Statement of Financial Accounting Standards No. 88

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Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits

December 1985

Financial Accounting Standards Board
of the Financial Accounting Foundation
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Statement of Financial Accounting Standards No. 88

Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits

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FAS 88: Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits

FAS 88 Summary

This Statement establishes standards for an employer's accounting for settlement of defined benefit pension obligations, for curtailment of a defined benefit pension plan, and for termination benefits. This Statement is closely related to FASB Statement No. 87, *Employers' Accounting for Pensions*, and should be considered in that context.

Statement 87 continues the past practice of delaying the recognition in net periodic pension cost of (a) gains and losses from experience different from that assumed, (b) the effects of changes in assumptions, and (c) the cost of retroactive plan amendments. However, this Statement requires immediate recognition of certain previously unrecognized amounts when certain transactions or events occur. It prescribes the method for determining the amount to be recognized in earnings when a pension obligation is settled or a plan is curtailed. Settlement is defined as an irrevocable action that relieves the employer (or the plan) of primary responsibility for an obligation and eliminates significant risks related to the obligation and the assets used to effect the settlement. A curtailment is defined as a significant reduction in, or an elimination of, defined benefit accruals for present employees' future services.

This Statement incorporates, with certain modifications, existing standards on employers' accounting for termination benefits paid to employees, and supersedes FASB Statement No. 74, *Accounting for Special Termination Benefits Paid to Employees*.

Prior to this Statement, an employer that entered into an asset reversion transaction involving the termination of one plan and establishment of a successor defined benefit plan was precluded from immediately recognizing any resulting gain in earnings. This Statement specifies how that employer should determine the gain to be recognized in earnings at the time of initial application of Statement 87.

INTRODUCTION

1. This Statement addresses an employer's accounting for a settlement or a curtailment of its defined benefit pension plan and for termination benefits. The conclusions reached in this

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Statement have been adopted within the general framework for accounting for pensions as set forth in FASB Statement No. 87, *Employers' Accounting for Pensions*.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Scope

2. This Statement applies to an employer that sponsors a defined benefit pension plan accounted for under the provisions of Statement 87 if all or part of the plan's pension benefit obligation is settled or the plan is curtailed. It also applies to an employer that offers benefits to employees in connection with their termination of employment.

Definitions

Settlement

3. For purposes of this Statement, a *settlement* is defined as a transaction that (a) is an irrevocable action, (b) relieves the employer (or the plan) of primary responsibility for a pension benefit obligation, and (c) eliminates significant risks related to the obligation and the assets used to effect the settlement. Examples of transactions that constitute a settlement include (a) making lump-sum cash payments to plan participants in exchange for their rights to receive specified pension benefits and (b) purchasing nonparticipating annuity contracts to cover vested benefits.

4. A transaction that does not meet all of the above three criteria does not constitute a settlement for purposes of this Statement. 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.

Annuity Contract

5. An *annuity contract* is a contract in which an insurance company [1] unconditionally undertakes a legal obligation to provide specified benefits to specific individuals in return for a fixed consideration or premium. An annuity contract is irrevocable and involves the transfer of significant risk from the employer to the insurance company. Some annuity contracts (participating annuity contracts) provide that the purchaser (either the plan or the employer) may

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participate in the experience of the insurance company. Under those contracts, the insurance company ordinarily pays dividends to the purchaser. 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 company, the purchase of the contract does not constitute a settlement.

Curtailment

6. For purposes of this Statement, a *curtailment* is 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. Curtailments include:

a. Termination of employees' services earlier than expected, which may or may not involve closing a facility or discontinuing a segment of a business
b. 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.

Relationship of Settlements and Curtailments to Other Events

7. A settlement and a curtailment may occur separately or together. 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. 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. 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).

8. Paragraphs 9-15 of this Statement describe the accounting for a settlement, a plan curtailment, and for termination benefits that are not directly related to a disposal of a segment of a business. Paragraph 16 addresses the accounting if those events are directly related to a disposal of a segment of a business.

Accounting for Settlement of the Pension Obligation

9. For purposes of this Statement, the maximum gain or loss subject to recognition in earnings when a pension obligation is settled is the unrecognized net gain or loss defined in paragraph 29 of Statement 87 [2] plus any remaining unrecognized net asset existing at the date of initial application of Statement 87 (as discussed in paragraph 21 of this Statement). That maximum

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amount includes any gain or loss first measured at the time of settlement. The maximum 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.

10. If the purchase of a participating annuity 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 earnings.

11. If the cost of all settlements [3] 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 recognition is permitted but not required for those settlements. However, the accounting policy adopted shall be applied consistently from year to year.

Accounting for a Plan Curtailment

12. The unrecognized prior service cost 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 plan amendment and were expected to receive benefits under the plan, then the loss associated with the curtailment is half of the remaining unrecognized prior service cost related to that plan amendment. For purposes of applying the provisions of this paragraph, unrecognized prior service cost includes the cost of retroactive plan amendments (refer to paragraphs 24-25 of Statement 87) and any remaining unrecognized net obligation existing at the date of initial application of Statement 87 (as discussed in paragraph 21 of this Statement).

13. The projected benefit obligation may be decreased (a gain) or increased (a loss) by a curtailment.[4]

a. To the extent that such a gain exceeds any unrecognized net loss (or the entire gain, if an unrecognized net gain exists), it is a *curtailment gain*
b. To the extent that such a loss exceeds any unrecognized net gain (or the entire loss, if an unrecognized net loss exists), it is a *curtailment loss*.

For purposes of applying the provisions of this paragraph, any remaining unrecognized net asset existing at the date of initial application of Statement 87 (as discussed in paragraph 21 of this Statement) shall be treated as an unrecognized net gain and shall be combined with the unrecognized net gain or loss arising subsequent to transition to Statement 87.

14. If the sum of the effects identified in paragraphs 12 and 13 is a net loss, it shall be recognized in earnings when it is probable that a curtailment will occur and the effects described are reasonably estimable. If the sum of those effects is a net gain, it shall be recognized in

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earnings when the related employees terminate or the plan suspension or amendment is adopted.

Termination Benefits

15. 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, occurs. 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 employees will be entitled to benefits and the amount can be reasonably estimated. 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. 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 payments. A situation involving termination benefits may also involve a curtailment to be accounted for under paragraphs 12-14.

Disposal of a Segment

16. If the gain or loss measured in accordance with paragraphs 9, 10, 12, 13, or 15 is directly related to a disposal of a segment of a business, it shall be included in determining the gain or loss associated with that event and 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*.

Disclosure and Presentation

17. An employer that recognizes a gain or loss under the provisions of this Statement, whether directly related to the disposal of a segment of a business or otherwise, shall disclose the following:

a. A description of the nature of the event(s)
b. The amount of gain or loss recognized.

Supersession of FASB Statement 74

18. This Statement supersedes FASB Statement No. 74, *Accounting for Special Termination Benefits Paid to Employees*.

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Effective Date and Transition

19. This Statement shall be effective for events occurring in fiscal years beginning with the fiscal year in which Statement 87 is first applied. Restatement of previously issued annual financial statements is not permitted. If a decision is made initially to apply this Statement in other than the first interim period of an employer's fiscal year, previous interim periods of that year shall be restated.

