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Audit and Enterprise Risk Services

Financial Reporting Considerations Related to Pension and Other Postretirement Benefits

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This publication, which updates Financial Reporting Alert 13-3, highlights accounting considerations related to the calculations and disclosures entities provide under U.S. GAAP in connection with their defined benefit pension and other postretirement benefit plans. This update includes a discussion of the new mortality tables and mortality improvement scale issued by the Society of Actuaries (SOA) Retirement Plans Experience Committee (RPEC) in October 2014.

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Underlying Assumptions

In measuring each plan's defined benefit obligation and recording the net periodic benefit cost, financial statement preparers should understand, evaluate, and reach conclusions about the reasonableness of the underlying assumptions, particularly those that could be affected by continuing financial market volatility. ASC 715-30-35-42[1] states that "each significant assumption used shall reflect the best estimate solely with respect to that individual assumption."

Entities should comprehensively assess the relevancy and reasonableness of each significant assumption on an ongoing basis (e.g., by considering the impact of significant developments that have occurred in the entity's business). Management should establish processes and internal controls to ensure that the entity appropriately selects each of the assumptions used in accounting for its defined benefit plans. The internal controls should be designed to ensure that the amounts reported in the financial statements properly reflect the underlying assumptions (e.g., discount rate, estimated long-term rate of return, mortality, turnover, health care costs) and that the documentation maintained in the entity's accounting records sufficiently demonstrates management's understanding of and reasons for using certain assumptions and methods (e.g., the method for determining the discount rate). Management should also document the key assumptions used and the reasons why certain assumptions may have changed from the prior reporting period. A leading practice is for management to prepare a memo supporting (1) the basis for each important assumption used and (2) how management determined which assumptions were important.

Mortality Assumption

Many entities rely on their actuarial firms for advice or recommendations concerning demographic assumptions, such as the mortality assumption. In many instances, actuaries recommend published tables that reflect broad-based studies of mortality. As stated above, under U.S. GAAP, each assumption should represent the "best estimate" for that assumption as of the current measurement date. The mortality tables used and adjustments made (e.g., for longevity improvements) should be appropriate for the employee base covered under the plan.

On October 27, 2014, the RPEC released a **report** on recent mortality experience of participants in private-sector single-employer pension plans, including a new set of mortality tables (RP-2014) and a new companion mortality improvement scale (MP-2014). The data underlying RP-2014 are based on a study of mortality experience in the period from 2004 through 2008, while the RP-2000 tables are based on data from 1990 through 1994, and Scale MP-2014 is based on more recent observed experience than the SOA's mortality projection Scales AA, BB, and BB-2D. The mortality improvement scale developed by the RPEC represents future expectations based on trend analysis from the data observed. In its report accompanying the new tables, the RPEC describes the process it undertook and how it considered the observed data when establishing the new mortality tables and improvement scale. These analyses show that longevity has improved more than expected by Scale AA derived from the prior mortality experience study.

Historically, many entities have used the RP-2000 tables and improvement Scale AA when selecting their mortality assumption. In selecting the year-end mortality assumption, entities should (1) carefully evaluate the RPEC's report, (2) obtain an understanding of the new RP-2014 mortality tables and MP-2014 improvement scale, and (3) consider the relevance of the data underlying such tables and improvement scale to the specific population covered by their defined benefit plans. In some circumstances, entities may also be able to consider other available information, such as plan-specific mortality experience, industry-specific mortality experience, or other relevant mortality experience. Entities should consider their rationale for changing the approach used in the prior year to select the mortality assumption (e.g., no longer using SOA-published tables or changing the extent to which longevity improvements are incorporated).

Editor's Note: Entities should robustly document their considerations (including any recommendations by their actuaries) in selecting this year's mortality assumptions for their defined benefit plans, including how they considered the SOA's reports on the new tables and longevity improvement scale. As discussed in **Underlying Assumptions** above, entities need to have processes and internal controls in place to ensure proper assessment of all relevant factors, including potentially contradictory data, when selecting the mortality assumption. Given the nature of the mortality assumption, we expect that many entities do not have such expertise internally. Therefore, it is important for entities to engage their actuarial firms early on when evaluating (1) the RP-2014 tables and longevity scale and (2) the effect of this new information on the mortality assumption for their benefit plans.

