

Statement of Financial Accounting Standards No. 112

[FAS112 Status Page](#)
[FAS112 Summary](#)

Employers' Accounting for Postemployment Benefits

(an amendment of FASB Statement No. 5 and 43)

November 1992



Financial Accounting Standards Board
of the Financial Accounting Foundation
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CONTENTS

	Paragraph Numbers
Introduction	1-3
Standards of Financial Accounting and Reporting:	
Scope 4-5	
Accounting for Postemployment Benefits.....	6
Disclosures	7
Amendments to Existing Pronouncements	8-11
Effective Date and Transition.....	12
Appendix: Background Information and Basis for Conclusions.....	13-25

FAS 112: Employers' Accounting for Postemployment Benefits an amendment of FASB Statements No. 5 and 43

FAS 112 Summary

This Statement establishes accounting standards for employers who provide benefits to former or inactive employees after employment but before retirement (referred to in this Statement as *postemployment benefits*). Postemployment benefits are all types of benefits provided to former or inactive employees, their beneficiaries, and covered dependents. Those benefits include, but are not limited to, salary continuation, supplemental unemployment benefits, severance benefits, disability-related benefits (including workers' compensation), job training and counseling, and continuation of benefits such as health care benefits and life insurance coverage.

This Statement requires employers to recognize the obligation to provide postemployment benefits in accordance with FASB Statement No. 43, *Accounting for Compensated Absences*, if the obligation is attributable to employees' services already rendered, employees' rights to those benefits accumulate or vest, payment of the benefits is probable, and the amount of the benefits can be reasonably estimated. If those four conditions are not met, the employer should account for postemployment benefits when it is probable that a liability has been incurred and the amount can be reasonably estimated in accordance with FASB Statement No. 5, *Accounting for Contingencies*. If an obligation for postemployment benefits is not accrued in accordance with Statements 5 or 43 only because the amount cannot be reasonably estimated, the financial statements shall disclose that fact.

This Statement is effective for fiscal years beginning after December 15, 1993.

INTRODUCTION

1. This Statement establishes standards of financial accounting and reporting for the estimated cost of benefits provided by an employer to former or inactive employees after employment but before retirement (referred to in this Statement as *postemployment benefits*). Postemployment benefits are all types of benefits provided to former or inactive employees, their beneficiaries,

and covered dependents. Inactive employees are those 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. Postemployment benefits include, but are not limited to, salary continuation, supplemental unemployment benefits, severance benefits, disability-related benefits (including workers' compensation), job training and counseling, and continuation of benefits such as health care benefits and life insurance coverage.

2. Prior to this Statement, employers' accounting for the cost of postemployment benefits varied. Some employers accrued the estimated cost of those benefits over the related service periods of active employees. Other employers applied a terminal accrual approach and recognized the estimated cost of those benefits at the date of the event giving rise to the payment of the benefits (for example, the death of an active employee, the temporary or permanent disability of an active employee, or the layoff of an employee). Still other employers recognized the cost of postemployment benefits when they were paid (cash basis). Some employers may have used different methods of accounting for different types of benefits.

3. The Board concluded that postemployment benefits are part of the compensation provided to an employee in exchange for service. FASB Statement No. 43, *Accounting for Compensated Absences*, addresses amounts paid to active employees while on a compensated absence, such as for vacation, occasional sick days, and holidays. Other long-term fringe benefits and postemployment benefits, however, are specifically excluded from the scope of that Statement. In addition, all employment-related costs are excluded from the scope of FASB Statement No. 5, *Accounting for Contingencies*. This Statement affirms the Board's view that generally accepted accounting principles require recognition of the cost of postemployment benefits on an accrual basis and amends Statements 5 and 43 to include the accounting for postemployment benefits. Therefore, Statement 43 will (a) continue to specify the accounting for amounts paid to active employees while on a compensated absence, such as for vacation, occasional sick days, and holidays, (b) continue to not address other long-term fringe benefits provided to active employees, and (c) specify the accounting for postemployment benefits provided to former or inactive employees prior to retirement that meet the conditions in paragraph 6, Statement 5 will specify the accounting for postemployment benefits that are not addressed by Statement 43 or by other FASB Statements or APB Opinions.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Scope

4. This Statement applies to all types of postemployment benefits provided to former or inactive employees, their beneficiaries, and covered dependents after employment but before

retirement, except as noted in the following paragraph. 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.

