee has the exclusive right to grant stock compensation to the individual for the employee service to the lessee.

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2. The lessee has a right to hire, fire, and control the activities of the individual. (The lessor also may have that right.)
3. The lessee has the exclusive right to determine the economic value of the services performed by the individual (including wages and the number of units and value of stock compensation granted).
4. The individual has the ability to participate in the lessee's employee benefit plans, if any, on the same basis as other comparable employees of the lessee.
5. The lessee agrees to and remits to the lessor funds sufficient to cover the complete compensation, including all payroll taxes, of the individual on or before a contractually agreed upon date or dates.

A nonemployee director does not satisfy this definition of employee. Nevertheless, nonemployee directors acting in their role as members of a board of directors are treated as employees if those directors were elected by the employer's shareholders or appointed to a board position that will be filled by shareholder election when the existing term expires. However, that requirement applies only to awards granted to nonemployee directors for their services as directors. Awards granted to those individuals for other services shall be accounted for as awards to nonemployees.

**Employee Stock Ownership Plan –** An employee stock ownership plan is an employee benefit plan that is described by the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code of 1986 as a stock bonus plan, or combination stock bonus and money purchase pension plan, designed to invest primarily in employer stock. Also called an employee share ownership plan.

**Fair Value –** The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

**Market Participant –** Buyers and sellers in the principal (or most advantageous) market for the asset or liability that have all of the following characteristics:

a. They are independent of each other, that is, they are not related parties, although the price in a related-party transaction may be used as an input to a fair value measurement if the reporting entity has evidence that the transaction was entered into at market terms
b. They are knowledgeable, having a reasonable understanding about the asset or liability and the transaction using all available information, including information that might be obtained through due diligence efforts that are usual and customary
c. They are able to enter into a transaction for the asset or liability
d. They are willing to enter into a transaction for the asset or liability, that is, they are motivated but not forced or otherwise compelled to do so.

**Orderly Transaction –** A transaction that assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (for example, a forced liquidation or distress sale).

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**Related Party –** Related parties include:

a. Affiliates of the entity
b. Entities for which investments in their equity securities would be required, absent the election of the fair value option under the Fair Value Option Subsection of Section 825-10-15, to be accounted for by the equity method by the investing entity
c. Trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of management
d. Principal owners of the entity and members of their immediate families
e. Management of the entity and members of their immediate families
f. Other parties with which the entity may deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests
g. Other parties that can significantly influence the management or operating policies of the transacting parties or that have an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests.

**Security –** A share, participation, or other interest in property or in an entity of the issuer or an obligation of the issuer that has all of the following characteristics:

a. It is either represented by an instrument issued in bearer or registered form or, if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer.
b. It is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment.
c. It either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations

**Settlement of an Award –** An action or event that irrevocably extinguishes the issuing entity's obligation under a share-based payment award. Transactions and events that constitute settlements include the following:

a. Exercise of a share option or lapse of an option at the end of its contractual term
b. Vesting of shares
c. Forfeiture of shares or share options due to failure to satisfy a vesting condition
d. An entity's repurchase of instruments in exchange for assets or for fully vested and transferable equity instruments.
e. The vesting of a share option is not a settlement because the entity remains obligated to issue shares upon exercise of the option.

**Top-Up Shares –** Top-up shares are shares or cash that an employer contributes to an employee stock ownership plan because the fair value of the shares released is less than the employer's liability for a particular benefit, such as a savings plan match.

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## Question 12.2.10

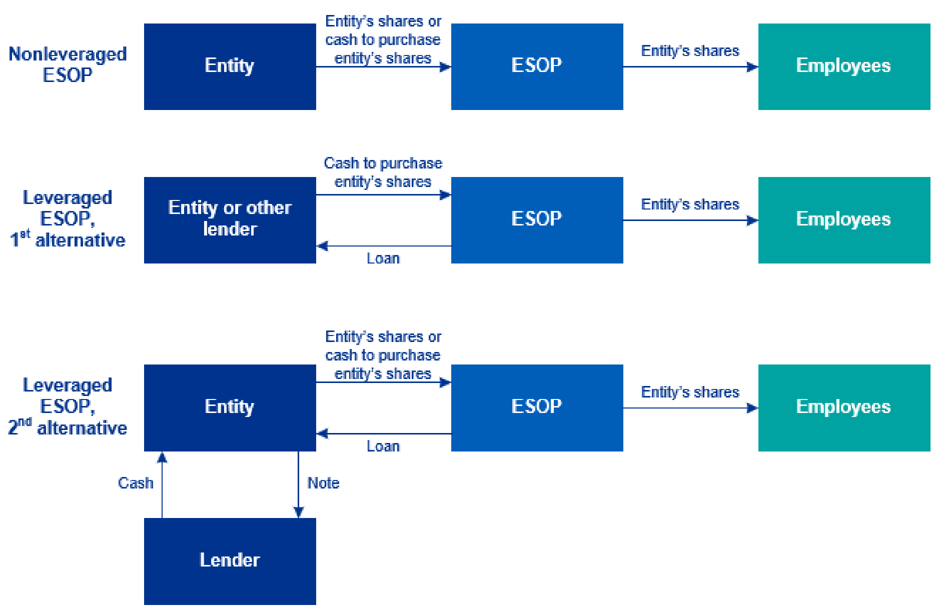
### What is the difference between a leveraged and nonleveraged ESOP?

**Interpretive response:** In a nonleveraged ESOP, the entity contributes its shares directly to the ESOP or provides cash to the ESOP to purchase its shares. In a leveraged ESOP, either the ESOP enters into a loan to purchase the entity's shares (first alternative below) or the entity enters into a loan to purchase its own shares to contribute to the ESOP (second alternative below). [718-40-05 3 – 05-4]

When the ESOP borrows funds (first alternative), the lender can be the entity or another lender. If another lender provides a loan directly to the ESOP, the entity generally would guarantee that loan. [718-40-05-3]

An entity may consider the tax incentives discussed in Question 12.2.40 to decide whether its ESOP should be leveraged or nonleveraged.

The following diagram demonstrates the different ESOP structures.




It is important to understand whether the ESOP is a leveraged or nonleveraged ESOP because the accounting differs. The following diagram provides a schematic that explains the accounting implications.

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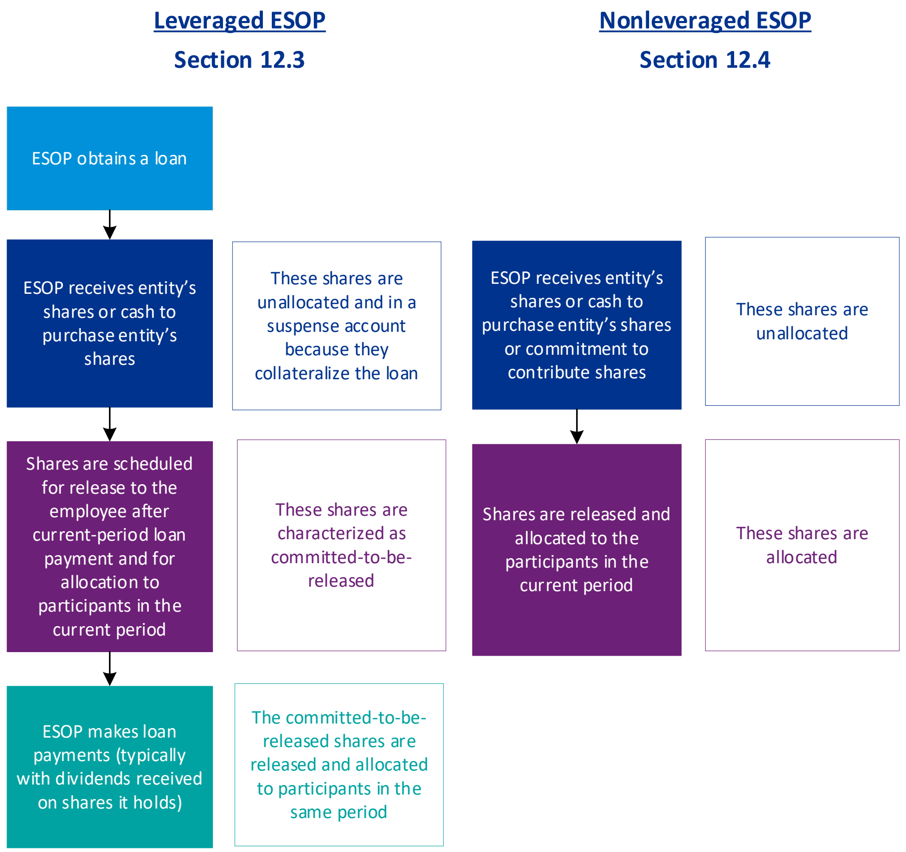


## Question 12.2.20

### How are shares in an ESOP allocated, tracked and distributed?

**Interpretive response:** Shares are allocated to ESOP participants based on a formula described in the plan documents – generally based on compensation, length of service or a combination of both. The ESOP must maintain a record of what shares have been allocated to each ESOP participant.

For any particular ESOP participant, such shares may be vested, unvested or partially vested. The terms of vesting are described in the plan document. Shares remain in the plan until they are distributed to the ESOP participants at a future date, which is either at the date of termination or retirement. Plan documents stipulate share distribution for scenarios beyond termination or retirement (e.g. death of an ESOP participant). Some ESOPs may also have in-service distributions, but these are not common.

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## Question 12.2.30

**How is fair value of a private entity's equity shares determined?**

**Interpretive response:** The entity's compensation cost related to ESOP awards is based on the fair value of an entity's shares, as discussed in Questions 12.3.60 and 12.4.10.

The AICPA has issued an Accounting and Valuation Guide, Valuation of Privately-Held-Company Equity Securities Issued as Compensation. Although the Guide is not authoritative, it provides measurement guidance when valuing equity shares of a privately held entity. The SEC staff sometimes references the examples and disclosure recommendations in the Guide in its comment letters on initial registration statements.

The Guide provides specific guidance on valuations for financial reporting purposes. Key issues to consider when valuing equity securities of privately held entities include: [AAG-STK]

- the application of Topic 820 to measuring equity securities of a privately held company issued as compensation;
- considerations for determining the appropriate basis of valuation – e.g. a minority interest subject to current ownership versus the sale of a controlling interest in an entity;
- leading practices for estimating the fair value of the equity securities of a privately held company based on the company's stage of development;
- factors to consider to determine control and marketability discounts; and
- the consideration of private and secondary market transactions in the security in the valuation process.

See chapter 2 of KPMG Handbook, Share-based payment, for further discussion.

## Question 12.2.40

**What are the tax advantages of an ESOP?**

**Interpretive response:** An ESOP may provide tax advantages to the entity, including: [US MTG.2103]

- cash contributions by the entity to the ESOP to pay the principal and interest on loans incurred by the ESOP may be tax deductible to the entity, subject to certain limitations;
- dividends paid to the ESOP are tax deductible to the entity if certain requirements are met; and
- under certain circumstances, a shareholder (other than a C corporation) may elect not to recognize a gain on the sale of qualified securities to an ESOP.

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An entity should consult with its legal and tax advisors for all of the legal and tax considerations when establishing an ESOP and maintaining its qualified status under the IRC and ERISA.

## Question 12.2.50

**Can the guidance in Subtopic 718-40 be applied by analogy to other arrangements similar to an ESOP?**

**Interpretive response:** No. Because the provisions of Subtopic 718-40 relate to an arrangement that receives special treatment under the IRC and ERISA, the guidance cannot be applied by analogy to other benefit arrangements with a structure similar to an ESOP.

An example of a plan with a similar structure is a rabbi trust funding defined contribution plan. Subtopic 718-40 would also not be applied to a leveraged share purchase arrangement outside the US because it is not an ESOP as defined by the IRC and ERISA.