Because of the improved life expectancies indicated by the observed data underlying the RP-2014 tables, an entity's benefit obligation is likely to increase in the absence of changes in other plan assumptions. Further, a change in the mortality assumption could have a significant effect on the entity's results of operations, particularly if the entity's accounting policy is to recognize remeasurement gains and losses in net income immediately. Public entities should consider the requirement in ASC 715-20-50-1(r) to disclose an "explanation of any significant change in the benefit obligation or plan assets not otherwise apparent in the other disclosures required by [ASC 715-20]." In addition to footnote disclosures, SEC registrants should consider the need to highlight in MD&A the effects of a mortality assumption change. If other matters affecting an entity's defined benefit plans (e.g., changes in other assumptions, events such as curtailments or settlements) also result in changes to the retirement benefit obligation or net periodic benefit costs, an entity should consider separately disclosing the effects of each individually significant change.

The IRS's next update to its mandated mortality tables may well reflect the observed data underlying the RP-2014 tables, but that change is not expected until 2016 or 2017. Since the IRS is required by statute to update the required mortality assumption only once every 10 years, the fact that the IRS is not adopting the RP-2014 tables immediately should not affect an entity's determination of its best estimate for the mortality assumption for the current fiscal year. However, the IRS's future update of its mortality tables could lead to an increase in minimum funding requirements. As a result, an entity may need to (1) evaluate the effect of pension funding requirements on its liquidity, (2) consider adjusting its investment strategy accordingly, and (3) consider the need for discussion in MD&A of any expected changes in funding requirements.

Discount Rate

Discount Rate Selection Method

ASC 715-30-35-44 requires that the discount rate reflect rates at which the defined benefit obligation could be effectively settled. In estimating those rates, it would be appropriate for an entity to use information about rates implicit in current prices of annuity contracts that could be used to settle the obligation. Alternatively, employers may look to rates of return on high-quality fixed-income investments that are currently available and expected to be available during the benefits' period to maturity.

One acceptable method of deriving the discount rate would be to use a model that reflects rates of zero-coupon, high-quality corporate bonds with maturity dates and amounts that match the timing and amount of the expected future benefit payments. Since there are a limited number of zero-coupon corporate bonds in the market, models are constructed with coupon-paying bonds whose yields are adjusted to approximate results that would have been obtained through the use of the zero-coupon bonds. Constructing a hypothetical portfolio of high-quality instruments with maturities that mirror the benefit obligation is one method that can be used to achieve this objective. Other methods that can be expected to produce results that are not materially different would also be acceptable — for example, use of a yield curve constructed by a third party such as an actuarial firm. The use of indices may also be acceptable.

Entities should focus on the requirement to use the best estimate when determining their discount rate selection method. ASC 715-30-55-26 through 55-28 state that an entity may change its method of selecting discount rates provided that the method results in "the best estimate of the effective settlement rates" as of the current measurement date. This change would be viewed as a change in estimate, and the effect would be included in actuarial gains and losses and accounted for in accordance with ASC 715-30-35-18 through 35-21. When an entity's method of selecting a discount rate results in higher rates than those being used by similar entities or in rates that remain consistent from year to year despite a fluctuating market, questions may be raised about whether the method is producing a reasonable result.

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

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

Hypothetical Bond Portfolios — Bond Pricing

Entities that use hypothetical bond portfolios (HBPs) to support the discount rate used to measure their postretirement benefit obligations should evaluate the impact of current market conditions on both bond pricing and bond selection. Credit market uncertainty may affect the level of trading activity for some bonds, resulting in large spreads between the bid and ask prices. Pricing should reflect the amount at which the postretirement benefit obligation could be settled. In the current market, bid price (which is often used because of the availability of data) may not necessarily represent the cost of acquiring a hypothetical portfolio. In evaluating the appropriateness of bond pricing used to develop their models, entities may find it helpful to consider the guidance in ASC 820-10-35-36C and 35-36D, which state, in part:

> If an asset or a liability measured at fair value has a bid price and an ask price (for example, an input from a dealer market), the price within the bid-ask spread that is most representative of fair value in the circumstances shall be used to measure fair value regardless of where the input is categorized within the fair value hierarchy (that is, Level 1, 2, or 3). . . . This Topic does not preclude the use of mid-market pricing or other pricing conventions that are used by market participants as a practical expedient for fair value measurements within a bid-ask spread.