20. Certain employers have settled significant portions of their pension obligations as part of transactions in which plan assets in excess of obligations reverted to the employer (asset reversion transactions). Consistent with prior standards, an employer that previously entered into an asset reversion transaction and continued to provide defined benefits recognized a credit on its statement of financial position for the amount withdrawn instead of recognizing a gain at the time of the withdrawal. Net periodic pension costs of subsequent periods were then reduced by amortization of the deferred gain (that is, the amount withdrawn). An employer that entered into such a transaction before the effective date of this Statement shall recognize a gain as the cumulative effect of a change in accounting principle at the time of initial application of Statement 87. The amount of gain recognized shall be the lesser of:

a. The unamortized amount related to the asset reversion
b. Any unrecognized net asset for the plan (or the successor plan) existing at the time of transition as defined in paragraph 77 of Statement 87.[5]

21. At the time of initial application of Statement 87, an employer may have an unrecognized net obligation or unrecognized net asset. For purposes of this Statement:

a. The portion of such an unrecognized net obligation remaining unamortized at the date of a subsequent curtailment shall be treated as unrecognized prior service cost before applying the provisions of paragraph 12.
b. The portion of such an unrecognized net asset remaining unamortized at the date of a subsequent settlement or curtailment shall be treated as an unrecognized net gain and shall be combined with the unrecognized net gain or loss arising subsequent to transition to Statement 87 before applying the provisions of paragraphs 9 and 13.

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

This Statement was adopted by the affirmative votes of five members of the Financial Accounting Standards Board. Messrs. Mosso and Wyatt dissented.

Mr. Mosso dissents because the provisions of paragraph 14 of this Statement do not conform to the clear guidance of paragraphs 91-97 of FASB Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information*. By recognizing curtailment losses and deferring curtailment gains, the Statement perpetuates the rule of conservatism in its most extreme form, that is, "anticipate no profits but anticipate all losses." Concepts Statement 2 unequivocally rejected that form of conservatism: "Conservatism in financial reporting should no longer connote deliberate, consistent understatement of net assets and profits." The clear thrust of Concepts Statement 2 was clouded by the guidance of FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*, but it was not amended. The conceptual framework was designed to raise the quality of accounting standard setting. It cannot achieve that goal if it is ignored without good and ample cause. Mr. Mosso finds no such cause in this case. Paragraph 41 of this Statement cites FASB Statement No. 5, *Accounting for Contingencies*, and Opinion 30 as precedents to be followed. Both standards predated Concepts Statement 2. Paradoxically, therefore, a concepts Statement, the primary purpose of which is to provide guidance to the Board in setting standards, is nullified because it conflicts with preexisting standards.

Mr. Wyatt does not support the issuance of this Statement because he believes that its conclusions are inconsistent with the basic thrust of the policy of delayed recognition of gains and losses adopted in Statement 87. He believes that useful information is not provided by following delayed recognition in some circumstances and not following it in others. Settlements with employees in the absence of a plan curtailment are, in his view, in substance investment or funding transactions that may be as usual in the context of a pension plan as are the events that give rise to the gains and losses and prior service cost for which delayed recognition is provided in Statement 87. In those circumstances the plan continues and employees continue to earn benefits, and many times those benefits are identical to (or enhanced from) those earned prior to the settlement. If, as the Board concluded in Statement 87, it is appropriate to delay recognition of gains and losses and prior service cost related to a defined benefit plan, then delayed recognition should not be discontinued while the plan is, in substance, continued.

Mr. Wyatt also disagrees with the conclusion that the purchase of participating annuity contracts should be deemed to be a settlement that creates gain or loss recognition. Participating annuity contracts are a type of investment of pension assets—an alternative to an investment in equity securities, long-term bonds, real estate, and so forth. Decisions to change investment vehicles, for example, from equity securities to bonds, are not a sufficient basis to recognize gains and losses under the delayed recognition philosophy adopted in Statement 87. He believes that the change in investment vehicle to participating annuity contracts likewise should not be viewed as sufficient to warrant gain or loss recognition.

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Mr. Wyatt believes the conclusions in this Statement create the very volatility in earnings that the delayed recognition philosophy of Statement 87 was intended to mitigate, and that delayed recognition of gains and losses should be continued until both a settlement and a plan curtailment occurs.

Members of the Financial Accounting Standards Board:

Donald J. Kirk, *Chairman*
Frank E. Block
Victor H. Brown
Raymond C. Lauver
David Mosso
Robert T. Sprouse
Arthur R. Wyatt

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Appendix A

BASIS FOR CONCLUSIONS

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Appendix A: BASIS FOR CONCLUSIONS

Introduction

22. In February 1985, the Board decided that issuing a separate Statement on an employer's accounting for a settlement of a pension obligation, a curtailment of a defined benefit pension plan, or termination benefits would provide a greater opportunity for both the Board and the public to identify and fully consider those issues than would including them in the scope of Statement 87. An Exposure Draft of a proposed Statement, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*, was issued on June 14, 1985. The Board received 110 letters of comment in response to the Exposure Draft. This appendix discusses the significant comments contained in those letters of comment and heard from commentators at the July and August 1985 public hearing on the Exposure Draft. This appendix also discusses the factors that were deemed significant by members of the Board in reaching the conclusions in this Statement. It includes reasons for accepting certain views and rejecting others. Individual Board members gave greater weight to some factors than to others.

Plan Termination and Delayed Recognition

23. Statement 87 provides for delayed recognition of gains or losses arising in the ordinary operations of a defined benefit pension plan. That Statement also provides for delayed recognition of the cost of retroactive plan amendments (prior service cost). As a consequence of delayed recognition, at any time amounts of net gain or loss and prior service cost ordinarily will remain unrecognized in the employer's financial statements.

24. This Statement defines the events that require certain previously unrecognized amounts to be recognized in earnings and as adjustments to liabilities or assets. It is clear that the previously unrecognized net gain or loss and the previously unrecognized prior service cost should be recognized in the period when all of the following conditions are met:

a. All pension obligations are settled.
b. Defined benefits are no longer accrued under the plan.
c. The plan is not replaced by another defined benefit plan.
d. No plan assets remain.
e. The employees are terminated.
f. The plan ceases to exist as an entity.

25. It is not uncommon for some, but not all, of the above conditions to exist in a particular

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situation. For example, the present obligation for benefits may be settled without terminating the plan, or a plan may be suspended so that no further benefits will accrue for future services but its obligations are not settled. In other situations one or more of the above conditions may apply to only part of a plan. For example, one plan may be divided into two plans, one of which is then terminated, or one-half of the employees in a plan may terminate employment and the obligation for their benefits may be settled. Those situations have raised accounting issues.

26. If recognition of previously unrecognized prior service cost and net gain or loss were required only when a plan is completely terminated and settled and if no recognition occurred when a plan is partially curtailed or an obligation is partially settled, certain anomalies and implementation problems would result. For example, if one employer had two plants with separate plans and another employer had two plants with a single plan, the accounting result of closing one plant and settling the related obligation would be a recognizable event for one employer but not for the other. Also, if recognition were an all-or-nothing proposition, it would be necessary to determine when the extent of settlement or curtailment is sufficient for recognition. If all employees but one from a large group are terminated and obligations to the terminated employees are settled, presumably the accounting should reflect a plan termination. But it is not clear whether that accounting should apply if 5 percent, 10 percent, or 25 percent of the original group was to remain. Accordingly, the Board concluded that a complete plan termination and settlement need not occur in order to recognize previously unrecognized amounts.

Settlement of the Obligation

27. The Board concluded that settlement of all or part of the pension benefit obligation should be the event that requires recognition of all or part of the previously unrecognized net gain or loss. Most of the respondents to the Exposure Draft agreed. The Board noted that one basis for delayed recognition of gains and losses under Statement 87 is the possibility that gains or losses occurring in one period would be offset by losses or gains in subsequent periods. To the extent that the obligation has been settled, the possibility of future gains or losses related to that obligation and to the assets used to effect the settlement is diminished. The Board also noted that settlement of all or a large portion of an obligation could be viewed as realization of past gains or losses associated with that portion of the obligation and the assets used to effect the settlement. That realization would not be affected by the employer's subsequent decision to undertake or not to undertake future defined benefit obligations.