Other US GAAP applies to benefit arrangements that are not ESOPs under the IRC and ERISA – e.g. Topic 712 (nonretirement postemployment benefits), Topic 715 (retirement benefits), Topic 718 (stock compensation). Accounting for rabbi trusts is discussed in chapter 1 of KPMG Handbook, Share-based payment. Other defined contribution plans are discussed in chapter 5 of this Handbook.

# 12.3 Leveraged ESOPs

## 12.3.10 Overview

To understand how an entity accounts for its sponsorship of a leveraged ESOP, it is important to first understand how the typical leveraged ESOP works.

### Excerpt from ASC 718-40

**20 Glossary**

**Allocated Shares –** Allocated shares are shares in an employee stock ownership plan trust that have been assigned to individual participant accounts based on a known formula. Internal Revenue Service (IRS) rules require allocations to be nondiscriminatory generally based on compensation, length of service, or a combination of both. For any particular participant such shares may be vested, unvested, or partially vested.

**Committed-to-Be-Released Shares –** Committed-to-be-released shares are shares that, although not legally released, will be released by a future scheduled and committed debt service payment and will be allocated to employees for service rendered in the current accounting period. The period of employee service to which shares relate is generally defined in the employee

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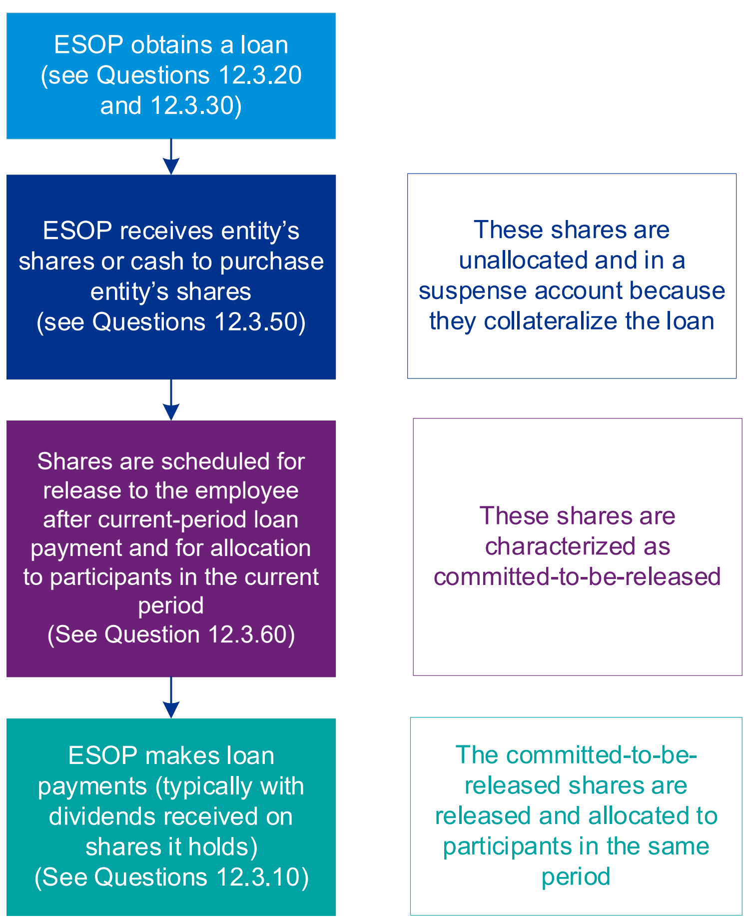
stock ownership plan documents. Shares are legally released from suspense and from serving as collateral for employee stock ownership plan debt as a result of payment of debt service. Those shares are required to be allocated to participant accounts as of the end of the employee stock ownership plan's fiscal year. Formulas used to determine the number of shares released can be based on either of the following:

a. The ratio of the current principal amount to the total original principal amount (in which case unearned employee stock ownership plan shares and debt balance will move in tandem)
b. The ratio of the current principal plus interest amount to the total original principal plus interest to be paid.

Shares are released more rapidly under the second method than under the first. Tax law permits the first method only if the employee stock ownership plan debt meets certain criteria.

**Suspense Shares –** The shares initially held by the employee stock ownership plan in a suspense account are called suspense shares. Suspense shares are shares that have not been released, committed to be released, or allocated to participant accounts. Suspense shares generally collateralize employee stock ownership plan debt.

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### Question 12.3.10

**What is the difference between a suspense share, a committed-to-be-released share and an allocated share?**

**Interpretive response:** When shares are initially acquired by a leveraged ESOP (either by purchase or contribution), they are called suspense shares until they are committed to be released. Shares become committed to be released in the plan year that the ESOP intends to release them and allocate them to ESOP participant accounts. The plan document will indicate how many shares are required to be released each year by either indicating the number to be released or providing a formula for determining the number.

Suspense shares also typically collateralize the debt. When they do, they cannot be legally released and allocated until the loan payment is made for the period.

Released shares are generally allocated to participant accounts immediately after the loan payment. The released shares are required to be allocated by the end of the ESOP fiscal year. Even though these shares are earned by ESOP participants throughout the period for their service, the shares are not allocated until after the loan payment. [718-40 Glossary]

## 12.3.20 ESOP obtains a loan

In a leveraged ESOP, either the ESOP or the entity borrows money to buy the entity's shares (i.e. ESOP shares).

### Question 12.3.20

**How is the purchase of ESOP shares financed in a leveraged ESOP?**

**Interpretive response:** There are three types of loans used to finance the purchase of ESOP shares. [718-40 Glossary, 718-40-05-3]

— **Direct loan.** A loan made by a lender other than the entity to the ESOP, but the entity may (and often does) guarantee the loan or provides some other type of commitment to the lender.

— **Indirect loan.** A loan made by the entity to the ESOP, with the entity obtaining a related outside loan.

— **Employer loan.** A loan made by the entity, with no related outside loan.

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## Question 12.3.30

### How does the entity account for loans that finance the purchase of ESOP shares?

**Interpretive response:**

### Direct loan

A direct loan is recorded on the entity's balance sheet as debt even though the loan is between the ESOP and an outside lender. This requires the entity to: [718-40-25-9(a)]

- accrue interest on the debt; and
- reduce the debt for cash payments made by the ESOP to the outside lender.

Example journal entries for a direct loan are in the FASB example in section 12.3.60 (Case A of Subtopic 718-40's Example 1).

### Indirect loan

In an indirect loan arrangement, the entity recognizes the loan it enters into with an outside lender as debt on its balance sheet, which means it accrues interest cost and reduces the debt and accrued interest payable for loan payments. Example journal entries for a direct loan are in the FASB example in section 12.3.60 (Case B of Subtopic 718-40's Example 1).

The entity does not recognize the loan it makes to the ESOP on its balance sheet, and therefore does not recognize contributions to the ESOP or payments from the ESOP to satisfy the loan – e.g. it does not recognize any interest income from the loan. [718-40-25-9(b)]

In practice, an entity may choose to record the loan between itself and the ESOP for record keeping purposes but would only recognize external transactions.

### Employer loan

An entity does not recognize an employer loan on its balance sheet, and therefore does not recognize contributions to the ESOP or payments from the ESOP to satisfy the loan – e.g. it does not recognize any interest income from the loan. [718-40-25-9(d)]

In practice, an entity may choose to record the loan between itself and the ESOP for record keeping purposes but would only recognize external transactions.

Example journal entries for an employer loan are in Subtopic 718-40's Example 2.

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## Question 12.3.40

**Can the interest incurred on an ESOP loan be capitalized?**

**Interpretive response:** An entity's interest cost related to ESOP direct loans and the indirect loan that is recorded is eligible to be capitalized under Subtopic 835-20 (capitalization of interest). An entity needs to evaluate the criteria in Subtopic 835-20 to assess whether it capitalizes the interest.

## 12.3.30 ESOP purchases and releases shares

### Excerpt from ASC 718-40

**25 Recognition**

**Leveraged Employee Stock Ownership Plans**

**> Purchase of Shares by a Leveraged Employee Stock Ownership Plan**

**25-10** An employer shall report the issuance of shares or the sale of treasury shares to an employee stock ownership plan when they occur and shall report a corresponding charge to unearned employee stock ownership plan shares, a contra-equity account. Furthermore, even if a leveraged employee stock ownership plan buys outstanding shares of employer stock on the market rather than from the employer, the employer shall charge unearned employee stock ownership plan shares and credit either cash or debt, depending on whether the employee stock ownership plan is internally or externally leveraged (see the preceding paragraph).

**> Release of Leveraged Employee Stock Ownership Plan Shares**

**25-11** Employee stock ownership plan shares are released for different purposes:

a. To compensate employees directly
b. To settle employer liabilities for other employee benefits
c. To replace dividends on allocated shares that are used for debt service.

**25-12** As employee stock ownership plan shares are committed to be released, unearned employee stock ownership plan shares should be credited and, depending on the purpose for which the shares are released shall be charged to one of the following accounts:

a. Compensation cost
b. Dividends payable
c. Compensation liabilities.

**25-13** Under this Subtopic, when shares are committed to be released, rather than when shares are legally released, is significant for accounting purposes. Employee stock ownership plan shares are legally released from an employee stock ownership plan's suspense account (and from serving as collateral for employee stock ownership plan debt) when debt payments are made, but the

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employee service to which the shares released relates is continuous. For purposes of reporting compensation cost and satisfaction of liabilities under this Subtopic, accounting recognition shall occur when shares are committed to be released, which may occur before the shares are legally released. Shares that have not been legally released, but that relate to employee services rendered during an accounting period (interim or annual) ending before the related debt service payment is made, shall be considered committed to be released. The periods of employee service to which shares relate are generally specified in the employee stock ownership plan documents.

**25-14** Some employers agree to provide a specified or determinable benefit, such as a contribution to a 401(k) plan or to a formula profit-sharing plan, to employees and use the employee stock ownership plan to partially or fully fund the benefit. Employers shall recognize compensation cost and liabilities associated with providing such benefits to employees in the same manner they would had an employee stock ownership plan not been used to fund the benefit. For employee stock ownership plan shares committed to be released to **settle** liabilities for such benefits, employers shall report satisfaction of the liabilities when the shares are committed to be released to settle the liability. The number of shares released to settle the liability shall be based on the **fair value** of shares as of dates specified by the employers, which are usually specified in the employee stock ownership plan documents.

**30 Initial Measurement**

**Leveraged Employee Stock Ownership Plans**

**30-1** Regardless of the account charged (see paragraphs 718-40-25-11 through 25-12), the amount of the charge shall be based on fair values of **committed-to-be-released shares**.

**30-2** Some employers establish **employee stock ownership plans** that are not linked to any other **employee** benefit or compensation promise; therefore, the employee stock ownership plan shares directly compensate the employees. For employee stock ownership plan shares committed to be released to compensate employees directly, the employer shall recognize compensation cost equal to the **fair value** of the shares committed to be released. The shares generally shall be deemed to be committed to be released ratably during an accounting period as the employees perform services, and, accordingly, average fair values shall be used to determine the amount of compensation cost to recognize each reporting period (interim or annual). The amount of compensation cost recognized in previous interim periods shall not be adjusted for subsequent changes in the fair value of shares.

**30-3** Unearned employee stock ownership plan shares shall be credited as shares are committed to be released based on the cost of the shares to the employee stock ownership plan. Employers shall charge or credit the difference between the fair value of shares committed to be released and the cost of those shares to the employee stock ownership plan to shareholders' equity in the same manner as gains and losses on sales of treasury stock (generally to additional paid-in capital).

**30-4** The fair value of employee stock ownership plan shares is needed to apply certain provisions of this Subtopic.

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There are a few different sources for ESOP shares.

— New shares. The entity can contribute newly issued shares to the ESOP.
— Treasury shares. The entity can contribute treasury shares to the ESOP.
— Open market shares. The ESOP can buy shares directly on the open market.

## Question 12.3.50
**How are the shares in an ESOP reported on the entity's balance sheet?**

**Interpretive response:**

### New shares or treasury shares

An entity records ESOP shares in its equity with a corresponding charge to 'unearned ESOP shares'. Unearned ESOP shares is a contra-equity account reported within equity. This occurs regardless of whether the entity contributes the shares to the ESOP or the ESOP purchases the shares.