5. This Statement does not apply to:
 - a. Postemployment benefits provided through a pension or postretirement benefit plan (FASB Statements No. 87, *Employers' Accounting for Pensions*, No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*, and No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, specify the accounting for those costs.)
 - b. Individual deferred compensation arrangements that are addressed by APB Opinion No. 12, *Omnibus Opinion—1967*, as amended by Statement 106
 - c. Special or contractual termination benefits covered by Statements 88 and 106
 - d. Stock compensation plans that are addressed by APB Opinion No. 25, *Accounting for Stock Issued to Employees*.

Accounting for Postemployment Benefits

6. Postemployment benefits that meet the conditions in paragraph 6 of Statement 43 shall be accounted for in accordance with that Statement. Paragraph 6 of Statement 43 states:

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,
- c. Payment of the compensation is probable, and
- d. The amount can be reasonably estimated. [Footnote references omitted.]

Postemployment benefits that are within the scope of this Statement and that do not meet those conditions shall be accounted for in accordance with Statement 5. Paragraph 8 of Statement 5 states:

An estimated loss from a loss contingency (as defined in paragraph 1) shall be accrued by a charge to income if *both* of the following conditions are met:

- a. Information available prior to issuance of the financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements. It is implicit in this condition

- that it must 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. [Footnote references omitted.]

Disclosures

7. If an obligation for postemployment benefits is not accrued in accordance with Statements 5 or 43 only because the amount cannot be reasonably estimated, the financial statements shall disclose that fact.

Amendments to Existing Pronouncements

8. The following sentences are added to the end of paragraph 1 of Statement 43:

This Statement also applies to all forms of postemployment benefits, as defined in FASB Statement No. 112, *Employers' Accounting for Postemployment Benefits*, that meet the conditions in paragraph 6 of this Statement, except as noted in the following paragraph. Postemployment benefits that do not meet the conditions in paragraph 6 of this Statement shall be accounted for in accordance with FASB Statement No. 5, *Accounting for Contingencies*, as amended by Statement 112. This Statement does not address the accounting for benefits paid to active employees other than compensated absences.

9. The following paragraph replaces paragraph 2 of Statement 43:

This Statement does not apply to:

- a. Postemployment benefits provided through a pension or postretirement benefit plan (FASB Statements No. 87, *Employers' Accounting for Pensions*, No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*, and No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, specify the accounting for those costs.)
- b. Individual deferred compensation arrangements that are addressed by APB Opinion No. 12, *Omnibus Opinion—1967*, as amended by Statement 106
- c. Special or contractual termination benefits covered by Statements 88 and 106
- d. Stock compensation plans that are addressed by APB Opinion No. 25, *Accounting for Stock Issued to Employees*.

This Statement does not address the allocation of costs of compensated absences to interim periods. The cost of postemployment benefits as determined under this Statement that is directly related to the disposal of a segment of a business or a portion

of a line of business shall be recognized pursuant to the requirements of APB Opinion No. 30, Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions, and included in determining the gain or loss associated with that event.

10. The last two sentences of paragraph 7 of Statement 5 are deleted and replaced by the following sentence:

Accounting for other employment-related costs is also excluded from the scope of this Statement except for postemployment benefits that become subject to this Statement through application of FASB Statement No. 112, *Employers' Accounting for Postemployment Benefits*.

11. In paragraph 8(a) of FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*, the words *postemployment benefits*, are inserted after *other postretirement benefits including health care and life insurance benefits*, and No. 112, *Employers' Accounting for Postemployment Benefits*, is inserted after No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, to exclude an employer's obligation for postemployment benefits from the requirements for disclosures about fair value.