28. The Board acknowledges that other actions an employer can take, especially those related to plan assets, can affect the possibility of a subsequent net gain or loss. For example, an employer may avoid or minimize certain risks by investing in a portfolio of high-quality fixed-income securities with principal and interest payment dates similar to the estimated payment dates of benefits (as with a dedicated bond portfolio). However, settlement differs from other actions in that (a)it is irrevocable, (b) it relieves the employer (or the plan) of primary responsibility for the obligation, and (c) it eliminates significant risks related to the obligation

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(such as the risk that participants will live longer than assumed) and to the assets used to effect the settlement. The decision to have a dedicated bond portfolio can be reversed, it does not relieve the employer of primary responsibility for the obligation, and such a strategy does not eliminate mortality risk. The Board concluded that the circumstances requiring gain or loss recognition should be narrowly defined.

29. The Exposure Draft would have defined settlement as a discharge of the pension obligation by (a) making a lump-sum cash payment to plan participants in exchange for their rights to receive specified pension benefits or (b)purchasing annuity contracts. Several respondents argued that the definition was event specific and therefore too restrictive. They noted that settlements could be accomplished by means other than those identified in the definition, such as by payments in noncash assets or by transfer of employee interests into a defined contribution plan. Those respondents suggested that criteria for a settlement should be set forth to describe characteristics of a settlement. The Board agreed that the Statement should establish criteria (as described in paragraph 28) rather than attempt to identify every transaction that might constitute a settlement.

30. The Board recognized that changes in the previously estimated value of the obligation and the assets may become evident at the time the obligation is settled. (For example, the interest rates inherent in the price actually paid for annuities may be different from the assumed discount rates.) Some respondents suggested that such changes should be recognized immediately in earnings as a gain or loss directly resulting from the settlement. The Board concluded that, based on the measurement principles adopted in Statement 87, such changes reflect factors expected to be considered in the measurement of the pension obligation and plan assets. Accordingly, the Board concluded that those amounts should be included with the previously unrecognized net gain or loss before a pro rata portion of that amount is recognized. Most of the respondents who addressed the issue agreed.

31. This Statement requires measurement of the pro rata portion of the unrecognized net gain or loss based on the decrease in the projected benefit obligation resulting from a settlement. The Board also considered basing that measurement in part on the decrease in plan assets resulting from the event. The Board acknowledges that a decrease in the amount of plan assets can affect the possibility of future gains and losses. The Board concluded that it would be simpler and more practical to base the measurement only on the obligation settled.

32. The Exposure Draft would have proscribed recognition of a previously unrecognized net gain or loss if the cost of settlements was less than or equal to the amount of obligation arising from the service cost and interest cost components of net periodic pension cost during the current year. This occurs, for example, when a plan regularly purchases annuities each year for benefits accumulated in that year. The basis for that proposal was that recognition of a previously unrecognized net gain or loss should not be required if the portion of the obligation settled is insignificant and that an obligation settled in the year in which it was incurred would not ordinarily give rise to significant gains or losses. Several respondents suggested that the benefits

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covered by the settlement may not relate to the obligation arising in the current year as in the case of settlement of pension obligations for employees upon retirement. The Board acknowledges that possibility and concluded that recognition of a previously unrecognized net gain or loss should be permitted, but not required, if the costs of the settlements do not exceed the limit described above. The Board believes that for many small plans, retaining that threshold for required recognition will reduce the cost of complying with this Statement.

Participating Annuity Contracts

33. As described in paragraph 5, a participating annuity contract (participating contract) allows the purchaser to participate in some way in the insurance company's experience subsequent to the purchase of the contract. That is, if the insurance company'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 will reduce the cost of the contract. To that extent, a participating contract has some characteristics of an investment. However, many respondents agreed with the view in the Exposure Draft that the employer is as fully relieved of the obligation by the purchase of a participating contract as it is by the purchase of a nonparticipating contract. Except as indicated in paragraphs 34 and 35, the Board concluded that it would be appropriate to treat a participating contract the same as a nonparticipating contract and to consider purchases of participating contracts as settlements of pension obligations.

34. The Board realized that it is difficult to determine the extent to which a participating contract exposes the purchaser to the risk of unfavorable experience, which would be reflected in lower than expected future dividends. The Board also recognized that 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. The Board also is aware that some participating contracts may require or permit payment of additional premiums if experience is unfavorable. Accordingly, the Board concluded that if a participating 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. If the purchase of a participating contract constitutes a settlement for purposes of this Statement, recognition of a previously unrecognized net gain or loss is required (paragraph 9) except for small settlements (paragraph 32). However, the possibility of a subsequent loss is not completely eliminated with a participating contract because realization of the participation right is not assured. Therefore, in recognition of the continuing risk related to the participation right, this Statement requires reduction of the maximum gain (paragraph 10) subject to pro rata recognition by an amount equal to the cost of the participation right.

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Curtailment of the Plan

36. The Exposure Draft proposed and most respondents agreed that a plan curtailment should be the event that requires recognition of previously unrecognized prior service cost. One basis for delayed recognition of prior service cost is the likelihood of future economic benefits to the employer as a result of the amendment. Those benefits, in the Board's view, are derived from the future services of employees, and the amortization of unrecognized prior service cost is based on those services.

37. A curtailment, as defined in this Statement, is 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. The Board concluded that either of those situations raises sufficient doubt about the continued existence of the future economic benefits to justify recognition of the prior service cost when it is probable that a curtailment will occur, the effects are reasonably estimable, and the net result of the curtailment (as described in paragraph 14) is a loss.

38. The Board also considered whether either a settlement or the termination of one plan and the adoption of a substantially equivalent replacement plan should trigger recognition of prior service cost. The Board concluded that neither of those events, absent a curtailment, raises sufficient doubt as to the existence of future economic benefits to trigger such recognition.

39. A curtailment may directly cause a decrease in the projected benefit obligation (a gain) or an increase in the projected benefit obligation (a loss). For example, an obligation based on employees' projected final compensation levels normally will be reduced if the employees leave earlier than expected (a gain). Also, an obligation based on estimated rates of acceptance of subsidized early retirement benefits [6] normally will be increased by an event that causes eligible employees to leave earlier than previously expected (a loss). Conceptually, the Board believes it would be appropriate to recognize such gains or losses immediately to the extent they represent adjustments of previously recognized net periodic pension cost (that is, to the extent they do not represent the reversal of previous unrecognized losses or gains). However, the obligation eliminated or created by a curtailment may not be independent of previously unrecognized losses or gains. For example, part of that obligation could relate to past changes in actuarial assumptions about projected compensation levels that produced gains or losses not yet fully recognized. To illustrate, if in year one the employer increases the estimated rate of increase in salaries from 6 percent to 8 percent, that creates an additional obligation and an unrecognized loss. If in year two the employer terminates those employees, the obligation related to their projected salaries is eliminated and a gain arises, which is, at least in part, a reversal of the previously unrecognized loss.

40. The Board concluded that a curtailment gain or loss as defined in paragraph 13 (which does not include recognition of prior service cost) should first be offset to the extent possible

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against the plan's previously existing unrecognized net loss or gain. Any remainder of the curtailment gain or loss cannot, at least in an overall sense, be a reversal of unrecognized amounts, and therefore, recognition of that remainder is appropriate.