The entity recognizes this equity at the time the ESOP receives the shares. The contra-equity account can be presented as a separate line item or net within the respective class of stock within equity. If presented net in equity, the entity includes adequate disclosures to describe the net presentation.

### Open market shares

If the ESOP purchases shares on the open market, the entity still debits unearned ESOP shares. However, instead of equity, the credit is to cash or debt (depending on the nature of the transaction). [718-40-25-10]

The FASB examples in section 12.3.60 contain journal entries illustrating an entity's recognition of this equity.

The ESOP shares and a proportionate amount of unearned ESOP shares may need to be recorded within temporary equity if there is a put option to redeem the shares at an established price. This is discussed in Question 7.2.100 of KPMG Handbook, Debt and equity financing.

## Question 12.3.60
**How is compensation expense determined for a leveraged ESOP?**

**Interpretive response:** Compensation expense for a given period is based on the shares committed to be released during the period, even when they are released by the end of the period. The compensation expense recorded is calculated as the number of shares committed to be released for the period multiplied by the period average fair value price per share. Although shares may not be released until year-end, the period average is used because the shares are generally earned ratably over the period of service.

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The entity records compensation expense based on its reporting periods, whether interim or annual. The amount of compensation expense recorded in interim periods is not adjusted for subsequent changes in the fair value of shares. [718-40-30-2]

See example journal entries in section 12.3.60.

## 12.3.40 ESOP receives dividends on shares

### Excerpt from ASC 718-40

**25 Recognition**

**Leveraged Employee Stock Ownership Plans**

**> Dividends on Employee Stock Ownership Plan Shares**

**25-15** The Internal Revenue Code allows employers to use dividends on employee stock ownership plan shares that have been allocated to participants for debt service if participants are allocated shares of employer stock with a fair value no less than the amount of the dividends used for debt service. If shares released will include shares designated to replace dividends on previously allocated shares used for debt service, employers shall report the settlement of the dividend payable when the shares are committed to be released to replace the dividends on shares used for debt service. (See the following two paragraphs; only dividends on allocated shares shall be charged to retained earnings.) The number of shares committed to be released to replace the dividends on allocated shares used for debt service shall be based on the fair value of shares as of dates specified by the employer, which are usually specified in the employee stock ownership plan documents based on the employer's interpretation of current Internal Revenue Service regulations.

**25-16** Because employers control the use of dividends on unallocated shares, dividends on unallocated shares shall not be considered dividends for financial reporting purposes. Dividends on unallocated shares used to pay debt service shall be reported as a reduction of debt or of accrued interest payable. Dividends on unallocated shares paid to participants or added to participant accounts shall be reported as compensation cost.

**25-17** Dividends on allocated shares shall be charged to retained earnings. The dividends payable may be satisfied either by contributing cash to the participant accounts, by contributing additional shares to participant accounts, or by releasing shares from the employee stock ownership plans suspense account to participant accounts (see paragraph 718-40-25-15).

### Excerpt from ASC 718-740

**> Employee Stock Ownership Plans**

**25-6** For employers with leveraged employee stock ownership plans, the

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amount of employee stock ownership plan-related expense reported under the requirements of Subtopic 718-40 for a period may differ from the amount of the employee stock ownership plan-related income tax deduction (prescribed by income tax rules and regulations) for that period. Differences result in either of the following situations:

a. The fair value of shares committed to be released differs from the cost of those shares to the employee stock ownership plan.
b. The timing of expense recognition is different for income tax and financial reporting purposes.

Such differences shall be reported in accordance with the requirements of Subtopic 740-10.

**45-5** The tax effect of the difference, if any, between the cost of shares committed to be released and the fair value of the shares shall be recognized as income tax expense or benefit in the income statement.

**45-7** The tax benefit of tax-deductible dividends on allocated and unallocated employee stock ownership plan shares shall be recognized in income taxes allocated to continuing operations.

## Question 12.3.70
**How does an entity account for dividends on ESOP shares?**

**Interpretive response:** Accounting for dividends paid on ESOP shares depends on whether the ESOP shares are unallocated or allocated.

### Unallocated shares (i.e. suspense shares and committed-to-be-released shares)

The entity determines the use of dividends on unallocated shares based on the ESOP plan document. The more common use of dividends on unallocated shares is to make payments on the ESOP's debt. However, the entity may decide to use dividends on unallocated shares to compensate ESOP participants by adding the value of the dividends to participant accounts.

The entity does not recognize the dividends paid on unallocated shares in retained earnings, because the entity does not relinquish control over the use of the dividends on the unallocated ESOP shares until it allocates the shares. The dividends are instead recognized as a reduction of taxable income. Subtopic 718-40's Example 1 Case A in section 12.3.60 contains journal entries illustrating an entity's recognition of dividends on allocated and unallocated shares as well as the calculation of taxable income.

### Allocated shares

The entity debits retained earnings and credits dividends payable when the dividend is declared for all allocated shares. The dividend payable is resolved when other shares are subsequently committed to be released to replace the dividends that were used for debt service. [718-40-25-15]

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## Question 12.3.80

### How does an entity make up the difference between the value of dividends withdrawn and shares allocated?

**Background:** The IRC allows an entity to use the dividends on allocated ESOP shares for debt service if the employees are then allocated shares with a fair value no less than the amount of the dividends that were used for debt service.

The timing of when these replacement shares are allocated, and the method used to calculate the number of shares can result in a difference in value. In Subtopic 718-40's Example 1 Case A in section 12.3.60, the dividends are declared and paid quarterly. The shares allocated to replace dividends used for debt service are allocated in the following year based on the average share price for that year. A difference in value can arise from the change in the share price since the time the dividends were declared and paid.

**Interpretive response:** The IRS has not issued guidance about what entities are required to do to make up the difference between the value of dividends withdrawn and the shares allocated. In practice, a wide variety of techniques may satisfy the IRC requirements. [718-40-25-15]

## Question 12.3.90

### How is the tax effect of a leveraged ESOP accounted for?

**Interpretive response:** For an entity with a leveraged ESOP, the amount of ESOP-related compensation expense reported for a period may differ from the amount of the ESOP-related income tax deduction for that period. Differences result if:

— the fair value of shares committed to be released is different from the cost of those shares to the ESOP; and
— the timing of the compensation expense recognition is different for income tax and financial reporting purposes.

An entity accounts for these differences based on Topic 740 (income taxes), similarly to other share-based compensation arrangement income tax differences. [718-40-30-3]

The entity records the tax benefit of tax-deductible dividends on allocated and unallocated ESOP shares as a reduction of income tax expense allocated to continuing operations. [718-740-45-7]

For additional guidance, see section 8 of KPMG Handbook, Accounting for income taxes.

Subtopic 718-40's Example 1 Case A in section 12.3.60 includes the tax calculation and the related journal entries.

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## 12.3.50 Plan termination

### Excerpt from ASC 718-40

**40 Derecognition**

**Leveraged Employee Stock Ownership Plans**

**> Plan Termination**

**40-1** This Section may contain summaries or references to specific tax code or other regulations that existed at the time that the standard was issued. The Financial Accounting Standards Board (FASB) does not monitor such code or regulations and assumes no responsibility for the current accuracy of the summaries or references. Users must evaluate such code or regulations to determine consistency of the current code or regulation with that presented.

**40-2** Upon termination of a leveraged **employee stock ownership plan**, either in whole or in part, all outstanding debt related to the shares being terminated shall be repaid or refinanced. An employee stock ownership plan may repay the debt using an employer contribution to the plan, dividends on employee stock ownership plan shares, the proceeds from selling suspense shares to the employer or to another party, or some combination of these. The tax law limits the shares employers may reacquire to the number of shares with a fair value equal to the applicable unpaid debt and requires that the remaining shares, if any, shall be allocated to participants.

**40-3** If the employer makes a contribution to the employee stock ownership plan or pays dividends on unallocated shares that are used by the employee stock ownership plan to repay the debt, the employer shall charge the debt and accrued interest payable when the employee stock ownership plan makes the payment to the outside lender. Similarly, an employer sponsoring an employee stock ownership plan with an indirect loan shall report loan repayments as reductions of the debt and accrued interest payable.

**40-4** If the employee stock ownership plan sells the suspense shares and uses the proceeds to repay the debt, the employer shall report the release of the suspense shares as a credit to unearned employee stock ownership plan shares based on the cost of the shares to the employee stock ownership plan, charge debt, and accrued interest payable, and recognize the difference in paid-in capital.

**40-5** However, if there is a difference between the amount paid to an outside lender and the net carrying amount of the debt, paragraph 470-50-40-2 requires that difference to be included in the employer's income when the debt is extinguished.

**40-6** If an employer reacquires the suspense shares from the employee stock ownership plan, the purchase of the shares shall be accounted for as a treasury stock transaction. The treasury stock shall be reported at the fair value of the shares at the reacquisition date. Unearned employee stock ownership plan shares shall be credited for the cost of the shares, and the difference shall be recognized in additional paid-in capital.

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**40-7** If the fair value of the suspense shares on the termination date is more than the unpaid debt balance, the release of the remaining suspense shares to participants shall be charged to compensation in accordance with paragraphs 718-40-25-11 through 25-15. That is, compensation cost shall equal the fair value of the shares at the date the employee stock ownership plan debt is extinguished, because that is when the shares are committed to be released.

## Question 12.3.100

### When can an entity terminate a leveraged ESOP?

**Interpretive response:** The IRC makes it difficult, and generally uneconomical, to terminate a leveraged ESOP. It requires a valid business reason to terminate a leveraged ESOP – e.g. a significant shrinkage in the workforce or bankruptcy. [718-40-40-1]

The IRC requires that ESOP participants become fully vested in their account balances when the ESOP is terminated. This may result in a windfall to an employee with shares not yet vested. [IRC §411(d)(3)]

The termination can also result in a windfall to ESOP participants if the fair value of shares has increased. See Question 12.3.120.

An entity should consult with its legal and financial advisors for all of the legal and tax considerations when terminating a leveraged ESOP.

## Question 12.3.110

### How is the termination of a leveraged ESOP accounted for?

**Interpretive response:** When a leveraged ESOP is terminated, the ESOP can repay the loan using (1) an entity contribution to the plan, (2) dividends on ESOP shares, (3) the proceeds from selling suspense shares to the entity or to another party, or some combination of these. [718-40-40-2]

#### (1) Entity contribution to the plan or (2) dividends on ESOP shares

When the ESOP has a direct or indirect loan, the entity writes off the loan and accrued interest payable when the ESOP makes the payment to the outside lender. [718-40-40-3]

When the ESOP has an employer loan, there is no accounting recognition related to an employer loan being forgiven because of the intercompany elimination.

#### (3) Proceeds from selling suspense shares to the entity or to another party

The entity reports the release of the suspense shares as a credit to unearned ESOP shares based on the cost of the ESOP shares, writes off the loan, and accrued interest payable, and recognizes the difference in paid-in capital. [718-40-40-4]

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If there is a difference between the amount paid to an outside lender and the net carrying amount of the loan, that difference is recognized as income. [718-40-40-5]

The repurchased shares are accounted for as treasury stock. [718-40-40-6]

Subtopic 718-40's Example 1 Case A in section 12.3.60 illustrates the journal entries recorded upon termination of a leveraged ESOP.

## Question 12.3.120

### How is the termination of a leveraged ESOP accounted for when the fair value of suspense shares sold to repay the loan exceeds the loan repayment?

**Interpretive response:** The tax law limits the shares entities may reacquire to the number of shares with a fair value equal to the applicable unpaid loan and requires that any remaining shares be allocated to ESOP participants. This fact pattern can result in a windfall to participants. [718-40-40-2]

Under Subtopic 718-40, the release of suspense shares to ESOP participants is recognized as compensation expense. The compensation expense in this instance is the fair value of the released shares at the date the ESOP loan is terminated. [718-40-40-7]

This derecognition guidance applies only to suspense shares on the termination of an ESOP. For all other ESOP shares, the recognition guidance under paragraph 718-40-25-12 applies (see section 12.3.30) and the average fair value is used. Illustrative journal entries are included in Example 12.3.10.