Hypothetical Bond Portfolios — Bond Selection

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

Outliers may include bonds that have high yields because:

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

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

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

Hypothetical Bond Portfolios — Use of Collateralized Bonds

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

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

As previously mentioned, an entity may elect to use a yield curve that was constructed by a third party to support its discount rate. Many yield curves constructed by third parties are supported by a white paper or other documentation that discusses how the yield curves are constructed. Management should understand how the yield curve it has used to develop its discount rate was constructed as well as the universe of bonds included in the analysis. If applicable, management should also evaluate and reach conclusions about the reasonableness of the approach the third party used to adjust the bond universe that was used to develop the yield curve.

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

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

Use of Indices in Selecting a Discount Rate

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

Editor’s Note: For eurozone and U.K. plans, discount rates may be selected from several available indices. Sources of these indices include Bloomberg, Reuters, and Markit.

Markit, which manages and administers the Markit iBoxx bond indices, states on its Web site that “Markit iBoxx [bond] indices are rebalanced monthly on the last business day of the month . . . . Changes in ratings are only taken into account if they are publicly known two business days before the end of the month.” For example, under this method, bonds that have been downgraded in late November and that are no longer considered high-quality by iBoxx may be included in the construction of the November 30 indices (i.e., the indices may include bonds that are considered “outliers”). In addition, we have noted that a Markit iBoxx index may, on occasion, include a callable bond that could distort the index depending on the maturity assumed.

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

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

ASC 715-60-20 defines “health care cost trend rate” as an “assumption about the annual rates of change in the cost of health care benefits currently provided by the postretirement benefit plan . . . . The health care cost trend rates implicitly consider estimates of health care inflation, changes in health care utilization or delivery patterns, technological advances, and changes in the health status of the plan participants.” The health care cost trend rate is used to project the change in the cost of health care over the period for which the plan provides benefits to its participants. Many plans use trend rate assumptions that include (1) a rate for the year after the measurement date that reflects the recent trend of health care cost increases, (2) gradually decreasing trend rates for each of the next several years, and (3) an ultimate trend rate that is used for all remaining years.

Historically, the ultimate health care cost trend rate has been less than the discount rate. While discount rates have started to recover from their record lows in previous years, the discount rate for some plans has fallen below the ultimate health care cost trend rate. Some concerns have been raised regarding this phenomenon, since expectations of long-term inflation rates are assumed to be implicit in both the health care cost trend rate and the discount rate. In such situations, entities should consider all the facts and circumstances of their plan(s) to determine whether the assumptions used (e.g., ultimate health care cost trend rate of 5 percent and discount rate of 4 percent) are reasonable. Entities should also remember that (1) the discount rate reflects spot rates observable in the market as of the plan's measurement date, since it represents the rates at which the defined benefit obligation could be effectively settled on that date (given the rates implicit in current prices of annuity contracts or the rates of return on high-quality fixed-income investments that are currently available and expected to be available during the benefits' period to maturity), and (2) the health care cost trend rate is used to project the change in health care costs over the long term.

Expected Long-Term Rate of Return

The expected long-term rate of return on plan assets[2] is a component of an entity's net periodic benefit cost and should represent the average rate of earnings expected over the long term on the funds invested to provide future benefits (existing plan assets and contributions expected during the current year). The long-term rate of return is set as of the beginning of an entity's fiscal year (e.g., January 1, 2014, for a calendar-year-end entity). If the target allocation has changed from the prior year, an entity should consider whether adjusting its assumption about the long-term rate of return is warranted.

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

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

Net Periodic Benefit Cost

Entities should consider the effect of the gain or loss amortization component of net periodic benefit cost. Many entities record the minimum amortization amount (the excess outside the "corridor").[3] The amortization is based on accumulated gain or loss as of the beginning of the year. Accordingly, the change in discount rates and favorable asset returns in equity markets in 2014 will not affect net periodic benefit cost until the following year.