41. The Exposure Draft would have required recognition of the results of a curtailment (which could be a net gain or net loss when combined with recognition of prior service cost) when it is probable that a curtailment will occur and the effects of the curtailment can be reasonably estimated. Several respondents objected to that provision. Those respondents suggested that recognition of a gain prior to termination of the related employees or adoption of the plan suspension or amendment may be inconsistent with the current literature as adopted in FASB Statement No. 5, *Accounting for Contingencies* (paragraph 17) and Opinion 30 (paragraph 15) which indicate that certain gains should not be reflected in earnings prior to realization.

42. Statement 87 continues the delayed recognition features of past practice so that gains or losses are not recognized as they occur (that is, when they are realized or when they are realizable as defined in paragraph 83 of FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*,) but are recognized systematically and gradually over subsequent periods. The Board acknowledges that delayed recognition in the income statement is not consistent with Concepts Statement 5 and that recognition of only a minimum liability in the balance sheet is not necessarily consistent with the Board's position on conservatism taken in FASB Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information* (paragraphs 91-97). The Board considered whether curtailment gains should be recognized before the curtailment occurs. It concluded that continuing the delayed recognition feature of Statement 87 for a curtailment gain should be retained until the related employees terminate or the plan suspension or amendment is adopted. That would be consistent with Opinion 30 and would avoid the inconsistent results that would otherwise occur depending on whether the curtailment gain is directly related to a disposal of a segment of a business.

Termination Benefits

43. Statement 74 addressed accounting for special termination benefits whether or not provided through a defined benefit pension plan, that are offered for a short period of time in exchange for employees' voluntary termination of service. The primary conclusion of the Board in Statement 74 was that the cost of special termination benefits should be recognized as a liability and a loss when the employees accept the offer and the amount can be reasonably estimated. That conclusion is incorporated in this Statement. The cost of other termination benefits provided by the existing terms of a plan that are payable only in the event of employees' involuntary termination of service due to a plant closing or a similar event should be recognized when it is probable that employees will be entitled to benefits and the amount can be reasonably estimated. The majority of respondents addressing this issue agreed with those conclusions.

44. Paragraph 3 of Statement 74 stated:

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> The termination of employees under a special termination benefit arrangement may affect the estimated costs of other employee benefits, such as pension benefits, because of differences between past assumptions and actual experience. If reliably measurable, the effects of any such changes on an employer's previously accrued expenses for those benefits that result directly from the termination of employees shall be included in measuring the termination expense. [Footnote reference omitted.]

This Statement supersedes that paragraph and provides that a gain or loss arising as a direct result of a curtailment, including a curtailment resulting from an offer of special termination benefits, is first offset against any previously existing unrecognized net loss or gain and any excess is then recognized (paragraph 13). The reasons for adopting that approach are discussed in paragraphs 39 and 40. Most respondents addressing this issue agreed with the Board's conclusion.

Other Events

45. The Board considered whether other events not involving settlement of the obligation or curtailment of the plan should result in recognition of the prior service cost and net gain or loss unrecognized under Statement 87. None was identified.

Combination of Events or Transactions, including a Disposal of a Segment

46. Some respondents suggested that the Board reconsider whether the recognition criteria applicable to a settlement, a curtailment, or termination benefits should apply to a related series of those events or transactions (for example, as the result of a decision to close a plant). Those respondents noted that the recognition criteria proposed in the Exposure Draft could result in recognizing gains or losses in different reporting periods. The Board concluded that the recognition date as adopted in Opinion 30 should prevail for those events that are directly related to a disposal of a segment of a business and that the net results of those events should be included in determining the gain or loss associated with the disposal. For situations other than a disposal of a segment of a business, the Board concluded that the recognition criteria should not be changed because the various management decisions have no inherent cause and effect relationship.

47. Other respondents requested that the Board provide guidance in this Statement as to the 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. Those respondents suggested that guidance is necessary because the sequence selected can affect the determination of the aggregate gain or loss to be recognized. The Board concluded that selection of the event to be measured first is arbitrary and agreed that neither order is demonstrably superior to the other. However, the Board concluded that an employer should consistently apply the same sequence of events in

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determining the effects of all settlements and curtailments that are to be recognized at the same time.

Disclosure and Presentation

48. The Board considered whether gains or losses recognized under paragraphs 9, 10, 12, 13, and 15 of this Statement always should be accounted for as extraordinary items. The Board concluded that only when the criteria of Opinion 30 are met should those gains or losses be classified as extraordinary items. The Board noted that for many companies those gains or losses generally do not result from the type of unusual and infrequently occurring event or transaction required by Opinion 30 to be reported as an extraordinary item. The Board also concluded, however, that disclosure of the net amount recognized and the nature of the event(s) would be useful and should be required.

Transition

49. The Board concluded that initial application of this Statement should coincide with initial application of Statement 87 because the principal provisions of this Statement are defined in terms of amounts, such as unrecognized net gain or loss, that are introduced by Statement 87.

50. The Board noted that at the time of transition to Statement 87 an unrecognized net obligation would most likely be the result of past plan amendments rather than past losses. Accordingly, the Board concluded that an unrecognized net obligation at transition should be treated the same as unrecognized prior service cost arising subsequent to transition for purposes of determining the accounting for a curtailment (paragraph 21).

51. The Board also noted that at the time of transition to Statement 87 an unrecognized net asset would most likely be the result of past gains or excess pension cost accruals rather than plan amendments. Accordingly, the Board concluded that an unrecognized net asset at transition should be treated the same as an unrecognized net gain arising subsequent to transition for purposes of determining the accounting for a settlement or a curtailment (paragraph 21). Most of the respondents addressing the transition provisions as proposed in the Exposure Draft agreed.

Asset Reversions

52. The Board concluded that retroactive application of most provisions of this Statement would be impracticable and that restatement of previously issued financial statements should be proscribed. However, for employers that have entered into the asset reversion transactions described in paragraph 20, the Board concluded that the adjustment to prior accounting required by that paragraph was practical and would improve both the comparability and representational faithfulness of financial statements. That adjustment will avoid what would otherwise be significant differences in future reported net periodic pension costs and liabilities resulting from reversions completed before and after applying Statement 87.

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53. A few respondents suggested deleting paragraph 20 of this Statement. They would not adjust past accounting but would allow the transition provisions of Statement 87 to take care of all past unrecognized gains or losses. Those respondents believe that paragraph 20 is inappropriate for two reasons.

54. First, they believe it is a selective and asymmetrical retroactive application of the Statement. It would not adjust past accounting for settlements that involved net unrecognized losses or net unrecognized gains that were not accompanied by asset withdrawals. It would also not adjust past accounting for plan curtailments, although they believe that may be less of a problem because those gains or losses were presumably recognized in compliance with APB Opinion No. 8, *Accounting for the Cost of Pension Plans*.

55. Second, they believe that paragraph 20 is inconsistent with the fundamental premise of existing practice, which is endorsed by Statement 87, that funding should not determine accounting. Since the amount of cash withdrawn in an asset reversion is an arbitrary decision and is unlikely to be the same as the gain or loss resulting from a settlement, as determined under the provisions of this Statement, measurements of earnings and shareholders' equity should not be predicated on that funding decision.

56. The Board concluded that adjustment of previous accounting for curtailments and for settlements not involving reversions was not practical because no objective measure of the previously unrecognized net gain or loss is readily available. The Board realized that the gain recognized under paragraph 20 is not likely to be the same as the amount that would have been recognized if paragraphs 9 and 10 had been applied at the date of the transaction and that the gain recognized is a function of a past funding decision (that is, the decision to withdraw a particular sum). However, the Board concluded that the amount to be recognized under paragraph 20 is objectively determinable and that the provisions of that paragraph will reduce the differences in accounting that result from reversions completed before and after the initial application of Statement 87. The Board noted that asset reversions are often material transactions and that credit balances on statements of financial position resulting from those transactions do not represent obligations. The Board also concluded that all employers that had such credit balances should be required to apply paragraph 20 because to permit but not require its application would result in different accounting for similar facts and circumstances. The Board concluded that, on balance, the provisions of paragraph 20 would provide more useful information than the alternative of applying the provisions of this Statement only to transactions occurring after a particular date.