## Example 12.3.10

### ESOP termination if the entity reacquires shares from the ESOP

This example uses the assumptions from Subtopic 718-40's Example 1 Case A included in section 12.3.60. The following assumptions are reproduced here for reference.

The ESOP borrows $1,000,000 from an outside lender at 10% for five years and uses the proceeds to buy 100,000 shares of newly issued common stock of the sponsor for $10 per share, which is the market price of those shares on the date of issuance. Principal and interest are payable in equal annual installments at the end of each year.

| Year | Principal | Interest | Total debt service | Year-end debt balance |
|---|---|---|---|---|
| 1 | $ 163,800 | $ 100,000 | $ 263,800 | $ 836,200 |
| 2 | 180,200 | 83,600 | 263,800 | 656,000 |
| 3 | 198,200 | 65,600 | 263,800 | 457,800 |

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Shares are released from the suspense account for allocation to ESOP participants' accounts based on a principal-plus-interest formula. The released shares are allocated to participant accounts the following year.

| Year | Cumulative number of shares | | |
|---|---|---|---|
| | Released | Allocated | Year-end suspense shares |
| 1 | 20,000 | 0 | 80,000 |
| 2 | 40,000 | 20,000 | 60,000 |
| 3 | 60,000 | 40,000 | 40,000 |

The following are the year-end and average market values of a share of common stock.

| Year | Year-end | Average |
|---|---|---|
| 1 | $11.50 | $ 10.75 |
| 2 | 9.00 | 10.25 |
| 3 | 10.00 | 9.50 |

### Scenario 1: Fair Value of suspense shares less than debt repayment

The ESOP is terminated at the end of Year 2 and the suspense shares are sold to pay down the debt. The fair value of suspense shares is $540,000 (60,000 shares × $9 per share), which is less than the amount of debt repayment.

The entity records the release of the unearned ESOP shares as a credit based on the cost of shares to the ESOP. The entity records the repayment of the debt and the net cash (difference between the debt repayment and the repurchase amount). The difference is recorded to additional paid-in capital.

| | *Debit* | *Credit* |
|---|---|---|
| Debt | 656,000 | |
| Additional paid-in capital | 60,000 | |
| Unearned ESOP shares | | 600,000 |
| Cash | | 116,000 |

### Scenario 2: Fair Value of suspense shares more than debt repayment

The ESOP is terminated at the end of Year 1 and the suspense shares are sold to pay down the debt. The fair value of suspense shares is $920,000 (80,000 shares × $11.50 per share), which is more than the amount of debt repayment.

Because the fair value of shares exceeds the unpaid debt balance, suspense shares are used to repay the debt balance first and then remaining shares are recognized as compensation cost. The amount of suspense shares used to repay the debt balance is 72,713 shares ($836,200 ÷ $11.50 per share). The amount of suspense shares recognized as compensation cost is the remaining 7,287 shares (80,000 – 72,713).

The entity records the release of the unearned ESOP shares as a credit based on the cost of shares to the ESOP. The entity records the repayment of the debt. The amount recorded to additional paid-in capital represents the

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difference between the cost of shares to the ESOP and the new reacquired cost of shares to the entity. The shares were originally sold to the ESOP at $10 per share but were reacquired at $11.50 per share.

| | *Debit* | *Credit* |
|---|---|---|
| Debt | 836,200 | |
| Compensation cost[1] | 83,800 | |
| Unearned ESOP shares | | 800,000 |
| Additional paid-in capital[2] | | 120,000 |
| *To recognize repayment of ESOP debt upon termination and sale of suspense shares.* | | |

Notes:

1. Calculated based on the fair value of the shares at the date the ESOP debt is extinguished (7,287 shares × $11.50 per share).
2. Calculated based on difference between the cost of shares to the ESOP and the new reacquired cost of shares to the entity ($11.50 – $10 = $1.50) × the number of suspense shares (80,000).

## 12.3.60 FASB examples

Topic 718 includes several examples of leveraged ESOPs.

### Excerpt from ASC 718-40

**Implementation Guidance and Illustrations**

**General**

**> Illustrations**

**55-1** This Section contains illustrations of the requirements of this Subtopic for employers with **employee stock ownership plans**.

**55-2** The Examples do not address all possible circumstances that may arise in applying the guidance in this Subtopic. The Examples are for annual reporting periods and, accordingly, do not demonstrate the application of the Subtopic to interim financial statements. However, depending on the circumstances, many of the journal entries illustrated would be made for interim financial statements.

**Leveraged Employee Stock Ownership Plans**

**> Illustrations**

**>> Example 1: Employee Stock Ownership Plan Leveraged with a Direct or Indirect Loan**

**55-3** The following Cases illustrate the guidance in paragraphs 718-40-25-7 through 25-17; 718-40-30-1 through 30-4; 718-40-35-1; 718-40-40-1 through 40-

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7; and 718-40-45-3 through 45-8:

a. A common-stock leveraged employee stock ownership plan with a direct loan (Case A)
b. A common-stock leveraged employee stock ownership plan used to fund the employer's match of a 401(k) savings plan with an indirect loan (Case B)
c. A convertible-preferred-stock leveraged employee stock ownership plan with a direct loan (Case C).

**>>> Case A: A Common-Stock Leveraged Employee Stock Ownership Plan with a Direct Loan**

**55-4** This Case illustrates a common stock leveraged employee stock ownership plan with a direct loan. This Case has the following assumptions:

a. On January 1, Year 1, Entity A establishes a leveraged employee stock ownership plan.
b. The employee stock ownership plan borrows $1,000,000 from an outside lender at 10 percent for 5 years and uses the proceeds to buy 100,000 shares of newly issued common stock of the sponsor for $10 per share, which is the market price of those shares on the date of issuance.
c. Debt service is funded by cash contributions and dividends on employer stock held by the employee stock ownership plan.
d. Dividends on all shares held by the employee stock ownership plan are used for debt service.
e. Cash contributions are made at the end of each year.
f. The year-end and average market values of a share of common stock follow.

| *Year* | *Year-End* | *Average* |
|---|---|---|
| 1 | $ 11.50 | $ 10.75 |
| 2 | 9.00 | 10.25 |
| 3 | 10.00 | 9.50 |
| 4 | 12.00 | 11.00 |
| 5 | 14.40 | 13.20 |

g. The common stock pays normal dividends at the end of each quarter of 12.5 cents per share ($50,000 for the employee stock ownership plan's shares each year). Accordingly, in this Case, the average fair value of shares is used to determine the number of shares used to satisfy the employers' obligation to replace dividends on allocated shares used for debt service.
h. Principal and interest are payable in equal annual installments at the end of each year. Debt service is as follows.

| *Year* | *Principal* | *Interest* | *Total Debt Services* |
|---|---|---|---|
| 1 | $ 163,800 | $ 100,000 | $ 263,800 |
| 2 | 180,200 | 83,600 | 263,800 |
| 3 | 198,200 | 65,600 | 263,800 |

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| | | | |
|---|---|---|---|
| 4 | 218,000 | 45,800 | 263,800 |
| 5 | 239,800 | 24,000 | 263,800 |
| | $ 1,000,000 | $ 319,000 | $ 1,319,000 |

i. The number of shares released each year is as follows.

| Year | Dividends | Compensation | Total |
|---|---|---|---|
| 1 | 0 | 20,000 | 20,000 |
| 2 | 976 | 19,024 | 20,000 |
| 3 | 2,105 | 17,895 | 20,000 |
| 4 | 2,727 | 17,273 | 20,000 |
| 5 | 3,030 | 16,970 | 20,000 |

j. The number of shares released for dividends is determined by dividing the amount of dividends on allocated shares by the average fair value of a share of common stock (for Year 2: $10,000 divided by $10.25 equals 976 shares). In this illustration, the remaining shares are released for compensation (for Year 2: 20,000 less 976 equals 19,024 shares).

k. Shares are released from the suspense account for allocation to participants' accounts based on a principal-plus-interest formula. The released shares are allocated to participant accounts the following year. Shares released and allocated follow.

l. Income before employee stock ownership plan related charges is as follows.

m. All interest cost and compensation cost are charged to expense each year.

n. Excluding employee stock ownership plan shares, 1,000,000 shares are outstanding on average each year.

o. Entity A follows the guidance in Subtopic 740-10.

p. Entity A's combined statutory tax rate is 40 percent each year.

q. Entity A's only book-tax differences are those associated with its employee stock ownership plan.

r. No valuation allowance is necessary for deferred tax assets.

**55-5** The following table sets forth Entity A's employee stock ownership plan-related information. All amounts represent changes (credits in parentheses) in account balances.

| Year | Principal | Unearned Employee Stock Ownership Plan Shares | Paid-in Capital | Dividends | Interest Expense | Cash |
|---|---|---|---|---|---|---|
| Notes | (1) | (2) | (3) | (4) | (5) | (6) |
| 1 | $163,800 | $(200,000) | $(15,000) | $ - | $215,000 | $(263,800) |
| 2 | 180,200 | (200,000) | (5,000) | 10,000 | 195,000 | (263,800) |
| 3 | 196,200 | (200,000) | 10,000 | 20,000 | 170,000 | (263,800) |
| 4 | 218,000 | (200,000) | (20,000) | 30,000 | 190,000 | (263,800) |

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| | | | | | | |
|---|---|---|---|---|---|---|
| 5 | 239,800 | (200,000) | (64,000) | 40,000 | 224,000 | (263,800) |
| Total | $1,000,000 | $(1,000,000) | $(94,000) | $100,000 | $994,000 | $(1,319,000) |

Notes:

(1) See the table in (h) of the preceding paragraph.
(2) Total number of shares released for year (20,000) multiplied by the cost per share to employee stock ownership plan ($10).
(3) Total number of shares released for year (20,000) multiplied by the difference between average fair value per share (see the table in [f] of the preceding paragraph) and cost per share to employee stock ownership plan ($10). [Year 1: 20,000 shares multiplied by ($10.75-$10.00)]
(4) Cumulative number of allocated shares (see the table in [k] of the preceding paragraph) multiplied by the dividend per share. [Year 2: 20,000 shares multiplied by $.50]
(5) Number of shares released for compensation (see the table in [i] of the preceding paragraph) multiplied by the average fair value per share for the period (see the table in [f] of the preceding paragraph). The amounts in this column have been rounded.
(6) The cash disbursed each year is comprised of $213,800 contribution and $50,000 in dividends.

