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Heads Up

In This Issue

Package Deal

FASB Proposes Guidance on Presentation of Net Periodic Benefit Cost and Disclosures Related to Defined Benefit Plans

by John Franco, Emily Hache, Karen Wiltsie, and Curt Weller, Deloitte & Touche LLP

Introduction

On January 26, 2016, the FASB issued two proposed ASUs[1] that would amend the requirements in ASC 715[2] related to (1) the income statement presentation of the components of net periodic benefit cost for the defined benefit pension and other postretirement plans an entity sponsors and (2) disclosures about those defined benefit plans.

The income statement presentation project is part of the Board's simplification initiative.[3] Under the proposed guidance, entities would present current service cost with other current employee compensation costs and present the remaining components of net benefit cost elsewhere in the income statement.

The proposed changes related to disclosures are part of the FASB's disclosure framework project, which the Board launched in 2014 to improve the effectiveness of disclosures in notes to financial statements. Under the proposed guidance, an entity would consider materiality in determining the extent of its defined benefit plan footnote disclosures. The proposal also contains a number of disclosure requirements that would be added to or deleted from U.S. GAAP.

Comments on both proposed ASUs are due by April 25, 2016.

This *Heads Up* summarizes the key provisions of the proposed ASUs. The appendix to the *Heads Up* contains the proposals' questions for respondents, which have been reproduced for ease of reference.

[1] FASB Proposed Accounting Standards Updates, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost* and *Changes to the Disclosure Requirements for Defined Benefit Plans*.

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

[3] The Board's simplification initiative focuses on projects that are narrow in scope and involve limited changes to guidance that can be made quickly. Launched in June 2014, the 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.

Key Provisions of the Proposed ASUs

Improving the Presentation of Net Periodic Benefit Cost

Under U.S. GAAP, net benefit cost (i.e., defined benefit pension cost and postretirement benefit cost) comprises several components that reflect different aspects of an employer's financial arrangements as well as the cost of benefits earned by employees. These components are aggregated for reporting purposes in the financial statements. Currently, there is no specific guidance on where in the income statement an entity should present net benefit cost. In addition, many stakeholders are critical of net presentation because it combines elements that are different in nature and that users would evaluate differently in analyzing an entity's current and future financial performance. Accordingly, the FASB seeks to improve the usefulness of the presentation of net benefit cost in the income statement.

The proposed ASU would require an entity to (1) disaggregate the current service cost component from the other components of net benefit cost and present it with other current compensation costs for the related employees in the income statement and (2) present the remaining components of net benefit cost elsewhere in the income statement and outside of income from operations, if such a subtotal is presented.

In addition, the proposal would limit the portion of net benefit cost eligible for capitalization (e.g., as part of inventory or property, plant, and equipment) to the service cost component.

> **Editor's Note:** The Board decided not to require further disaggregation of the other components of net benefit cost as part of the proposed amendments. However, an entity can decide to further disaggregate the presentation of such components if the entity believes that such information would be useful to financial statement users as long as the entity adequately describes in the financial statements the nature of those disaggregated components.

The proposed ASU would require retrospective application for the change in the presentation of the service cost component and the other components of net benefit cost in the income statement. However, the proposal's requirement to capitalize only the current service cost component in assets would be applied prospectively. An entity would disclose the nature of and reason for the change in accounting principle in the first interim and annual reporting periods in which it adopts the ASU.

Defined Benefit Plan Disclosure Requirements

The proposed ASU on an employer's defined benefit plan disclosures contains an overall objective for the disclosures and guidance on how an entity would consider materiality in determining the extent of its defined benefit plan disclosures.

> **Editor's Note:** In September 2015, the FASB issued a proposed ASU[4] that would amend ASC 235 to clarify that in the notes to the financial statements, preparers may consider materiality in evaluating the need to include particular disclosures. The proposal would also remove language in existing requirements that potentially makes it difficult for preparers to exclude immaterial disclosures. The Board considered the proposed amendments to ASC 235 in deciding to propose changes to the disclosure requirements for an entity's defined benefit pension and other postretirement plans. The comment period for the proposed amendments to ASC 235 ended in December 2015, and the Board plans to review feedback on the proposal and commence redeliberations in the coming months.

[4] FASB Proposed Accounting Standards Update, *Notes to Financial Statements (Topic 235): Assessing Whether Disclosures Are Material*.

The proposed ASU would add to or remove from ASC 715 a number of disclosure requirements related to an entity's defined benefit pension and other postretirement plans.

Editor's Note: In March 2014, the FASB issued a proposed concepts statement[5] as part of its disclosure framework project. Before finalizing that guidance, the Board is testing the proposed concepts by applying them to a number of projects on improving the effectiveness of required disclosures, including defined benefit pension and other postretirement benefits. The Board applied the proposed concepts statement's guidelines in making tentative decisions on the guidance in the proposed ASU.

Specifically, the proposal would add requirements for an entity to disclose:

- The nature of the benefits provided, the covered employee groups, and a description of the type of plan formula.
- The weighted-average interest crediting rate used in an entity's cash balance pension plans and other similar plans.
- The quantitative and qualitative disclosures required under ASC 820-10-50-6A for plan assets that an entity measures by using the net asset value (NAV) practical expedient. For each class of investment measured at NAV, those disclosures would include:
    - The fair value measurement of the investments and a description of the investee's investment strategies.
    - For investments that cannot be directly redeemed with the investee, an estimate of the period over which the investee's underlying assets are expected to be liquidated and result in distributions to investors.
    - The amount of unfunded commitments.
    - A general description of the terms and conditions upon which investors may redeem their investments.
    - The circumstances in which an otherwise redeemable investment may be unredeemable, and certain disclosures about any investments that are currently not redeemable.
    - Significant restrictions on the ability to sell the investments.
    - Certain disclosures related to intended sales of investments.
- A narrative description of the reasons for significant gains and losses resulting from remeasurement of the benefit obligation and plan assets.