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Appendix B: ILLUSTRATIONS

57. This appendix contains separate illustrations of the following requirements of this Statement:

1. Accounting for a plan termination without a replacement defined benefit plan
2. Accounting for the settlement of a pension obligation
3. Accounting for a plan curtailment
4. Calculation of unrecognized prior service cost associated with services of terminated employees
5. Accounting for a plan curtailment when termination benefits are offered to employees
6. Transition for an employer that completed an asset reversion prior to the initial application of Statement 87.

Illustration 1—Accounting for a Plan Termination without a Replacement Defined Benefit Plan

Company A sponsored a final-pay noncontributory defined benefit plan. On November 16, 1988, the employer terminated the plan, settled the accumulated benefit obligation of $1,500,000 (nonvested benefits became vested upon termination of the plan) by purchasing nonparticipating annuity contracts, and withdrew excess assets. Defined benefits were not provided under any successor plan. The plan ceased to exist as an entity.

As a result, Company A recognized a gain of $900,000, determined as follows:

	Company A (in thousands)		
	Before Termination	**Effect of Termination**	**After Termination**
Assets and obligations:			
Accumulated benefit obligation	$(1,500)	$ 1,500 [a]	$ 0
Effects of projected future compensation levels	(400)	400 [b]	0
Projected benefit obligation	(1,900)	1,900	0
Plan assets at fair value	2,100	(1,500) [a]	
		(600) [c]	0
Items not yet recognized in earnings:			
Unrecognized net asset at transition [d, e]	(200)	200	0
Unrecognized net gain subsequent to transition [e]	(300)	300	0
(Accrued)/prepaid pension cost on the statement of financial position	$ (300)	$ 300	$ 0

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Illustration 2—Accounting for a Settlement of a Pension Obligation

The following examples illustrate the accounting for a settlement of a pension obligation in three specific situations. The first example (Company B) had an unrecognized net obligation at the date of transition to Statement 87, and the second and third examples (Company C and Company D) each had unrecognized net assets at the date of transition. Each company settled a portion of the obligation subsequent to transition to Statement 87. Company B had a retroactive plan amendment after transition; Company C and Company D did not.

Example 2A—Projected Benefit Obligation Exceeds Plan Assets

Company B sponsors a final-pay noncontributory defined benefit plan. On December 31, 1988, the plan settled the vested benefit portion ($1,300,000) of the projected benefit obligation through the purchase of nonparticipating annuity contracts.

As a result, Company B recognized a gain of $195,000, determined as follows:

	Company B (in thousands)		
	Before Settlement	Effect of Settlement	After Settlement
Assets and obligations:			
Vested benefit obligation	$(1,300)	$1,300[a]	$ 0
Nonvested benefits	(200)		(200)
Accumulated benefit obligation	(1,500)	1,300	(200)
Effects of projected future compensation levels	(500)		(500)
Projected benefit obligation	(2,000)	1,300	(700)
Plan assets at fair value	1,400	(1,300)[a]	100
Items not yet recognized in earnings:			
Unrecognized net obligation at transition [b]	650		650
Unrecognized prior service cost from amendment subsequent to transition	150		150
Unrecognized net gain subsequent to transition[c]	(300)	195	(105)
(Accrued)/prepaid pension cost on the statement of financial position	$ (100)	$ 195	$ 95

Example 2B—Plan Assets Exceed the Projected Benefit Obligation

Company C sponsors a final-pay noncontributory defined benefit plan. On December 31, 1988, the plan settled the vested benefit portion ($1,300,000) of the projected benefit obligation

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through the purchase of nonparticipating annuity contracts.

As a result, Company C recognized a gain of $325,000 determined as follows:

	Company C (in thousands)		
	Before Settlement	Effect of Settlement	After Settlement
Assets and obligations:			
Vested benefit obligation	$(1,300)	$1,300[a]	$ 0
Nonvested benefits	(200)		(200)
Accumulated benefit obligation	(1,500)	1,300	(200)
Effects of projected future compensation levels	(500)		(500)
Projected benefit obligation	(2,000)	1,300	(700)
Plan assets at fair value	2,100	(1,300)[a]	800
Items not yet recognized in earnings:			
Unrecognized net asset at transition[b], [c]	(200)	130	(70)
Unrecognized net gain subsequent to transition[c]	(300)	195	(105)
(Accrued)/prepaid pension cost on the statement of financial position	$ (400)	$ 325	$ (75)

Example 2C—Plan Assets Exceed the Projected Benefit Obligation and a Participating Annuity Contract Is Purchased to Settle Benefits

Company D sponsors a final-pay noncontributory defined benefit plan. On December 31, 1988, the plan settled the vested benefit portion ($1,300,000) of the projected benefit obligation through the purchase of a participating annuity contract at a cost of $1,430,000. The plan could have purchased a nonparticipating contract covering the same benefits for $1,300,000. The participation features of the contract warranted a conclusion that its purchase constituted a settlement.

As a result, Company D recognized a gain of $240,000, (rounded), determined as follows:

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	Company D (in thousands)		
	Before Settlement	Effect of Settlement	After Settlement
Assets and obligations:			
Vested benefit obligation	$(1,300)	$1,300[a]	$ 0
Nonvested benefits	(200)		(200)
Accumulated benefit obligation	(1,500)	1,300	(200)
Effects of projected future compensation levels	(500)		(500)
Projected benefit obligation	(2,000)	1,300	(700)
Plan assets at fair value:			
Participation right		130[a]	130
Other plan assets	2,100	(1,430)[a]	670
Items not yet recognized in earnings:			
Unrecognized net asset at transition[b, c]	(200)	130[d]	(70)
Unrecognized net gain subsequent to transition[c]	(300)	110[d]	(190)
(Accrued)/prepaid pension cost on the statement of financial position	$ (400)	$ 240	$ (160)

Illustration 3—Accounting for a Plan Curtailment

The following examples illustrate the accounting for a curtailment in two specific situations. The first example (Company E) had an unrecognized net obligation at the date of transition to Statement 87 and a retroactive plan amendment after transition. The second example (Company F) had an unrecognized net asset at the date of transition. Both companies curtailed their plans subsequent to transition to Statement 87.

Example 3A—Disposal of a Segment—Projected Benefit Obligation Exceeds Plan Assets

Company E sponsors a final-pay noncontributory defined benefit plan. On January 1, 1988 (one year after transition) the company had a retroactive plan amendment resulting in $800,000 of prior service cost. On December 31, 1989, the management of Company E committed itself to a formal plan to dispose of a segment of its business. In connection with the disposal, the number of employees accumulating benefits under the plan would be reduced significantly. The portion of the projected benefit obligation based on the expected future compensation levels of the terminated employees was $90,000, and nonvested benefits of the terminated employees amounted to $20,000. The plan also had an unrecognized net obligation at the date of transition

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to Statement 87 that is treated as unrecognized prior service cost for purposes of applying this Statement. The remaining expected future years of service associated with those employees present at the date of transition was reduced by 30 percent due to the termination of employees. Accordingly, 30 percent of the unrecognized net obligation remaining unamortized at December 31, 1989 was a loss which amounted to $120,000.

The unrecognized prior service cost (which relates to the plan amendment of January 1, 1988) associated with the previously expected years of service of the terminated employees that will not be rendered was a loss which amounted to $160,000.