**55-6** Entity A would record journal entries from inception through Year 5 as follows.

***January 1, Year 1 (inception)***

| | | |
|---|---|---|
| Cash | $ 1,000,000 | |
| Debt | | $1,000,000 |
| [To record the employee stock ownership plan's loan] | | |
| Unearned employee stock ownership plan shares (equity) | 1,000,000 | |
| Common stock and paid-in capital | | 1,000,000 |
| [To record the issuance of 100,000 shares to the employee stock ownership plan at $10 per share] | | |

**Year 1**

| | | |
|---|---|---|
| Interest expense | 100,000 | |
| Accrued interest payable | | 100,000 |
| [To record interest expense] | | |
| Accrued interest payable | 100,000 | |
| Debt | 163,800 | |
| Cash | | 263,800 |
| [To record debt payment (The cash disbursement of $263,800 consists of $50,000 in dividends, none of which is charged to retained earnings in Year 1, and $213,800 supplemental cash contribution to the employee stock ownership plan)] | | |
| Compensation expense | 215,000 | |
| Paid-in capital | | 15,000 |
| Unearned employee stock ownership plan shares | | 200,000 |
| [To record release of 20,000 shares at an average fair value of $10.75 per share (shares cost employee stock ownership plan $10)] | | |

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| | | |
|---|---|---|
| Deferred tax asset | 14,480 | |
| Provision for income taxes | 600,000 | |
| Income taxes payable | | 614,480 |
| [To record income taxes for Year 1] | | |
| **Year 2** | | |
| Interest expense | $ 83,600 | |
| Accrued interest payable | | $ 83,600 |
| [To record interest expense] | | |
| Accrued interest payable | 83,600 | |
| Debt | 180,200 | |
| Cash | | 263,800 |
| [To record debt payment (The cash disbursement of $263,800 consists of $50,000 in dividends, $10,000 of which is charged to retained earnings in Year 2, and $213,800 supplemental cash contribution to the employee stock ownership plan)] | | |
| Retained earnings | 10,000 | |
| Dividends payable | | 10,000 |
| [To record declaration of $.50 per share dividend on the 20,000 allocated shares] | | |
| Compensation expense | 195,000 | |
| Dividends payable | 10,000 | |
| Paid-in capital | | 5,000 |
| Unearned employee stock ownership plan shares | | 200,000 |
| [To record release of 20,000 shares (19,024 for compensation and 976 for dividends) at an average fair value for $10,25 per share (shares cost employee stock ownership plan $10 per share)] | | |
| Deferred tax asset | 7,920 | |
| Provision for income taxes | 646,560 | |
| Income taxes payable | | 654,480 |
| [To record release of 20,000 shares at an average fair value of $10.75 per share (shares cost employee stock ownership plan $10)] | | |
| Deferred tax asset | 14,480 | |
| Provision for income taxes | 600,000 | |
| Income taxes payable | | 614,480 |
| [To record income taxes for Year 2] | | |
| **Year 3** | | |
| Interest expense | $ 65,600 | |
| Accrued interest payable | | $ 65,600 |
| [To record interest expense] | | |
| Accrued interest payable | 65,600 | |

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| | | |
|---|---|---|
| Debt | 198,200 | |
| Cash | | 263,800 |
| [To record debt payment] | | |
| Retained earnings | 20,000 | |
| Dividends payable | | 20,000 |
| [To record declaration of $.50 per share dividend on the 40,000 allocated shares] | | |
| Compensation expense | 195,000 | |
| Dividends payable | 10,000 | |
| Paid-in capital | | 5,000 |
| Unearned employee stock ownership plan shares | | 200,000 |
| [To record release of 20,000 shares (19,024 for compensation and 976 for dividends) at an average fair value for $10.25 per share (shares cost employee stock ownership plan $10 per share)] | | |
| Compensation expense | 170,000 | |
| Dividends payable | 20,000 | |
| Paid-in capital | 10,000 | |
| Unearned employee stock ownership plan shares | | 200,000 |
| [To record release of 20,000 shares (17,895 for compensation and 2,105 for dividends) at an average fair value of $9.50 per share (shares cost employee stock ownership plan $10 per share)] | | |
| Deferred tax asset | 720 | |
| Provision for income taxes | 693,760 | |
| Income taxes payable | | 694,480 |
| [To record income taxes for Year 3] | | |
| **Year 4** | | |
| Interest expense | $ 45,800 | |
| Accrued interest payable | | $ 45,800 |
| [To record interest expense] | | |
| Accrued interest payable | 45,800 | |
| Debt | 218,000 | |
| Cash | | 263,800 |
| [To record debt payment] | | |
| Retained earnings | 30,000 | |
| Dividends payable | | 30,000 |
| [To record declaration of $.50 per share dividend on the 60,000 allocated shares] | | |
| Compensation expense | 190,000 | |
| Dividends payable | 30,000 | |

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| | | |
|---|---|---|
| Paid-in capital | | 20,000 |
| Unearned employee stock ownership plan shares | | 200,000 |
| [To record release of 20,000 shares (17,273 for compensation and 2,727 for dividends) at an average fair value for $11.00 per share (shares cost employee stock ownership plan $10 per share)] | | |
| Provision for income | 741,680 | |
| Deferred tax asset | | 7,200 |
| Income taxes payable | | 734,480 |
| [To record income taxes for Year 4] | | |
| **Year 5** | | |
| Interest expense | $ 24,000 | |
| Accrued interest payable | | $ 24,000 |
| [To record interest expense] | | |
| Accrued interest payable | 24,000 | |
| Debt | 239,800 | |
| Cash | | 263,800 |
| [To record debt payment] | | |
| Retained earnings | 40,000 | |
| Dividends payable | | 40,000 |
| [To record declaration of $.50 per share dividend on the 80,000 allocated shares] | | |
| Compensation expense | 224,000 | |
| Dividends payable | 40,000 | |
| Paid-in capital | | 64,000 |
| Unearned employee stock ownership plan shares | | 200,000 |
| [To record release of 20,000 shares (16,970 for compensation and 3,030 for dividends) at an average fair value for $13.20 per share (shares cost employee stock ownership plan $10 per share)] | | |
| Provision for income taxes | 790,400 | |
| Deferred tax asset | | 15,920 |
| Income taxes payable | | 774,480 |
| [To record income taxes for Year 5] | | |

**55-7** Assuming Entity A terminates its employee stock ownership plan at the end of Year 2 (when the fair value of the **suspense shares** is $540,000 [60,000 shares multiplied by $9 per share], the unearned employee stock ownership plan share balance is $600,000, and the unpaid debt balance is $656,000), and assuming the suspense shares are sold to pay down the debt, Entity A would make the following journal entry.

| | | |
|---|---|---|
| Debt | $ 656,000 | |
| Additional paid-in capital | 60,000 | |

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| | |
|---|---|
| Unearned employee stock ownership in plan shares | $ 600,000 |
| Cash | 116,000 |

[To record repayment of the employee stock ownership plan's loan and termination of the plan]

**55-8** The following tables set forth Entity A's tax (assuming no termination) and earnings per share (EPS) computations.

| | *Year* | | | | |
|---|---|---|---|---|---|
| | *1* | *2* | *3* | *4* | *5* |
| Income before employee stock ownership plan | $ 1,800,000 | $ 1,900,000 | $ 2,000,000 | $ 2,100,000 | $ 2,200,000 |
| Interest expense | (100,000) | (83,600) | (65,600) | (45,800) | (24,000) |
| Compensation expense | (215,000) | (195,000) | (170,000) | (190,000) | (224,000) |
| Pretax income | 1,485,000 | 1,621,400 | 1,764,400 | 1,863,200 | 1,952,000 |
| Provision for income tax | | | | | |
| Currently payable | 614,480 | 654,480 | 694,480 | 734,480 | 774,480 |
| Deferred | (14,480) | (7,920) | (720) | 7,200 | 15,920 |
| Total | 600,000 | 646,560 | 693,760 | 741,680 | 790,400 |
| Net income | $ 885,000 | $ 974,840 | $ 1,070,640 | $ 1,122,520 | $ 1,161,600 |
| Average shares outstanding | 1,010,000 | 1,030,000 | 1,050,000 | 1,070,000 | 1,090,000 |
| Earnings per share | $ .88 | $ .95 | $ 1.02 | $ 1.05 | $ 1.07 |

| | *Year* | | | | |
|---|---|---|---|---|---|
| | *1* | *2* | *3* | *4* | *5* |
| Current provision: | | | | | |
| Income before employee stock ownership plan | $ 1,800,000 | $ 1,900,000 | $ 2,000,000 | $ 2,100,000 | $ 2,200,000 |
| Employee stock ownership plan contribution | (213,800) | (213,800) | (213,800) | (213,800) | (213,800) |
| Employee stock ownership plan dividends | (50,000) | (50,000) | (50,000) | (50,000) | (50,000) |
| Taxable income | 1,536,200 | 1,636,200 | 1,736,200 | 1,836,200 | 1,936,200 |
| Multiplied by 40 percent | $ 614,480 | $ 654,480 | $ 694,480 | $ 734,480 | $ 774,480 |

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| | | | | | |
|---|---|---|---|---|---|
| Deferred provision: | | | | | |
| Reduction in unearned employee stock ownership plan shares for financial reporting | $ 200,000 | $ 200,000 | $ 200,000 | $ 200,000 | $ 200,000 |
| Related tax deduction [(a)] | 163,800 | 180,200 | 198,200 | 218,800 | 239,800 |
| Difference | (36,200) | (19,800) | (1,800) | 18,000 | 39,800 |
| Tax rate | 40% | 40% | 40% | 40% | 40% |
| Deferred tax expense + (benefit) | $ (14,480) | $ (7,920) | $ (720) | 7,200 | 15,920 |

(a) This amount is the principal repayment

| | Year | | | | |
|---|---|---|---|---|---|
| | *1* | *2* | *3* | *4* | *5* |
| Pretax income | $ 1,485,000 | $ 1,621,400 | $ 1,764,400 | $ 1,864,200 | $ 1,952,000 |
| Tax at 40 percent (statutory rate) | 594.000 | 648,560 | 705,760 | 745,680 | 780,800 |
| Benefit of employee stock ownership plan dividends | - | (4,000) | (8,000) | (12,000) | (16,000) |
| Effect of difference between average fair value and cost of released shares | 6,000 | 2,000 | (4,000) | 8,000 | 25,600 |
| Provision as reported | $ 600,000 | $ 646,560 | $ 693,760 | $ 741,680 | $ 790,400 |

**55-9** The entity would provide the following disclosures for the end of Year 3.

The entity sponsors a leveraged employee stock ownership plan that covers all U.S. **employees** who work 20 or more hours per week. The entity makes annual contributions to the employee stock ownership plan equal to the employee stock ownership plan's debt service less dividends received by the employee stock ownership plan. All dividends received by the employee stock ownership plan are used to pay debt service. The employee stock ownership plan shares initially were pledged as collateral for its debt. As the debt is repaid, shares are released from collateral and allocated to active employees, based on the proportion of debt service paid in the year. The entity accounts for its employee stock ownership plan in accordance with this Subtopic. Accordingly, the debt of the employee stock ownership plan is recorded as debt and the shares pledged as collateral are reported as unearned employee stock ownership plan shares in the statement of financial position. As shares are released from collateral, the entity reports compensation expense equal to the current market price of the shares, and the shares become outstanding for EPS computations. Dividends on allocated employee stock ownership plan shares are recorded as a reduction of retained earnings; dividends on unallocated employee stock ownership plan shares are recorded as a reduction of debt and accrued interest. Employee stock ownership plan compensation expense was $170,000, $195,000, and $215,000 for Years 3, 2, and 1, respectively. The employee stock ownership plan shares as of December 31 were as follows.

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| | *Year 3* | *Year 2* |
|---|---|---|
| Allocated shares | 40,000 | 20,000 |
| Shares released for allocation | 20,000 | 20,000 |
| Unreleased shares | 40,000 | 60,000 |
| Total employee stock ownership plan shares | 100,000 | 100,000 |
| Fair value of unreleased shares at December 31 | $ 400,000 | $ 540,000 |

**>>> Case B: A Common-Stock Leveraged Employee Stock Ownership Plan Used to Fund the Employer's Match of a 401(k) Savings Plan with an Indirect loan**

**55-10** This Case illustrates a common stock leveraged employee stock ownership plan used to fund the employer's match of a 401(k) savings plan with an indirect loan. On January 1, Year 1, Entity B established an employee stock ownership plan to fund the employer's match of its savings plan. All of the assumptions are the same as those outlined in Case A for Entity A, except as follows:

a. Entity B loaned its employee stock ownership plan $1,000,000 and concurrently obtained a related loan. The terms of both lending arrangements are the same as for Case A's outside loan.
b. Entity B uses shares released by the employee stock ownership plan to satisfy its matching obligation of 50 percent of voluntary employee contributions to the savings plan. The average fair value of the shares for each year is used to determine the number of shares necessary to satisfy the matching obligation.
c. If the fair value of the shares released is less than Entity B's matching obligation, Entity B contributes additional newly issued shares to the employee stock ownership plan to satisfy the remaining obligation.
d. Shares used to replace dividends on allocated shares used to service debt do not count toward the employer's match.
e. The employee contributions, required employer match, and the number of shares needed to fund the employee match follow

| *Year* | *Employee Contributions* | *Employer Match* | *Number of Shares* |
|---|---|---|---|
| 1 | $ 400,000 | $ 200,000 | 18,605 |
| 2 | 410,000 | 205,000 | 20,000 |
| 3 | 420,000 | 210,000 | 22,105 |
| 4 | 430,000 | 215,000 | 19,545 |
| 5 | 440,800 | 220,000 | 16,667 |

Note that the number of shares needed to satisfy the employer's matching obligation is determined by dividing the matching obligation by the average fair value of a share of common stock (for Year 1: $200,000 divided by $10.75 [see

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above table for average fair values] equals 18,605 shares).

