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FASB Amends Guidance on Presentation of Net Periodic Benefit Cost Related to Defined Benefit Plans

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Introduction

On March 10, 2017, the FASB issued ASU 2017-07,[1] which amends the requirements in ASC 715[2] related to the income statement presentation of the components of net periodic benefit cost for an entity's sponsored defined benefit pension and other postretirement plans.

Background

Under current U.S. GAAP, net benefit cost (i.e., defined benefit pension cost and postretirement benefit cost) consists of 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 and reported net in the financial statements. However, many stakeholders have criticized such net presentation because it does not permit financial statement users to evaluate different types of components separately when they assess an entity's current and future financial performance. In addition, there is currently no specific guidance on where in the income statement an entity should present net benefit cost.

[1] FASB Accounting Standards Update No. 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*.

[2] FASB Accounting Standards Codification Topic 715, *Compensation — Retirement Benefits*.

Key Provisions of the ASU

ASU 2017-07 requires entities to (1) disaggregate the current-service-cost component from the other components of net benefit cost (the "other components") and present it with other current compensation costs for related employees in the income statement and (2) present the other components elsewhere in the income statement and outside of income from operations if such a subtotal is presented.

The ASU also requires entities to disclose the income statement lines that contain the other components if they are not presented on appropriately described separate lines.

Editor's Note

While the ASU does not require entities to further disaggregate the other components, they may do so if they believe that the information would be helpful to financial statement users. However, entities must disclose which financial statement lines contain the disaggregated components.

In addition, only the service-cost component of net benefit cost is eligible for capitalization (e.g., as part of inventory or property, plant, and equipment). This is a change from current practice, under which entities capitalize the aggregate net benefit cost when applicable.

Editor's Note

One FASB board member dissented from the decision to issue the ASU, noting his belief that the ASU focuses on mandating specific classifications for reporting operating and nonoperating financial performance rather than on truly improving the transparency of retirement benefit costs. He indicated that to avoid having to reconsider its conclusions, the FASB should have deferred the ASU's amendments until it completes its broader research project on performance reporting. He also observed that the new guidance will result in inconsistencies or contradictions with other requirements currently in U.S. GAAP.

Another board member dissented because he believes that the amendments' benefits do not outweigh the costs for rate-regulated entities. Such entities would be likely to incur significant costs for system changes as a result of the ASU's requirement that entities are permitted to capitalize only the service-cost component as part of self-constructed assets and would capitalize the other components of net benefit cost as a regulatory asset because they are allowable costs.

Effective Date, Early Adoption, and Transition

The ASU's amendments are effective for public business entities for interim and annual periods beginning after December 15, 2017. For other entities, the amendments are effective for annual periods beginning after December 15, 2018, and interim periods in the subsequent annual period.

Early adoption is permitted as of the beginning of any annual period for which an entity's financial statements (interim or annual) have not been issued or made available for issuance (i.e., an entity should early adopt the amendments within the first interim period if it issues interim financial statements).

Entities must use (1) a retrospective transition method to adopt the requirement for separate presentation in the income statement of service costs and other components and (2) a prospective transition method to adopt the requirement to limit the capitalization (e.g., as part of inventory) of benefit costs to the service cost component. Further, entities must disclose the nature of and reason for the change in accounting principle in both the first interim and annual reporting periods in which they adopt the amendments.

The ASU also establishes a practical expedient upon transition that permits entities to use their previously disclosed service cost and other costs from the prior years' pension and other postretirement benefit plan footnotes in the comparative periods as appropriate estimates when retrospectively changing the presentation of these costs in the income statement. Entities that apply the practical expedient need to disclose that they did so.

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