The proposed guidance would also eliminate an entity's requirement to disclose:

- The amount of the accumulated benefit obligation.
- For pension plans with accumulated benefit obligations in excess of plan assets, the aggregate pension accumulated benefit obligation and aggregate fair value of plan assets. (However, for pension plans with projected benefit obligations in excess of plan assets, entities would still need to disclose the aggregate projected benefit obligation and aggregate fair value of plan assets.)
- Information about plan assets to be returned to the entity, including expected timing.
- Disclosures about transactions resulting from the June 2001 amendments to the Japanese Welfare Pension Insurance Law.
- Disclosures about (1) benefits covered by related-party insurance and annuity contracts and (2) significant transactions between the plan and related parties. (Entities would only need to provide the related-party disclosures required under ASC 850.)

[5] FASB Proposed Concepts Statement, *Conceptual Framework for Financial Reporting, Chapter 8: Notes to Financial Statements*.

- The amounts in accumulated other comprehensive income expected to be recognized as part of net periodic benefit cost over the next year.
- For nonpublic entities with Level 3 plan assets in the fair value hierarchy measured on a recurring basis, a reconciliation of the opening balances to the closing balances. (However, those entities would still need to disclose transfers of plan assets into and out of Level 3 and any purchases of Level 3 assets by the plan.)

Under the proposed guidance, entities would be required to disaggregate disclosures between foreign and domestic defined benefit pension and other postretirement plans. Currently, this disaggregation is required only when the foreign plans are ”significant relative to the total benefit obligation” and use ”significantly different assumptions.”

In addition, nonpublic entities would need to disclose the effects of a one-percentage-point change on the assumed health care costs and the effect of this change in rates on service cost, interest cost, and the benefit obligation for postretirement health care benefits. Public entities are already required to disclose this information.

Editor’s Note: The Board believes that additional costs incurred by entities as a result of implementing the proposed new disclosure requirements would be offset by cost reductions associated with the elimination of other disclosure requirements as well as the omission of immaterial disclosures.

The amendments would be applied retrospectively to all periods presented, except for those related to disclosures about plan assets that entities measure by using the net asset value practical expedient. Such changes would be applied beginning with the initial period of adoption.

Effective Date and Transition

After the Board considers feedback received on the proposed ASUs, it will determine effective dates for the final guidance as well as whether to permit early adoption.

Appendix — Questions for Respondents

The proposed ASUs' questions for respondents are reproduced below for ease of reference.

Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost

Question 1: Should the service cost component be reported in the income statement apart from the other components of net benefit cost as defined in paragraphs 715-30-35-4 and 715-60-35-9 and be the only component eligible to be capitalized in assets? Why or why not?

Question 2: Would it be useful to require presentation of the prior service cost or credit component separately from the other components? Should all of the components of net benefit cost other than the service cost component (for example, the prior service cost or credit component) be presented outside a subtotal of income from operations, if one is presented? Why or why not?

Question 3: Would it be useful to require presentation of the net amount of the interest cost component and expected return on plan assets separately from the other components of net benefit cost to improve convergence with International Financial Reporting Standards (IFRS) or for other purposes? Why or why not?

Question 4: Would the proposed amendments improve the usefulness of financial information provided to users? Why or why not?

Question 5: Should the proposed amendments be different for rate-regulated entities? Why or why not?

Question 6: Would the proposed amendments be operable without incurring significant incremental costs by entities (such as not-for-profit entities, entities that enter into cost-plus contracts or government contracts including but not limited to contracts under Cost Accounting Standards Board regulations, and entities that allocate cost from cost pools)? Why or why not?

Question 7: How much time would be necessary to adopt the proposed amendments? Should early adoption be permitted? Would the amount of time needed to apply the proposed amendments by entities other than public business entities be different from the amount of time needed by public business entities? Why or why not?

Question 8: Should the proposed amendments be applied retrospectively for the presentation of the service cost component and other components of net benefit cost in the income statement and prospectively, on and after the effective date, for the capitalization of the service cost component of net benefit cost in assets when applicable?

Question 9: Should the disclosures of the nature of and reason for the change in accounting principle be required in the first interim and annual reporting periods of adoption? Why or why not?

Changes to the Disclosure Requirements for Defined Benefit Plans

Question 1: Would the proposed amendments result in more effective, decision-useful information about defined benefit pension and other postretirement plans? If not, please explain why. Would the proposed amendments result in the elimination of decision-useful information about defined benefit pension and other postretirement plans? If yes, please explain why.

Question 2: Are the proposed disclosure requirements operable and auditable? If not, which aspects pose operability or auditability issues and why?

Question 3: Would any of the proposed disclosures impose significant incremental costs? If so, please describe the nature and extent of the additional costs.

Question 4: Are there any other disclosures that should be required by Subtopic 715-20 on the basis of the proposed Concepts Statement or for other reasons? Please explain why.

Question 5: Are there any other disclosure requirements retained following the review of Subtopic 715-20 that should be removed on the basis of the proposed Concepts Statement or for other reasons? Please explain why.

To see how the Board applied the decision questions from the proposed Concepts Statement to Subtopic 715-20, see *Decision Questions Considered in Establishing Disclosure Requirements* on this project's summary page on the FASB's website.

Question 6: How much time would be needed to implement the proposed amendments? Should the amount of time needed to implement the proposed amendments by nonpublic entities be different from the amount of time needed by public entities? Should early adoption be permitted? If yes to either question, please explain why.

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