The sum of the effects resulting from the plan curtailment was a loss of $170,000, determined as follows:

	Company E (in thousands)		
	Before Curtailment	**Effect of Curtailment**	**After Curtailment**
Assets and obligations:			
Vested benefit obligation	$(1,300)		$(1,300)
Nonvested benefits	(200)	$ 20	(180)
Accumulated benefit obligation	(1,500)	20	(1,480)
Effects of projected future compensation levels	(500)	90	(410)
Projected benefit obligation	(2,000)	110 [a]	(1,890)
Plan assets at fair value:	1,400		1,400
Items not yet recognized in earnings:			
Unrecognized net obligation at transition [b]	400	(120)[b]	280
Unrecognized prior service cost resulting from plan amendment [c]	651	(160)[c]	491
Unrecognized net gain subsequent to transition	(151)		(151)
(Accrued)/prepaid pension cost on the statement of financial position	$ 300	$(170)[d]	$ 130

Example 3B—Plan Assets Exceed the Projected Benefit Obligation

Company F sponsors a final-pay noncontributory defined benefit plan. On July 27, 1990, the management of Company F decided to reduce significantly the operations of a line of business products. Although the decision did not result in closing down any facilities, it required the termination of a significant number of employees. The termination of employees took place on November 1, 1990.

The portion of the projected benefit obligation based on expected future compensation levels of the terminated employees was $90,000, and the portion of nonvested benefits related to the

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terminated employees was $20,000.

As a result, Company F recognized a gain of $110,000 on November 1, 1990, * determined as follows:

Company F (in thousands)			
	As of November 1, 1990		
	Before Realization of Curtailment Gain	Effect of Curtailment	After Realization of Curtailment Gain
Assets and obligations:			
Vested benefit obligation	$(1,300)		$(1,300)
Nonvested benefits	(300)	$ 20	(280)
Accumulated benefit obligation	(1,600)	20	(1,580)
Effects of projected future compensation levels	(400)	90	(310)
Projected benefit obligation	(2,000)	110[a]	(1,890)
Plan assets at fair value	2,100		2,100
Items not yet recognized in earnings:			
Unrecognized net asset at transition[a]	(200)	0[a]	(200)
Unrecognized net loss subsequent to transition	100	0[a]	100
(Accrued)/prepaid pension cost on the statement of financial position	$ 0	$ 110	$ 110

Illustration 4—Calculation of Unrecognized Prior Service Cost Associated with Services of Terminated Employees

Company S sponsors a final-pay noncontributory defined benefit plan. On January 1, 1988, the company had a retroactive plan amendment resulting in prior service cost of $800,000.

The unrecognized prior service cost that results from the plan amendment is amortized based on the expected future years of service of participants active as of January 1, 1988 who are expected to receive benefits under the plan.

As of January 1, 1988, the company had 100 employees who were expected to receive benefits under the plan. Based on the assumption that 5 percent of that group (5 employees) leaves (either quits or retires) in each of the next 20 years, the expected future years of service amounted to 1,050.

The amount of prior service cost associated with each expected future year of service is $762($800,000 ÷ 1,050). Exhibit A illustrates the originally expected expiration of the

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anticipated service years.

On December 31, 1990, Company S terminated 25 employees active at the date of the plan amendment. Immediately prior to the curtailment, 765 expected future years of service remained (1,050 less 285 years of service rendered in the previous 3 years). The curtailment reduced the total expected future years of service at December 31, 1990 from 765 to 555 (210) as illustrated in Exhibit B. Therefore, Company S will recognize $160,020 ($762 × 210) of prior service cost in conjunction with the curtailment.

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Exhibit A

Determination of Expected Years of Service Rendered in Each Year Before Curtailment

Individuals	Future Service Years	Year 88	89	90	91	92	93	94	95	96	97	98	99	00	01	02	03	04	05	06	07
A1-A5	5	5																			
B1-B5	10	5	5																		
C1-C5	15	5	5	5																	
D1-D5	20	5	5	5	5																
E1-E5	25	5	5	5	5	5															
F1-F5	30	5	5	5	5	5	5														
G1-G5	35	5	5	5	5	5	5	5													
H1-H5	40	5	5	5	5	5	5	5	5												
I1-I5	45	5	5	5	5	5	5	5	5	5											
J1-J5	50	5	5	5	5	5	5	5	5	5	5										
K1-K5	55	5	5	5	5	5	5	5	5	5	5	5									
L1-L5	60	5	5	5	5	5	5	5	5	5	5	5	5								
M1-M5	65	5	5	5	5	5	5	5	5	5	5	5	5	5							
N1-N5	70	5	5	5	5	5	5	5	5	5	5	5	5	5	5						
O1-O5	75	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5					
P1-P5	80	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5				
Q1-Q5	85	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5			
R1-R5	90	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5		
S1-S5	95	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	
T1-T5	100	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5
	1,050																				
Service Years Rendered		100	95	90	85	80	75	70	65	60	55	50	45	40	35	30	25	20	15	10	5
Amortization Fraction		100/1,050	95/1,050	90/1,050	85/1,050	80/1,050	75/1,050	70/1,050	65/1,050	60/1,050	55/1,050	50/1,050	45/1,050	40/1,050	35/1,050	30/1,050	25/1,050	20/1,050	15/1,050	10/1,050	5/1,050
Expected Future Years of Service Remaining at Year-End		950	855	765	680	600	525	455	390	330	275	225	180	140	105	75	50	30	15	5	0

Prior Service Cost $800,000

Total Expected Future Years of Service 1,050

Amortization Amount per Each Year of Service $ 762

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Exhibit B

Determination of Expected Years of Service Rendered in Each Year After Curtailment

Individuals	**88**	**89**	**90**	**91**	**92**	**93**	**94**	**95**	**96**	**97**	**98**	**99**	**00**	**01**	**02**	**03**	**04**	**05**	**06**	**07**
A1-A5	5																			
B1-B5	5	5																		
C1-C5	5	5	5																	
D1-D5*	5	5	5																	
E1-E5	5	5	5	5	5															
F1-F5	5	5	5	5	5	5														
G1-G5	5	5	5	5	5	5	5													
H1-H5*	5	5	5																	
I1-I5	5	5	5	5	5	5	5	5	5											
J1-J5	5	5	5	5	5	5	5	5	5	5										
K1-K5	5	5	5	5	5	5	5	5	5	5	5									
L1-L5*	5	5	5																	
M1-M5	5	5	5	5	5	5	5	5	5	5	5	5	5							
N1-N5	5	5	5	5	5	5	5	5	5	5	5	5	5	5						
O1-O5*	5	5	5																	
P1-P5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5				
Q1-Q5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5			
R1-R5*	5	5	5																	
S1-S5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	
T1-T5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5	5
Service Years Rendered	100	95	90	60	60	55	50	45	45	40	35	30	30	25	20	20	15	10	10	5
Adjustment for Termination			210																	
Total	100	95	300	60	60	55	50	45	45	40	35	30	30	25	20	20	15	10	10	5
Amortization Fraction	100 / 1,050	95 / 1,050	300 / 1,050	60 / 1,050	60 / 1,050	55 / 1,050	50 / 1,050	45 / 1,050	45 / 1,050	40 / 1,050	35 / 1,050	30 / 1,050	30 / 1,050	25 / 1,050	20 / 1,050	20 / 1,050	15 / 1,050	10 / 1,050	10 / 1,050	5 / 1,050
Expected Future Years of Service Remaining at Year-End	950	855	555	495	435	380	330	285	240	200	165	135	105	80	60	40	25	15	5	0

*Terminated group of employees

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Illustration 5—Accounting for a Plan Curtailment When Termination Benefits Are Offered to Employees

Company G sponsors a final-pay noncontributory defined benefit plan. The company had an unrecognized net obligation at the date of transition to Statement 87 and did not have a retroactive plan amendment after that date. On May 11, 1990, the company offered for a short period of time (until June 30, 1990) special benefits to its employees in connection with their voluntary termination of employment (special termination benefits). The special termination benefit was a lump-sum payment to be made upon termination, payable in addition to the employee's regular plan benefits. The special termination benefit was paid directly from the employer's assets rather than from the plan assets.