**55-11** The 20,000 shares released each year based on debt service payments follow.

| Year | Number of Shares Needed to Settle 401(k) Liability | Total Employee Stock Ownership Plan Shares Released | Employee Stock Ownership Plan Shares Used for Dividends | Employee Stock Ownership Plan Shares Available to Settle 401(k) Liability | Compensation (Additional Shares) | Top-Up (Additional Shares) |
|---|---|---|---|---|---|---|
| *Notes* | *(1)* | *(2)* | *(3)* | *(4)* | *(5)* | *(6)* |
| 1 | 18,605 | 20,000 | 0 | 20,000 | 1,395 | 0 |
| 2 | 20,000 | 20,000 | 976 | 19,024 | 0 | 976 |
| 3 | 22,105 | 20,000 | 2,105 | 17,895 | 0 | 4,210 |
| 4 | 19,545 | 20,000 | 2,727 | 17,273 | 0 | 2,272 |
| 5 | 16,667 | 20,000 | 3,030 | 16,970 | 303 | 0 |

Notes:

(1) See the table in (e) of the preceding paragraph.
(2) See assumptions.
(3) See the table in paragraph 718-40-55-4(i)
(4) Total employees stock ownership plan shares released minus employee stock ownership plan shares used for dividends.
(5) If the employee stock ownership plan shares needed to settle the 401(k) liability (column 1) are less than the employee stock ownership plan shares available to settle the liability (column 4), then the remaining shares are considered compensation (this is the case in Year 1 and 5).
(6) If the employee stock ownership plan shares needed to settle the 401(k) liability (column 1) are greater than the employee stock ownership plan shares available to settle the liability (column 4), then the shortfall must be made up by the employer in the form of top-up shares (this is the case in Years 2, 3, and 4).

**55-12** Cumulative share amounts follow.

| | Cumulative Number of Shares | | |
|---|---|---|---|
| Year | Released | Allocated | Total Suspense Shares |
| 1 | 20,000 | 0 | 80,000 |
| 2 | 40,976 | 20,000 | 60,000 |
| 3 | 65,186 | 40,976 | 40,000 |
| 4 | 87,458 | 65,186 | 20,000 |
| 5 | 107,458 | 87,458 | 0 |

**55-13** Note that dividends on **top-up shares** are paid in cash. Cumulative shares released include top-up shares.

**55-14** The following table sets forth Entity B's employee stock ownership plan related information. All amounts represent changes (credits in parentheses) in account balances.

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| Year | Principal | Unearned Employee Stock Ownership Plan Shares | Paid-in Capital | Dividends | Interest Expense | Compensation Expense Employee Stock Ownership Plan | Compensation Expense Top-up | Cash |
|---|---|---|---|---|---|---|---|---|
| Notes | (1) | (2) | (3) | (4) | (1) | (5) | (6) | (7) |
| 1 | $ 163,800 | $(200,000) | $(15,000) | $ - | $100,000 | $215,000 | $ - | $(263,800) |
| 2 | 180,200 | (200,000) | (15,000) | 10,000 | 83,600 | 195,000 | 10,000 | (263,800) |
| 3 | 198,200 | (200,000) | (30,000) | 20,500 | 65,600 | 170,000 | 40,000 | (264,300) |
| 4 | 218,000 | (200,000) | (45,000) | 32,600 | 45,800 | 190,000 | 25,000 | (266,400) |
| 5 | 239,800 | (200,000) | (64,000) | 43,700 | 24,000 | 224,000 | - | (267,500) |
| Total | $1,000,000 | $(1,000,000) | $(169,000) | $106,800 | $319,000 | $994,000 | $75,000 | $(1,325,800) |

Notes:

(1) See the table in paragraph 718-40-55-4(h)
(2) Number of shares released during the year (20,000) multiplied by the cost per share to employee stock ownership plan ($10).
(3) Number of shares released during the year (20,000) multiplied by the difference between average fair value per share (see the table in paragraph 718-40-55-4(f) and cost per share to the employee stock ownership plan ($10) plus the additional paid-in capital that arises from the top-up shares contributed, which equates the compensation expense related to the top-up.
(4) Cumulative shares allocated (see the table in paragraph 718-40-55-12) multiplied by the dividend per share ($50).
(5) Number of employee stock ownership plan shares released for direct compensation plus number of shares released related to employer's match of 401(k) (see the table in paragraph 718-40-55-11) multiplied by the average fair value per share (see the table in paragraph 718-40-55-4[f]).
(6) Additional shares contributed (top-up) to satisfy the 401(k) obligation (see the table in paragraph 718-40-55-11) multiplied by the fair value of shares contributed.
(7) The cash disbursement to the employee stock ownership plan each year is composed of $213,800 contribution; $50,000 in dividends on original employee stock ownership plan shares; and dividends on top-up shares of $500 in Year 3, $2,600 in Year 4, and $3,700 in Year 5.

**55-15** Entity B would record journal entries from inception through Year 2 as follows.

| | | |
|---|---|---|
| **January 1, Year 1 (inception)** | | |
| Cash | 1,000,000 | |
| Debt | | 1,000,000 |
| [To record loan] | | |
| Unearned employee stock ownership plan shares (equity) | 1,000,000 | |
| Common stock and additional paid-in capital | | 1,000,000 |
| [To record the issuance of 100,000 shares to the employee stock ownership plan at $10 per share] | | |
| **Year 1** | | |
| Interest expense | 100,000 | |
| Accrued interest payable | | $100,000 |
| [To record interest expense] | | |

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| | | |
|---|---|---|
| Accrued interest payable | 100,000 | |
| Debt | 163,800 | |
| Cash | | 263,800 |
| [To record debt payment (The cash disbursement of $263,800 consists of $50,000 in dividends, none of which was charged to retained earnings in Year 1, and $213,800 supplemental cash contribution to the employee stock ownership plan)] | | |
| Compensation expense | 200,000 | |
| 401(k) liability | | 200,000 |
| [To record cost and liability related to employer's 401(k) match, which represents 50 percent of employee contributions] | | |
| 401(k) liability | 200,000 | |
| Compensation expense | 15,000 | |
| Unearned employee stock ownership plan shares | | 200,000 |
| Paid-in capital | | 15,000 |
| [To record release of 20,000 shares at an average fair value of $10.75 per share, 18,605 shares are used to satisfy 401(k) liability and the remaining 1,395 are used to compensate participants directly (shares cost employee stock ownership plan $10 per share)] | | |
| Deferred tax asset | 14,480 | |
| Provision for income taxes | 600,000 | |
| Income taxes payable | | 614,480 |
| [To record income taxes for Year 1 (See paragraphs 718-40-55-4 through 55-9 for detailed tax computation)] | | |
| **Year 2** | | |
| Interest expense | $83,600 | |
| Accrued interest payable | | $83,600 |
| [To record interest expense] | | |
| Accrued interest payable | 83,600 | |
| Debt | 180,200 | |
| Cash | | 263,800 |
| [To record debt payment (The cash disbursement of $263,800 consists of $50,000 in dividends, $10,000 of which was charged to retained earnings in year 2, and $213,800 supplemental cash contribution to the employee stock ownership plan)] | | |
| Compensation expense | 205,000 | |
| 401(k) liability | | 205,000 |
| [To record cost and liability related to employer's 401(k) match, which represents 50 percent of employee contributions] | | |
| Retained earnings | 10,000 | |
| Dividends payable | | 10,000 |
| [To record declaration of $.50 per share dividend on the 20,000 allocated shares] | | |
| 401(k) liability | 205,000 | |
| Dividends payable | 10,000 | |
| Unearned employee stock ownership plan shares | | 200,000 |

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| | | |
|---|---|---|
| Common stock/paid-in capital | | 15,000 |

[To record release of 20,000 shares plus contribution of an additional 976 shares to the employee stock ownership plan at an average fair value of $10.25 per share, 20,000 shares are used to satisfy 401(k) liability and the remaining 976 shares are used to replace dividends on allocated shares used for debt service (shares cost employee stock ownership plan $10 per share)]

| | | |
|---|---|---|
| Deferred tax asset | 7,920 | |
| Provisions for income taxes | 642,560 | |
| Income taxes payable | | 650,480 |

[To record income taxes for Year 2 (See paragraphs 718-40-55-4 through 55-9 for detailed tax computation)]

**55-16** Note that the journal entry differs from Case A because Entity B receives an additional $10,000 deduction ($4,000 tax benefit) for the 976 top-up shares.

**55-17** Assuming Entity B terminated its employee stock ownership plan at the end of Year 4 (when the fair value of the suspense shares is $240,000, the unearned employee stock ownership plan shares balance is $200,000, and the unpaid debt balance is $239,800), and assuming the employer buys back the suspense shares in an amount equal to the debt balance, there will be 17 suspense shares left, which must be allocated to participants. (In this Case the shares are used to partially satisfy the employer's 401(k) matching obligation.) Entity B would make the following journal entry.

| | | |
|---|---|---|
| Treasury stock | $39,800 | |
| 401(k) liability | 204 | |
| Additional paid-in capital | | $40,004 |
| Unearned employee stock ownership plan shares | | 200,000 |

[To record repurchase of employee stock ownership plan suspense shares and termination of the plan]

| | | |
|---|---|---|
| Debt | 239,800 | |
| Cash | | 239,800 |

[To record repayment of the employee stock ownership plan's loan]

**55-18** In this Case, Entity B's taxes would be computed the same way as Case A. For Entity B the average number of employee stock ownership plan shares outstanding would be as follows.

| *Year* | *Employee Stock Ownership Plan Shares Outstanding* |
|---|---|
| 1 | 10,000 |
| 2 | 30,488 |
| 3 | 53,081 |
| 4 | 76,322 |
| 5 | 97,458 |

**55-19** This represents the cumulative numbers of shares released at the beginning of the year plus the end of the year (see the table in the preceding paragraph) divided by 2.

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**55-20** The entity would provide the following disclosures for the end of Year 3.

The entity sponsors a 401(k) savings plan under which eligible U.S. employees may choose to save up to 6 percent of salary income on a pretax basis, subject to certain Internal Revenue Service (IRS) limits. The entity matches 50 percent of employee contributions with entity common stock. The shares for this purpose are provided principally by the entity's employee stock ownership plan, supplemented as needed by newly issued shares. The entity makes annual contributions to the employee stock ownership plan equal to the employee stock ownership plan's debt service less dividends received by the employee stock ownership plan. All dividends received by the employee stock ownership plan are used to pay debt service. The employee stock ownership plan shares initially were pledged as collateral for its debt. As the debt is repaid, shares are released from collateral and allocated to employees who made 401(k) contributions that year, based on the proportion of debt service paid in the year. The entity accounts for its employee stock ownership plan in accordance with this Subtopic. Accordingly, the shares pledged as collateral are reported as unearned employee stock ownership plan shares in the statement of financial position. As shares are released from collateral, the entity reports compensation expense equal to the current market price of the shares, and the shares become outstanding for EPS computations. Dividends on allocated employee stock ownership plan shares are recorded as a reduction of retained earnings; dividends on unallocated employee stock ownership plan shares are recorded as a reduction of debt and accrued interest.