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

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

As with all defined benefit retirement plans, plan sponsors' use of computational shortcuts and estimates is appropriate "provided the results are reasonably expected not to be materially different from the results of a detailed application."[4] Entities that use the mark-to-market approach should be vigilant when using shortcuts and approximations, since all changes in the measurement of the benefit obligation and plan assets immediately affect net periodic benefit cost.

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

Editor's Note: When entities adopt a policy to immediately recognize actuarial gains and losses as a component of net periodic pension cost, they may have presented non-GAAP financial measures that "remove the actual gain or loss from the performance measure and include an expected long-term rate of return."[5] The SEC noted that, in the absence of sufficient quantitative context about the nature of the adjustment, such measures may confuse investors. The staff suggested that registrants clearly label such adjustments and avoid the use of confusing or unclear terms in their disclosures.

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

Measurement Date for Plan Assets and Benefit Obligations

Measurement of Plan Assets

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

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

On October 14, 2014, as part of its **simplification initiative**,[6] the FASB issued a **proposed ASU**[7] to amend the measurement-date guidance in ASC 715. The proposed ASU contains a practical expedient that would allow an employer whose fiscal year-end does not fall on a calendar month-end (e.g., an entity that has a 52- or 53-week fiscal year), to measure retirement benefit obligations and related plan assets as of the month-end that is closest to the employer's fiscal year-end. The expedient would need to be elected as an accounting policy and be consistently applied. Because third-party plan asset custodians often provide information about fair value and classes of assets only as of the month-end, such an accounting policy would relieve the employer from adjusting the asset information to the appropriate fair values as of its fiscal year-end. The proposed ASU would be applied prospectively. However, the FASB has not decided on the effective date or whether early adoption would be permitted. Comments on the proposed ASU are due by December 15, 2014.

Measurement of Benefit Obligations

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

Curtailments

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

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

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

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

Settlements

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

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

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

Plan Sponsor Disclosures

Fair Value Measurement Disclosures

Because a sponsor's fair value measurement disclosures related to defined benefit plan assets are outside the scope of ASC 820, the FASB separately addressed a sponsor's fair value disclosures that are specific to its retirement plans. In accordance with ASC 715-20-50-1(d)(iv) for public entities or ASC 715-20-50-5(c)(iv) for nonpublic entities, the sponsor must disclose information about the fair value measurements of plan assets separately for each annual period for each class of plan assets.

Implementation issues have arisen about these disclosures, primarily about the Level 3 reconciliation disclosure. The FASB's rationale for requiring this disclosure is identical to its rationale for requiring the Level 3 reconciliation under ASC 820, except that gains and losses reported in earnings during the period must be presented separately from those recognized in other comprehensive income. We understand that the FASB will accept presentation alternatives as long as the rollforward disclosure meets the objective under ASC 715-20-50-1(d)(4) (ASC 715-20-50-5(c)(4) for nonpublic entities) of showing the "effect of fair value measurements using significant unobservable inputs (Level 3) on changes in plan assets **for the period**" (emphasis added).

Entities With Foreign Plans

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

Recent SEC Views

Recently, the SEC staff has addressed topics related to pension and other postretirement benefits because of factors such as the low-interest-rate environment, optionality in U.S. GAAP accounting methods, and significant assumptions used in the measurement of the benefit obligation. The staff has noted that it particularly focuses on the discount rate and the expected return on plan assets. In addition, the staff has indicated that it may be appropriate for a registrant to disclose the following:

- Whether a corridor is used to amortize the actuarial gains and losses; and, if so, how the corridor is determined and the period for amortization of the actuarial gains and losses in excess of the corridor.
- A sensitivity analysis estimating the effect of a change in assumption regarding the long-term rate of return. This estimate should be based on a reasonable range of likely outcomes.
- The extent to which historical performance was used to develop the expected long-term rate of return assumption. If use of the arithmetic mean to calculate the historical returns yields results that are materially different from the results yielded when the geometric mean is used to calculate such returns, it may be appropriate for an entity to disclose both calculations.
- The reasons why the assumption regarding the long-term rate of return has changed or is expected to change in the future.