On June 30, 15 percent of the employees accepted the offer. The amount of the special termination benefit payment was $125,000.

The portion of the projected benefit obligation based on the expected future compensation levels of the terminated employees amounted to $100,000, and all the employees terminated were fully vested in their accumulated benefits. The portion of the unrecognized net obligation at transition associated with the years of service no longer expected from the terminated employees was $150,000.

As a result, Company G recognized a loss of $175,000 that includes the cost of the special termination benefits and the loss * from the curtailment determined as follows:

	Company G (in thousands)		
	Before Curtailment	Effect of Curtailment	After Curtailment
Assets and obligations:			
Vested benefit obligation	$(1,300)		$(1,300)
Nonvested benefits	(200)		(200)
Accumulated benefit obligation	(1,500)		(1,500)
Effects of projected future compensation levels	(500)	$ 100	(400)
Projected benefit obligation	(2,000)	100[a]	(1,900)
Plan assets at fair value	1,400		1,400
Items not yet recognized in earnings:			
Unrecognized net obligation at transition[b]	800	(150)	650
Unrecognized net gain subsequent to transition	(300)		(300)
(Accrued)/prepaid pension cost on the statement of financial position	$ (100)	$ (50)	$ (150)
Loss on curtailment		$ 50	

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Cost of special termination benefits (lump-sum payments to terminated employees)	125
Total loss	$ 175[c]

Illustration 6—Transition for an Employer That Completed an Asset Reversion Prior to the Initial Application of Statement 87

Company H sponsors a final-pay noncontributory defined benefit pension plan. On September 9, 1981, the company settled a portion of its pension obligation through the purchase of annuity contracts and withdrew excess assets. The company continued to provide defined benefits to its employees. No gain was recognized on the transaction, and Company H recognized a credit in its statement of financial position equal to the amount of cash withdrawn. For financial reporting purposes, that amount was grouped with accrued or prepaid pension cost. In subsequent periods the amount of the reversion (a deferred gain) was amortized as a reduction of net periodic pension cost. The company had no other past differences between net periodic pension cost and amounts contributed and, therefore, had recognized no other accrued or prepaid pension cost.

As of January 1, 1985, the time of initial application of Statement 87, the unamortized amount of the reversion gain was $287,000. Company H's transition to Statement 87 would be accomplished as follows:

Company H
Computation of Unrecognized Net Asset
(in thousands)

Projected benefit obligation		$ (800)
Plan assets at fair value	$950	
Accrued pension cost on the statement of financial position	287	1,237
Unrecognized net asset		$ 437

Company H
(in thousands)

	Before Recognition of Reversion Gain	Effect of Recognition of Reversion Gain	After Recognition of Reversion Gain
Assets and obligations:			
Projected benefit obligation	$(800)		$ (800)
Plan assets at fair value	950		950
Item not yet recognized in earnings:			
Unrecognized net asset at transition	(437)	$ 287[a]	(150)
(Accrued)/prepaid pension cost on the statement of financial position	$(287)	$ 287[a]	$ 0

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Footnotes

FAS88, Footnote 1--If the insurance company is controlled by the employer, or if there is any reasonable doubt that the insurance company will meet its obligations under the contract, the purchase of the contract does not constitute a settlement for purposes of this Statement.

FAS88, Footnote 2--Paragraph 29 of Statement 87 states:

> *Gains and losses* are changes in the amount of either the projected benefit obligation or plan assets resulting from experience different from that assumed and from changes in assumptions. This Statement does not distinguish between those sources of gains and losses. Gains and losses include amounts that have been realized, for example by sale of a security, as well as amounts that are unrealized. 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 Statement does not require recognition of gains and losses as components of net pension cost of the period in which they arise. [Footnote reference omitted.]

FAS88, Footnote 3--For the following types of settlements, the cost of the settlement is:

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. (Refer to paragraph 61 of Statement 87.)

FAS88, Footnote 4--Increases in the projected benefit obligation that reflect termination benefits are excluded from the scope of this paragraph. (Refer to paragraph 15 of this Statement.)

FAS88, Footnote 5--Paragraph 77 of Statement 87 states:

For a defined benefit plan, an employer shall determine as of the measurement date...for the beginning of the fiscal year in which this Statement is first applied, the amounts of (a) the projected benefit obligation and (b) the fair value of plan assets plus previously recognized unfunded accrued pension cost or less previously recognized prepaid pension cost. The difference between those two amounts...represents an unrecognized net obligation...or an unrecognized net asset....

FAS88, Appendix A, Footnote 6--Some plans provide for early retirement benefits that are reduced to reflect fully the fact that payments begin sooner and extend over more periods than normal retirement benefits. If the actuarial present value of the reduced benefits is the same as the actuarial present value of the accumulated benefits assuming payments beginning at normal

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retirement age, the benefits are said to be subject to "full actuarial reduction," and no loss results when an employee takes early retirement. Subsidized early retirement benefits are benefits not subject to full actuarial reduction so that a loss results when an employee unexpectedly takes early retirement.

FAS88, Appendix B, Illustration 1 Footnote a--The accumulated benefits of $1,500 were settled by using an equivalent amount of plan assets to purchase nonparticipating annuity contracts.

FAS88, Appendix B, Illustration 1 Footnote b--The effects of projected future compensation levels ceased to be an obligation of the plan or the employer due to the termination of all plan participants. Under paragraph 13 of this Statement, the gain (that is, the decrease in the projected benefit obligation) resulting from the curtailment is first offset against any existing unrecognized net loss. Because the previously unrecognized amount in this case was a gain ($200 unrecognized net asset at transition plus $300 unrecognized net gain subsequent to transition), the $400 gain from the curtailment was recognized.

FAS88, Appendix B, Illustration 1 Footnote c--Plan assets, in excess of the amount used to settle the pension benefits, were withdrawn from the plan.

FAS88, Appendix B, Illustration 1 Footnote d--An unrecognized net asset at transition is treated as an unrecognized net gain for purposes of this Statement (paragraph 21).

FAS88, Appendix B, Illustration 1 Footnote e--A pro rata amount of the maximum gain (paragraph 9), which includes the unrecognized net gain subsequent to transition ($300) and the unamortized net asset from transition ($200), is recognized due to settlement. The projected benefit obligation was reduced from $1,500 to $0 (the curtailment initially reduced the projected benefit obligation from $1,900 to $1,500 as described in footnote b), a reduction of 100 percent. Accordingly, the entire unrecognized net gain of $500 ($300 + $200) was recognized.

The journal entry required to reflect the accounting for the plan termination was:

Cash	600	
Accrued/prepaid pension cost	300	
Gain from plan termination		900

The gain from the plan termination without a replacement defined benefit plan was composed of the following:

Gain from curtailment	$400
Gain from settlement	500
Total gain	$900

FAS88, Appendix B, Illustration 2, Example 2A, Footnote a--The vested benefits of $1,300 were

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settled by using plan assets to purchase nonparticipating annuity contracts.

FAS88, Appendix B, Illustration 2, Example 2A, Footnote b--An unrecognized net obligation at transition is treated as unrecognized prior service cost and therefore is not affected by settlement of the obligation (paragraph 21).