Compensation expense for the 401(k) match and the employee stock ownership plan was $210,000, $205,000, and $215,000 for Years 3, 2, and 1, respectively. The employee stock ownership plan shares as of December 31 were as follows.

| | Year 3 | Year 2 |
|---|---:|---:|
| Allocated shares | 40,976 | 20,000 |
| Shares released for allocation | 24,210 | 20,976 |
| Unreleased shares | 40,000 | 60,000 |
| Total employee stock ownership plan shares | 105,186 | 100,976 |
| Fair value of unreleased shares at December 31 | $400,000 | $540,000 |

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# 12.4 Nonleveraged ESOPs

## 12.4.10 Overview

### Excerpt from ASC 718-40

**25 Recognition**

**Nonleveraged Employee Stock Ownership Plans**

**25-18** This Subsection provides recognition guidance for nonleveraged **employee stock ownership plans**. It is organized as follows:

a. Contribution of shares to the employee stock ownership plan
b. Dividends on employee stock ownership plan shares
c. Shares allocated by year-end

**> Contribution of Shares to the Employee Stock Ownership Plan**

**25-19** Employers with nonleveraged employee stock ownership plans shall report compensation cost equal to the contribution called for in the period under the plan.

**> Dividends on Employee Stock Ownership Plan Shares**

**25-20** Employers with nonleveraged employee stock ownership plans shall charge dividends on shares held by the employee stock ownership plans to retained earnings, except that dividends on suspense account shares of a pension reversion employee stock ownership plan shall be accounted for the same way as dividends on suspense account shares of leveraged employee stock ownership plans (see paragraph 718-40-25-15 through 25-17).

**> Shares Allocated by Year-End**

**25-21** An employer with a nonleveraged employee stock ownership plan periodically contributes its shares or cash to its employee stock ownership plan on behalf of **employees**. The shares contributed or acquired with the cash contributed, which may be outstanding shares, treasury shares, or newly issued shares, shall be allocated to participant accounts and held by the employee stock ownership plan until distributed to the employees at a future date, such as on the date of termination or retirement. The shares of employer stock obtained by the nonleveraged employee stock ownership plan shall be allocated to individual participant accounts as of the end of the employee stock ownership plan's fiscal year. While this is the accounting treatment of employee stock ownership plan shares, it is mandated by tax law. The Codification does not keep up with changes in the tax law.

**30 Initial Measurement**

**Nonleveraged Employee Stock Ownership Plans**

**30-5** Compensation cost shall be measured as the fair value of the shares contributed to or committed to be contributed to the employee stock ownership plan or as the cash contributed to or committed to be contributed to the employee stock ownership plan, as appropriate under the terms of the plan.

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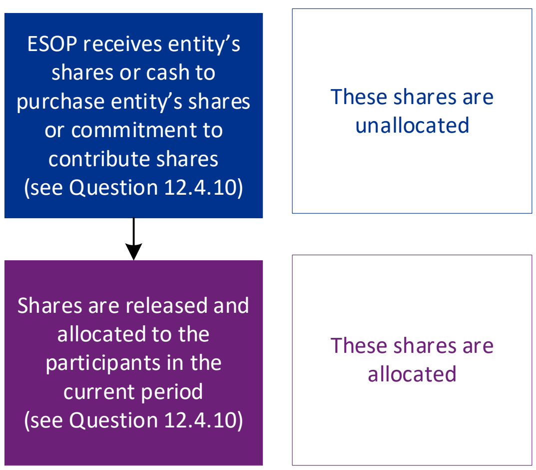
## Excerpt from ASC 718-740

**> Employee Stock Ownership Plans**

**25-7** Employers with nonleveraged employee stock ownership plans may accrue compensation cost for financial reporting purposes earlier than the cost is deductible for income tax purposes. Accruing the compensation cost earlier for financial reporting purposes creates a temporary difference under the requirements of Subtopic 740-10.

This section describes the accounting for nonleveraged ESOPs. The most common type of nonleveraged ESOP is a profit-sharing plan in which a defined portion of the entity's profits are contributed to the ESOP each year. The following diagram provides a schematic that explains the accounting implications.




## Question 12.4.10

### How does an entity account for contributions to a nonleveraged ESOP?

**Interpretive response:** The entity recognizes compensation cost when it:

- contributes shares to the ESOP; or
- commits to contribute shares to the ESOP.

Shares that are committed to be contributed are amounts outlined in the plan document but not yet contributed.

Compensation cost is equal to the fair value of shares contributed or committed to be contributed to the ESOP. The fair value of such shares is determined on the date of the contribution (generally described in the plan documents). The shares are allocated to employees by the ESOP's fiscal year-end. The entity does not adjust the compensation cost as the value of allocated shares changes. [718-40-25-19, 30-5]

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The entity's shares contributed to the nonleveraged ESOP remain in equity with other outstanding shares. The entity does not record a contra equity charge like it would for a leveraged ESOP. In a nonleveraged ESOP, there is no contra equity account to recognize because the shares are not securing the debt.

FASB Example 2 in section 12.4.20 illustrates the journal entries recorded for a nonleveraged ESOP.

## Question 12.4.20

**How does an entity account for dividends payable to a nonleveraged ESOP?**

**Interpretive response:** The entity charges the dividends payable to retained earnings when they are declared.

One exception is dividends on suspense account shares of a pension reversion ESOP. Dividends on suspense account shares of a pension reversion ESOP are accounted for similarly to shares held by leveraged ESOPs (see section 12.3.30). For more about pension reversion ESOPs, see section 12.5. [718-40-25-20]

## Question 12.4.30

**What is the income tax effect of a nonleveraged ESOP?**

**Interpretive response:** An entity with a nonleveraged ESOP may accrue compensation cost for financial reporting purposes earlier than the cost is deductible for income tax purposes. For a contribution not exceeding the applicable limitations, the timing of the deduction is governed by IRC section 404(a) – including the deeming rule under section 404(a)(6), which may allow a deduction to be taken for the preceding taxable year. [718-40-30-6, IRC §404(a)(6)]

Accruing the compensation cost earlier for financial reporting purposes creates a temporary difference, which is accounted for based on Topic 740 (income taxes). [718-740-25-7]

For additional guidance, see chapter 8 of KPMG Handbook, Accounting for income taxes.

## Question 12.4.40

**When can an entity terminate a nonleveraged ESOP?**

**Interpretive response:** The IRC makes it difficult, and generally uneconomical, to terminate a nonleveraged ESOP. It requires a valid business reason to terminate an ESOP – e.g. a significant shrinkage in the workforce or bankruptcy.

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The IRC requires that ESOP participants become fully vested in their account balances when the ESOP is terminated. This may result in a windfall to an employee with shares not yet vested. [IRC §411(d)(3)]

An entity should consult with its legal and financial advisors for all of the legal and tax considerations when terminating a nonleveraged ESOP.

## 12.4.20 FASB example

### Excerpt from ASC 718-40

**55 Implementation Guidance and Illustrations**

**Nonleveraged Employee Stock Ownership Plans**

**> Illustrations**

**>> Example 1: A Common Stock Nonleveraged Employee Stock Ownership Plan**

**55-34** This Example illustrates the guidance in paragraphs 718-40-25-2; 718-40 25-18 through 25-21; 718-40-30-5; and 718-40-45-9 for a common stock nonleveraged **employee stock ownership plan**.

**55-35** This Example has the following assumptions:

a. On January 1, Year 1, Entity C established a nonleveraged employee stock ownership plan
b. Entity C contributed 10 percent of pretax profit before employee stock ownership plan related charges to the employee stock ownership plan at the end of each of Years 1 through 5; the employee stock ownership plan bought newly issued employer stock with the contribution.
c. The number of shares, earnings, tax, and other relevant assumptions are the same as those for Example 1, Case A (see paragraph 718-40-55-4).

**55-36** The following chart sets forth Entity C's employee stock ownership plan-related information.

| Year | *Compensation Expense* | *Dividends* | *Number of Employee Stock Ownership Plan Shares Purchased* | *Cumulative Employee Stock Ownership Plan Shares* |
|---|---|---|---|---|
| *1* | *$ 180,000* | *$ -* | *15,652* | *15,652* |
| *2* | *190,000* | *7,830* | *21,111* | *36,763* |
| *3* | *200,000* | *18,280* | *20,000* | *56,763* |
| *4* | *210,000* | *28,380* | *17,500* | *74,263* |
| *5* | *220,000* | *37,130* | *15,278* | *89,541* |

**55-37** The year-end market value is used in this Example to determine the number of employee stock ownership plan shares purchased. [Year 1: $180,000 divided by $11.50 (See the table in the preceding paragraph) equals 15,652]

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**55-38** Entity C would record journal entries for Years 1 and 2 as follows.

| | | |
|---|---|---|
| **Year 1** | | |
| Compensation expense | $ 180,000 | |
| Common stock and/or paid-in capital | | $ 180,000 |
| [To record contribution, sale of shares, and compensation expense] | | |
| Provision for income taxes | 648,000 | |
| Income taxes payable | | 648,000 |
| [To record income taxes at 40 percent for Year 1 on earnings of $1,620,000 ($1,800,000 pre-employee stock ownership plan income less employee stock ownership plan compensation of $180,000)] | | |
| **Year 2** | | |
| Compensation expense | 190,000 | |
| Retained earnings | 7,830 | |
| Common stock and/or paid-in capital | | 190,000 |
| Dividends payable | | 7,830 |
| [To record contribution, sale of shares, declaration of dividends, and compensation expense] | | |
| Dividends payable | 7,830 | |
| Cash | | 7,830 |
| [To record payment of dividends] | | |
| Provision for income taxes | 684,000 | |
| Income taxes payable | | 684,000 |
| [To record income taxes at 40 percent for year 2 on earnings of $1,710,000 {$1,900,000 pre-employee stock ownership plan income less employee stock ownership plan compensation of $190,000)] | | |

## 12.5 General guidance for both leveraged and nonleveraged ESOPs

### Excerpt from ASC 718-40

**20 Glossary**

**Public Entity –** An entity that meets any of the following criteria:

a. Has equity securities that trade in a public market, either on a stock exchange (domestic or foreign) or in an over-the-counter market, including securities quoted only locally or regionally
b. Makes a filing with a regulatory agency in preparation for the sale of any class of equity securities in a public market
c. Is controlled by an entity covered by the preceding criteria. That is, a subsidiary of a public entity is itself a public entity.

An entity that has only debt securities trading in a public market (or that has

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made a filing with a regulatory agency in preparation to trade only debt securities) is not a public entity.

**25 Recognition**

**General**

**25-1** This Subsection provides guidance on recognition issues applicable to both leveraged and nonleveraged **employee stock ownership plans**. It covers the following issues:

a. Stock with a put option or a guaranteed redemption price (treasury stock recognition)
b. Pension reversion employee stock ownership plans (recognition of assets transferred from the pension plan).

**> Stock with a Put Option or a Guaranteed Redemption Price**

**25-2** Regardless of whether an employee stock ownership plan is leveraged or nonleveraged, employers are required to give a put option to participants holding employee stock ownership plan shares that are not readily tradable, which on exercise requires the employer to repurchase the shares at **fair value**. **Public entity** sponsors sometimes offer cash redemption options to participants who are eligible to withdraw traded shares from their accounts, which on exercise requires the employer to repurchase the shares at fair value. Employers shall report the satisfaction of such option exercises as purchases of treasury stock.

**> Pension Reversion Employee Stock Ownership Plans**

**25-3** An employer that terminates a defined benefit pension plan may avoid part of the excise tax on an asset reversion by transferring the assets to an existing or newly created employee stock ownership plan, which could be either leveraged or nonleveraged. The reverted assets may be used either to purchase shares of the employer stock or to retire existing employee stock ownership plan debt.

**25-4** If the assets from the pension plan are used by the employee stock ownership plan to purchase employer shares, the employer shall report the share issuance the same way as other share issuances to an employee stock ownership plan. The issuance of shares or the sale of treasury shares to the employee stock ownership plan shall be recognized when it occurs, and a corresponding charge to unearned employee stock ownership plan shares, a contra-equity account, shall be reported. If the shares are purchased on the market, the employer shall similarly charge unearned employee stock ownership plan shares. (The credit would be to cash.)