Effective Date and Transition

12. This Statement shall be effective for fiscal years beginning after December 15, 1993. Earlier application is encouraged. The effect of initially applying this Statement shall be reported as the effect of a change in accounting principle in a manner similar to the cumulative effect of a change in accounting principle (APB Opinion No. 20, *Accounting Changes*, paragraph 20). Pro forma effects of retroactive application (Opinion 20, paragraph 21) are not required. Previously issued financial statements shall not be restated.

**The provisions of this Statement
need not be applied to immaterial items.**

This Statement was adopted by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Dennis R. Beresford, *Chairman*
Joseph V. Anania
Victor H. Brown
James J. Leisenring
Robert H. Northcutt
A. Clarence Sampson
Robert J. Swieringa

Appendix

BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

CONTENTS

	Paragraph Numbers
Introduction	13–14
Background	15
Applicability of Other Pronouncements.....	16–23
Disclosures	24
Effective Date and Transition.....	25

Appendix: BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

Introduction

13. This appendix summarizes considerations that were deemed significant by Board members in reaching the conclusions in this Statement. It discusses reasons for accepting certain views and rejecting others. Individual Board members gave greater weight to some factors than to others.

14. The Board issued the Exposure Draft, *Employers' Accounting for Postemployment Benefits*, for public comment on May 12, 1992. Fifty-nine comment letters were received and most respondents agreed with the Board that the cost of postemployment benefits should be accounted for on an accrual basis. The Board concluded that it could reach an informed decision on the basis of existing information without a public hearing.

Background

15. The project on employers' accounting for pensions and other postemployment benefits was initially added to the Board's agenda in 1979. In 1984, the Board concluded that it should address employers' accounting for postemployment benefits other than pensions as a separate project. In 1987, the Board deferred consideration of issues relating to benefits provided after employment but before retirement to focus its resources on postretirement benefits other than pensions. The Board excluded postemployment benefits from the scope of Statement 106:

The accounting for benefits paid after employment but before retirement (for example, layoff benefits) is a separate phase of the Board's project on accounting for postemployment benefits other than pensions. The fact that this Statement does not apply to those benefits should not be construed as discouraging the use of accrual accounting for those benefits. [footnote 2]

Consequently, accounting for postemployment benefits other than retirement benefits is the final phase of the Board's project on employers' accounting for pensions and other postemployment benefits.

Applicability of Other Pronouncements

16. Certain postemployment benefits are covered by existing Statements or Opinions. Accounting for deferred compensation contracts is covered by Opinion 12 (as amended by Statement 106). Accounting for contractual and special termination benefits is covered by

Statements 88 and 106. Accounting for the disposal of a segment of a business is covered by Opinion 30. Accounting for benefits paid after retirement is covered by Statements 87, 88, and 106. This Statement does not change the accounting for those benefits.

17. The Board considered whether guidance is needed in addressing employers' accounting for postemployment benefits. In the Board's view, Statements 5 and 43 specify appropriate accounting for postemployment benefits. However, postemployment benefits were specifically excluded from the scope of those Statements because at the time those Statements were issued the Board had a project on its agenda to address the accounting for pensions and other postemployment benefits. Since that time, the Board issued Statements that address postretirement benefits but none that address the accounting for postemployment benefits. The Board, therefore, concluded that it is appropriate to amend Statements 5 and 43 to include the accounting for postemployment benefits.

18. Several respondents to the Exposure Draft commented that it would be inappropriate to account for postemployment benefits by applying the criteria in Statement 43. They stated that postemployment benefits generally do not vest and if postemployment benefits do not vest, an employer does not have an obligation to provide benefits until a future event occurs. The Board considered whether an employer's liability to provide nonvesting postemployment benefits arises only when a future event, such as termination or disability, occurs. If the rights to nonvesting postemployment benefits accumulate over the service period, then the event that creates a liability and affects the amount of benefits is the rendering of service by employees. If the payment of those benefits is probable and can be reasonably estimated, then the cost of those benefits should be recognized as they are earned by the employees. The Board concluded that if postemployment benefits meet the conditions in paragraph 6 of Statement 43, then the estimated cost of those benefits should be recognized in accordance with that Statement.