FAS88, Appendix B, Illustration 2 Example 2A Footnote c--A pro rata portion of the maximum gain (paragraph 9), the unrecognized net gain subsequent to transition, is recognized due to settlement. The projected benefit obligation was reduced from $2,000 to $700, a reduction of 65 percent. Accordingly, 65 percent of the maximum gain of $300, a gain of $195, was recognized. The journal entry required to reflect the accounting for the plan settlement was:

Accrued/prepaid pension cost	195	
Gain from settlement		195

FAS88, Appendix B, Illustration 2, Example 2B, Footnote a--The vested benefits of $1,300 were settled by using plan assets to purchase nonparticipating annuity contracts.

FAS88, Appendix B, Illustration 2, Example 2B, Footnote b--An unrecognized net asset at transition is treated as an unrecognized net gain for purposes of this Statement (paragraph 21).

FAS88, Appendix B, Illustration 2, Example 2B, Footnote c--A pro rata portion of the maximum gain (paragraph 9), which includes the unrecognized net gain subsequent to transition ($300) and the unamortized net asset from transition ($200), is recognized due to settlement. The projected benefit obligation was reduced from $2,000 to $700, a reduction of 65 percent. Accordingly, 65 percent of the maximum gain of $500 ($300 + $200), a gain of $325, was recognized. The journal entry required to reflect the accounting for the plan settlement was:

Accrued/prepaid pension cost	325	
Gain from settlement		325

FAS88, Appendix B, Illustration 2, Example 2C, Footnote a--The vested benefits of $1,300 were settled by using $1,430 of plan assets to purchase a participating annuity contract. However, a nonparticipating contract covering the same benefits could have been purchased for $1,300. The plan paid the additional $130 to obtain the participation right.

FAS88, Appendix B, Illustration 2, Example 2C, Footnote b--An unrecognized net asset at transition is treated as an unrecognized net gain for purposes of this section [refer to footnote 15].

FAS88, Appendix B, Illustration 2, Example 2C, Footnote c--A pro rata amount of the maximum gain (paragraph .177), which includes the unrecognized net gain subsequent to transition ($300) and the unamortized net asset from transition ($200), was recognized due to settlement.

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However, any gain on a settlement that uses a participating annuity contract shall be computed by first reducing the maximum gain by the cost of the participation right [$200 + ($300 - $130) = $370]. The projected benefit obligation was reduced from $2,000 to $700, a reduction of 65 percent. Accordingly, a gain of $240 (rounded) was recognized (.65 x $370). The journal entry required to reflect the accounting for the plan settlement was:

Accrued/prepaid pension cost	240	
Gain from settlement		240

FAS88, Appendix B, Illustration 2, Example 2C, Footnote d--The amount of gain from settlement was allocated as follows (rounded):

Unrecognized net asset at transition (.65 x $200)	$130
Unrecognized net gain subsequent to transition [.65 x ($300 - $130)]	110
	$240
	====

FAS88, Appendix B, Illustration 3, Example 3A, Footnote a—Under paragraph 13 of this Statement, the gain (that is, the decrease in the projected benefit obligation) resulting from the curtailment is first offset against any existing unrecognized net loss. Because the previously unrecognized amount in this case was a gain ($151 unrecognized net gain subsequent to transition), the $110 gain from the curtailment was recognized.

FAS88, Appendix B, Illustration 3, Example 3A, Footnote b—Because the plan had an unrecognized net obligation at the date of transition to Statement 87, the unrecognized amount is treated as prior service cost for purposes of applying this Statement. The remaining expected future years of service associated with those employees present at the date of transition was reduced by 30 percent due to the termination of employees. Accordingly, 30 percent of the unrecognized obligation remaining unamortized at the date of the curtailment was recognized which amounted to $120.

FAS88, Appendix B, Illustration 3, Example 3A, Footnote c—The unrecognized prior service cost (which related to the plan amendment of January 1, 1988) associated with the previously expected years of service of the terminated employees that will not be rendered was $160.

FAS88, Appendix B, Illustration 3, Example 3A, Footnote d—Under paragraph 16 of this Statement, the loss, which amounted to $170, should be recognized with other gains and losses resulting from the disposal of the segments.

FAS88, Appendix B, Illustration 3 Example 3B Footnote *--Under paragraph 14 of this Statement, if the sum of the effects resulting from the curtailment is a net loss, it is to be recognized when it is probable that the curtailment will occur and the effects are reasonably

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estimable. If the sum of those effects is a net gain, it is to be recognized when the related employees terminate. Company F estimated at July 27, 1990 that a net curtailment gain would result. Accordingly, the gain was recognized on the date employees terminated (November 1, 1990) and *was based on plan assets and obligations measured as of that date*.

FAS88, Appendix B, Illustration 3, Example 3B, Footnote a—Under paragraph 13 of this Statement, the curtailment gain (that is, the decrease in the projected benefit obligation) is first offset against any existing unrecognized net loss. The unrecognized net asset from transition is treated as an unrecognized net gain (paragraph 21). Thus the net amount of previously unrecognized gain or loss was a gain of $100 (unrecognized net loss of $100 plus the remaining unrecognized net asset from transition of $200). Because the previously unrecognized net amount was a gain, the $110 gain from curtailment was recognized.

If the previously existing unrecognized net amount had been a loss including the unrecognized net asset at transition and that loss exceeded the curtailment gain, the curtailment gain would have been offset, and no gain would have been recognized.

The journal entry required to reflect the accounting for the plan curtailment was:

Accrued/prepaid pension cost	110	
Gain from curtailment		110

FAS88, Appendix B, Illustration 5, Footnote *--Under paragraph 14 of this Statement, if the sum of the effects resulting from the curtailment is a net loss, it is to be recognized when it is probable that the curtailment will occur and the effects are reasonably estimable. In this example, the effects resulting from the curtailment were not reasonably estimable until June 30, 1990, the acceptance date for the offer of special termination benefits.

FAS88, Appendix B, Illustration 5, Footnote a--Under paragraph 13 of this section, the curtailment gain (that is, the decrease in the projected benefit obligation) is first offset against any existing unrecognized net loss. Since the previously unrecognized amount was a gain ($300 unrecognized net gain subsequent to transition), the $100 gain from the curtailment was recognized.

FAS88, Appendix B, Illustration 5, Footnote b--An unrecognized net obligation at the date of transition to this section is treated as unrecognized prior service cost for purposes of applying this section. The portion of unrecognized prior service cost associated with the years of service no longer expected from the terminated employees ($150) was recognized.

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FAS88, Appendix B, Illustration 5, Footnote c--The loss Company G recognized was $175, which includes the cost of the special termination benefits of $125, the gain related to salary progression of $100 and the recognition of prior service cost of $150. The journal entry required to reflect the accounting for this event was:

Loss on employee terminations	175	
Accrued/prepaid pension cost		50
Liability for termination benefits		125

If the company had paid the termination benefits from the pension plan (by amending the plan and using plan assets), the same loss would have been recognized, but $175 would have been credited to the accrued pension cost liability.

FAS88, Appendix B, Illustration 6, Footnote a--Under paragraph 20 of this Statement, an employer that completed an asset reversion prior to the effective date of this Statement should recognize a gain as the cumulative effect of a change in accounting principle at the time of initial application of Statement 87.

The gain recognized by Company H amounts to $287, which is the lesser of the unamortized amount of the reversion gain ($287) and the unrecognized net asset from transition ($437). The journal entry required to reflect the accounting as of January 1, 1985 was:

Accrued/prepaid pension cost	287	
Cumulative effect of a change in accounting principle		287

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