For more information, see Deloitte's ***SEC Comment Letters — Including Industry Insights: A Recap of Recent Trends***.

Health Care Reform

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

Entities need to continue to consider the impact on postretirement benefits of the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010 (collectively, the "Act"). The passage of the Act has resulted in comprehensive health care reform since its March 2010 enactment, with this reform continuing over the next several years. The Act, among other things, eliminated the annual and lifetime benefit caps on essential health benefits and imposed an excise tax on high-cost employer health plans. An entity should account for the Act's effects, such as the excise tax on high-cost plans, on the basis of the provisions of its current substantive benefit plans even if it is considering amending its plans before the related provision of the Act becomes effective.

Employee Group Waiver Plans

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

Employers either can continue to apply for federal RDS payments that are received by the employer directly or they can sponsor a Medicare Part D plan through an employee group waiver plan (EGWP)[8] to take advantage of the enhancements under the Act (via cost savings passed along from the health care plan administrator). An

EGWP is designed to provide benefits that are actuarially equivalent to Medicare Part D and must be run by the health care plan administrator.

It is generally expected that retiree plan participants will receive essentially the same prescription drug benefits under an EGWP as they would under an RDS approach. However, the cost of providing the benefit will generally be less. Depending on the specific plan design for cost sharing between the employer and the retiree, the cost savings may be realized by either party or both parties. If the benefits provided by the plan to the participants do not change as a result of the change from the RDS to an EGWP, only the assumption regarding plan costs has changed and the employer will record an actuarial gain. However, if a change from an RDS to an EGWP involves a "substantive" change to the plan benefits, that part of the change should be accounted for as a plan amendment due to a change in benefits provided to participants by the plan. For example, if the cost savings of the EGWP are shared between the plan sponsor and the retirees, a change to the benefits the plan provides would generally result and the employer should recognize a plan amendment under ASC 715-60-35. Furthermore, the timing of accounting for the plan amendment may need to be considered, depending on (1) whether the employer has the unilateral ability to make the change, (2) how changes to the substantive plan are communicated to participants and the detail and timing of this communication, and (3) the significance of the changes. Entities need to consider the potential effects of any such plan amendments that are made concurrently with their open-enrollment period for 2015, which will typically take place in late 2014, and recognize the accounting effects of any significant changes in the period of the change (e.g., the fourth quarter of 2014).

Private Health Care Exchanges

Some entities have either stopped or are planning to stop providing retiree health care benefits through an employer-sponsored health care plan. Instead, they will provide those retirees with annual vouchers or contributions, often via a health retirement account, that the retiree can use to purchase insurance from private health care exchanges. These private health care exchanges offer a range of plans that provide coverage similarly to how the plans offered through the public exchanges set up under the Act provide coverage. If the retiree chooses a plan that costs more than the employer's annual contribution to the retiree, he or she will have to pay the extra costs. Employers will make contributions during the retiree's lifetime such that the entity retains mortality risk. When an entity ceases providing retiree health care benefits through an employer-sponsored plan and starts making annual contributions to the retiree or via a health retirement account, it has not settled the defined benefit obligation because the entity is still exposed to mortality risk. However, the entity's defined benefit obligation has shifted to a plan that provides fixed annual contributions. This change should be accounted for as a plan amendment in accordance with ASC 715-60-35. Depending on the terms of the original entity-administered health plan, this type of amendment may either increase benefits (a positive plan amendment) or reduce benefits (a negative plan amendment).

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

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

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

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

5 For more information, see the **highlights** of the June 27, 2012, CAQ SEC Regulations Committee joint meeting with the SEC staff.

6 Launched in June 2014, the FASB's simplification initiative is intended to reduce the cost and complexity of current U.S. GAAP while maintaining or enhancing the usefulness of the related financial statement information. The initiative focuses on narrow-scope projects that involve limited changes to guidance.

7 FASB Proposed Accounting Standards Update, *Practical Expedient for the Measurement Date of an Employer's Defined Benefit Obligation and Plan Assets*.

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