19. Some respondents noted that Statement 43 does not require employers to accrue a liability for nonvesting accumulating rights to receive sick pay benefits and questioned whether that exception would apply to nonvesting accumulating rights to receive postemployment benefits. In developing Statement 43, the Board concluded that probable payments for accumulating sick pay benefits would rarely be material unless they vest or are paid without an illness-related absence. The Board also noted that the lower degree of reliability associated with estimates of future sick pay and the cost of making and evaluating those estimates did not justify a requirement for an accrual.

20. Unlike nonvesting sick pay, nonvesting postemployment benefits may be material for certain employers, especially in certain industries, depending on many factors including, but not limited to, the duration of benefit payments and the incidence of events giving rise to the payment of benefits. In addition, the fact that there are employers currently accruing the estimated cost of those benefits, some over applicable employee service periods and others using a terminal accrual approach, suggests that sufficient information is available to many employers on which to develop a reliable estimate without significant cost. Accordingly, the Board

concluded that the exception in Statement 43 should not be extended to postemployment benefits.

21. If postemployment benefits do not meet the conditions in paragraph 6 of Statement 43, then employers should recognize the estimated cost of those benefits in accordance with Statement 5. Statement 5 requires recognition of a loss contingency when it is probable that an asset has been impaired or a liability has been incurred and the amount of the loss can be reasonably estimated. Paragraph 59 of Statement 5 further clarifies the recognition of loss contingencies:

. . . even losses that are reasonably estimable should 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 enterprise's financial statements because those losses relate to a future period rather than the current or a prior period.

22. 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 Statement 5.

23. Several respondents requested that this Statement provide guidance on how to measure an employer's postemployment benefit obligation. FASB Statements 87 and 106 discuss measurement issues extensively. To the extent that similar issues apply to postemployment benefit plans, employers may refer to those Statements for guidance in measuring their obligations in compliance with the requirements of this Statement. Respondents also asked the Board to provide explicit guidance on the applicability and use of discounting. Statements 5 and 43 do not provide explicit guidance and readdressing those Statements is beyond the intended scope of this project. In addition, discounting is being addressed in the Board's existing project on present-value-based measurements. Accordingly, the Board decided not to provide explicit guidance on discounting in this Statement. As a result, the Board understands that the use of discounting in measuring postemployment benefit obligations will continue to be permitted but not required.

Disclosures

24. Statements 5 and 43 require disclosure if it is probable that an obligation has been incurred but it cannot be reasonably estimated. Statement 5 requires additional disclosures in other situations including when it is reasonably possible that a liability has been incurred. The Board decided not to apply the additional Statement 5 disclosures to postemployment benefit obligations because it believes that the additional cost of compliance is not warranted. Thus, this Statement requires disclosure only if an obligation for postemployment benefits is not accrued in

accordance with Statements 5 or 43 solely because the amount cannot be reasonably estimated.

Effective Date and Transition

25. The effect of initially applying this Statement is to be reported as the effect of a change in accounting principle. Some respondents recommended that an option be provided to recognize that effect over future periods. The Board considered whether a provision for delayed recognition of the transition amount was needed. A major objective of transition is to minimize implementation costs and mitigate disruption without unduly compromising the ability of financial statements to provide useful information. An important factor considered by the Board was the potential magnitude of the unrecorded postemployment benefit obligation. Information made available to the Board indicated that postemployment benefits are generally not as significant as pension or other postretirement benefits. The Board concluded that a provision for delayed recognition was not needed to mitigate the financial statement impact of immediately recognizing the transition amount when this Statement is adopted. That provision would have added unnecessary complexity to the application of this Statement, reduced financial statement comparability, and been inconsistent with Statements 5 and 43, which do not provide for delayed recognition at transition.