**25-5** Because the number of shares the employee stock ownership plan acquires in a pension plan reversion is usually more than the Internal Revenue Service (IRS) permits to be allocated to participant accounts in a single year, some of the shares are held in a suspense account until they are **committed to be released** in future years for allocation to participant accounts. The guidance in this Subtopic, for shares held by leveraged employee stock ownership plans, shall be applied to suspense account shares.

**25-6** If the assets from the pension plan reversion are used to repay the debt of an existing employee stock ownership plan, employee stock ownership plan

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shares are committed to be released from suspense. In such situations, the guidance for leveraged employee stock ownership plans in this Subtopic shall be followed. The employer shall reduce the debt as it is repaid and reduce unearned employee stock ownership plan shares as shares are committed to be released. How the committed-to-be-released shares are used determines what accounts are charged upon release of shares (see paragraphs 718-40-25-11 through 25-15).

## Question 12.5.10

### How is the redemption of ESOP shares by ESOP participants accounted for?

**Background:** ESOP participants may redeem their shares only at times permitted by law, which is typically on termination, hardship or retirement.

The ESOP documents determine how ESOP participants may redeem shares. Two redemption features are:

— fair value cash redemption feature (entity pays cash equal to the fair value of shares being redeemed);

— entity option to issue marketable securities in lieu of cash. If the shares are not readily tradable, entities are required to provide a put option. The ESOP documents may permit the ESOP to be a substitute for the entity as the buyer of the redeemed shares; however, the entity cannot require the ESOP to assume the obligation for the put option.

**Interpretive response:** The redemption options offered in the plan document will vary depending on whether the shares are readily tradable. If the participant-held entity shares in an ESOP represent shares that are readily tradable on an established market, an entity may offer cash redemption options to ESOP participants who are eligible to withdraw the traded shares from their accounts. Those cash redemption options are a convenience to ESOP participants, by saving them the brokerage commissions involved in the sale of what may be small holdings. [718-40-25-2]

Entity redemptions of ESOP shares from ESOP participants are purchases of treasury stock, even if there is a put option on the shares or a cash redemption option available to ESOP participants. The entity does not adjust the previously recognized compensation cost as the value of allocated shares changes. Question 12.6.10 discusses the classification of the shares when a put option is included in the securities held by ESOP participants.

## Question 12.5.20

### How are cash contribution commitments accounted for?

**Interpretive response:** A cash contribution commitment does not trigger compensation recognition.

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Cash contributions may be made to leveraged and nonleveraged ESOPs to either fund the related debt or to purchase additional shares, respectively. These contributions do not affect compensation cost. Only the commitment to release or contribute shares in an ESOP based on participant service rendered during the accounting period will result in the recognition of compensation cost (see Question 12.3.60).

Therefore, a cash contribution commitment made – e.g. an entity decision in December to make a cash contribution in the following year – does not trigger the recognition of compensation cost. [718-40-25-13]

## Question 12.5.30

**Is an ESOP consolidated by the entity?**

**Interpretive response:** An ESOP does not need to be consolidated because both leveraged and nonleveraged ESOPs qualify for scope exceptions.

An employee benefit plan subject to the provisions of Topic 715 (retirement benefits) is specifically excluded from the scope of Topic 810 (consolidation). [810-10-15-12a]

The AICPA Audit and Accounting Guide, Employee Benefit Plans, identifies a stock bonus plan as one of three general types of defined contribution plans. While not subject to the provisions of Topic 715, an ESOP, including a leveraged ESOP, is a stock bonus plan.

The AICPA Guide also identifies an ESOP, including a leveraged ESOP, as a unique form of defined contribution plan. Because ESOPs are a defined contribution plan – even though subject to the accounting and reporting provisions of Subtopic 718-40 rather than Topic 715 – the employee benefit plan scope exception in Topic 810 also applies.

## Question 12.5.40

**When does derivative accounting apply to a mandatory put feature?**

**Interpretive response:** An entity evaluates the mandatory put feature in a share issued by an ESOP to determine whether it is an embedded derivative that must be separated from the equity host (i.e. the ESOP share) and accounted for as a derivative.

By definition the put feature in a share issued by an ESOP is not freestanding because it is embedded with the ESOP share. However, the put feature is evaluated as if it were freestanding. The entity separately accounts for the embedded derivative feature if, among other things, the feature would meet the definition of a derivative if it was freestanding.

The three criteria that define a derivative are as follows.

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| | |
|---|---|
| **Underlying + notional amount or payment provision** | The financial instrument or other contract has both:<br>— one or more underlyings; and<br>— one or more notional amounts *or* payment provisions (or both). |
| **Initial net investment** | The financial instrument or other contract requires no, or a small, investment at inception of the contract – i.e. the initial net investment is zero, or smaller than would be required for other types of contracts expected to have similar responses to changes in market factors. |
| **Net settlement** | The net settlement characteristic is met if the financial instrument or other contract:<br>— requires or permits net settlement;<br>— can be readily settled net by a means outside of the contract; or<br>— provides for delivery of an asset that puts the recipient in a position not substantially different from net settlement. |

The underlying of the put feature is the share price and the notional is the amount of shares. The put is generally a feature of the contract requiring no initial net investment. And the mandatory put feature meets the net settlement criteria because it requires delivering cash for the securities underlying the put arrangement. [815-10-15-83]

For a nonpublic entity, the net settlement criterion under Topic 815 is generally not met because the ESOP shares are not readily convertible to cash. The put feature on those shares is not considered a derivative if it is freestanding for the same reason. [815-10-15-83]

For a public entity, the ESOP shares underlying the put feature may be readily convertible to cash and therefore may meet the net settlement criterion under Topic 815. However, the put feature is not considered a derivative (if freestanding) if the scope exception is met – i.e. the put is indexed to the entity's own stock and is classified in stockholder's equity. [815-10-15-74, 15-83]

The specific facts related to each ESOP put arrangement must be evaluated to determine how the provisions of Topic 815 apply to the arrangement. See the guidance in chapter 3 of KPMG Handbook, Derivatives and hedging, for the criteria to evaluate.

## Question 12.5.50

### How are nonvested allocated shares accounted for in the case of a participant's forfeiture?

**Interpretive response:** If individual ESOP participants forfeit nonvested allocated shares, entities generally reallocate them to other ESOP participants. The reallocation of forfeited shares does not result in a cost in the period the shares are reallocated, even when there is an increase or decrease in the fair value of the shares between the date the shares:

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— were originally contributed or committed to be contributed (in the case of a non-leveraged ESOP); or
— committed to be released (in the case of a leveraged ESOP) and the date they are reallocated.

The entity's obligation to the employees can be funded from these reallocated shares. [718-40-25-21]

## Example 12.5.10
### Reallocation of forfeited shares

ABC Corp. sponsors a nonleveraged ESOP to allow employees to participate in the profits of the entity. ABC contributes 10% of pretax profit (before ESOP-related charges) to the ESOP and the ESOP purchases newly issued employer stock.

ABC has three employees that participate equally in the plan. Each employee is vested in their shares after 5 years of service. ABC does not issue dividends on its stock.

The profit, compensation expense and number of ESOP shares purchased and allocated are as follows.

| Year | Pretax profit before ESOP-related charges | Compensation expense | Number of ESOP shares purchased and allocated |
|---|---|---|---|
| 1 | $ 645,000 | $ 64,500 | 6,000 |
| 2 | 738,000 | 73,800 | 7,200 |
| 3 | 760,000 | 76,000 | 8,000 |

The market values of a share of common stock are as follows.

| Year | Beginning of Year | Year-end | Average |
|---|---|---|---|
| 1 | $ 10.00 | $ 11.50 | $ 10.75 |
| 2 | 11.50 | 9.00 | 10.25 |
| 3 | 9.00 | 10.00 | 9.50 |

The number of ESOP shares allocated to each participant are as follows. Employee 2 leaves at the end of Year 2 and has not yet vested.

| Year | Employee 1 | Employee 2 | Employee 3 |
|---|---|---|---|
| 1 | 2,000 | 2,000 | 2,000 |
| 2 | 2,400 | 2,400 | 2,400 |
| 3 | 4,000 | n/a | 4,000 |

The 4,400 shares that were previously allocated to Employee 2 are forfeited and the entity is able to reallocate those shares to other ESOP participants. The forfeited shares were issued based on an average share price of $10.75 in Year

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1 and $10.25 in Year 2. The forfeited shares are worth $9.00 at the time of forfeiture at the end of Year 2.

ABC can use the 4,400 forfeited shares to fund the commitment of 8,000 shares in Year 3. The compensation expense recognized in Year 3 is $76,000 even though the forfeited shares being reallocated resulted in the entity's obligation being reduced.

# 12.6 Presentation and disclosure

## 12.6.10 Presentation

### Question 12.6.10

**How is an ESOP reported in the statement of cash flows?**

**Interpretive response:** In the case of a direct or indirect loan, an entity's payments on the recorded outside loan are reported within financing activities. An entity's payment of interest should be reported within operating activities. This is discussed in section 12.2.40 of KPMG Handbook, Statement of cash flows.

In the case of an employer loan, the cash flows between the entity and the ESOP are not reported in the statement of cash flows.

## 12.6.20 Disclosure

### Excerpt from ASC 718-40

**50 Disclosure**

**General**

**50-1** An employer sponsoring an **employee stock ownership plan** shall disclose all of the following information about the plan, if applicable:

a. A description of the plan, the basis for determining contributions, including the employee groups covered, and the nature and effect of significant matters affecting comparability of information for all periods presented. For leveraged employee stock ownership plans and pension reversion employee stock ownership plans, the description shall include the basis for releasing shares and how dividends on allocated and unallocated shares are used.
b. A description of the accounting policies followed for employee stock ownership plan transactions, including the method of measuring compensation, the classification of dividends on employee stock

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ownership plan shares, and the treatment of employee stock ownership plan shares for earnings per share (EPS) computations. If the employer has both old employee stock ownership plan shares for which it does not adopt the guidance in this Subtopic and new employee stock ownership plan shares for which the guidance in this Subtopic is required, the accounting policies for both blocks of shares shall be described.

c. The amount of compensation cost recognized during the period.
d. The number of allocated shares, committed-to-be-released shares, and suspense shares held by the employee stock ownership plan at the balance-sheet date. This disclosure shall be made separately for shares accounted for under this Subtopic and for grandfathered employee stock ownership plan shares.
e. The fair value of unearned employee stock ownership plan shares at the balance-sheet date for shares accounted for under this Subtopic. (Future tax deductions will be allowed only for the employee stock ownership plan's cost of unearned employee stock ownership plan shares.) This disclosure need not be made for old employee stock ownership plan shares for which the employer does not apply the guidance in this Subtopic.
f. The existence and nature of any repurchase obligation, including disclosure of the fair value (see paragraph 718-40-30-4) of the shares allocated as of the balance sheet date, which are subject to a repurchase obligation.
g. The amount and treatment in the EPS computation of the tax benefit related to dividends paid to any employee stock ownership plan, if material.

## Question 12.6.20
**How is an ESOP discussed in MD&A?**

**Interpretive response:** MD&A includes information relevant to assessing an entity's financial condition and operating results as determined by evaluating the amounts and certainty of cash flows from operations and other sources. The disclosures focus on material events and uncertainties that cause reported financial information not to be indicative of future financial results or financial conditions. [S-K Item 303(b), SEC Rel. 33-8350, 34-48960, FR-72.III.B.2]

Therefore, a registrant may have to discuss the potential effects of any material events and uncertainties concerning an ESOP in MD&A. Examples would include significant changes to the ESOP, unwinding of the ESOP or other material events.

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# Index of changes

This index lists the significant additions and changes made in this edition to assist you in locating recently added or updated content. New Questions and Examples added in this edition are identified throughout the Handbook with ** and items that have been significantly updated or revised are identified with #. Items that have been moved from another chapter without significant change are identified with ●.



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