

**VOLUME 13, CHAPTER 11: “ACCOUNTING FOR DEFINED BENEFIT PENSION
AND OTHER POSTRETIREMENT PLANS”**

SUMMARY OF MAJOR CHANGES

All changes are denoted by [blue font](#).

Substantive revisions are denoted by an asterisk (*) symbol preceding the section, paragraph, table, or figure that includes the revision.

Unless otherwise noted, chapters referenced are contained in this volume.

Hyperlinks are denoted by [***bold, italic, blue, and underlined font***](#).

The previous version dated [November 2013](#) is archived.

PARAGRAPH	EXPLANATION OF CHANGE/REVISION	PURPOSE
All	Updated hyperlinks and formatting to comply with current administrative instructions.	Revision
110303A.1	Clarified requirement to disaggregate the service cost (SC) component from the other components of net benefit cost on the income statement per Accounting Standards Codification (ASC) Topic 715.	Revision
110502	Added paragraph to clarify presentation of SC on the income statement per ASC Topic 715.	Addition

Table of Contents

1101	GENERAL	3
	110101. Purpose	3
	110102. Authoritative Guidance	3
1102	DEFINITIONS	3
	110201. Funded Status	3
	110202. Measurement Date.....	4
	110203. Net Periodic Pension Cost (NPPC)	4
	110204. Pension Provider	4
	110205. PA.....	4
	110206. PBO	4
	110207. Statement of Financial Position.....	4
1103	BASIC PENSION ACCOUNTING PRINCIPLES	4
	110301. Disclosure.....	4
	110302. Measurement Date.....	4
	*110303. Basis for Calculations.....	5
1104	BALANCE SHEET CLASSIFICATIONS	6
	110401. PA greater than PBO	6
	110402. PA less than PBO	6
	110403. Adjustments.....	6
1105	INCOME STATEMENT CLASSIFICATIONS.....	7
	110501. Presenting NPPC	7
	*110502. Presenting SC	7
1106	DISCLOSURES	7
1107	BASIC PENSION FUNDING (LIABILITY) PRINCIPLES	7
	110701. Calculation of Liabilities	7
	110702. Cost Methods.....	8
	110703. Methods Used for PVFB	8

CHAPTER 11

**ACCOUNTING FOR DEFINED BENEFIT PENSION AND OTHER
POSTRETIREMENT PLANS**

1101 GENERAL

110101. Purpose

This chapter provides requirements to account for defined benefit pension and other postretirement plans for single-employer plans. The policies in this chapter apply to Department of Defense Nonappropriated Fund Instrumentalities (NAFIs), their supporting Accounting Offices, and [Military Services Exchanges](#). This chapter does not pertain to Military Department plans that are considered multi-employer. This chapter provides basic pension accounting, funding principles, and a review of standards. Each NAFI and its Certified Public Accounting (CPA) firm providing financial services support should fully review the exceptions and variables associated with pension accounting prior to implementation.

110102. [Authoritative Guidance](#)

The annual reporting of Pension Plan assets and liabilities **must** be in conformance with Financial Accounting Standards Board Statement of [Financial Accounting Standards \(FAS\) Number \(No.\) 158](#), “Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans.” FAS No. 158 addresses the concern that employers’ accounting standards for defined benefit pension and postretirement plans fail to communicate the funded status of those plans in a complete and understandable way. FAS No. 158 cross references to Accounting Standards Codification (ASC) Topic [715](#), subtopics 20, 30, and 60 and Topic [958](#).

1102 DEFINITIONS

The standards contained within FAS No. 158 improve reporting for defined benefit pension and postretirement plans by requiring an employer to recognize certain financial activity occurring in the plans in their financial statements. This activity includes the overfunded or underfunded status of defined benefit pension and postretirement plans in the balance sheet. The actuarial gains and losses, prior service costs (SC), transition obligations, and credits that arise during the period are recognized through the income statement. [FAS No. 158 provides additional information regarding](#) the types of plans for the financial statement reader. Terms NAFIs and Military Departments should be aware of [include those listed in paragraphs 110201 through 110207](#).

110201. Funded Status

The funded status is the difference between the [projected benefit obligation \(PBO\)](#) (also known as the pension liability) and the [plan assets \(PA\)](#) at fair value.

110202. Measurement Date

The measurement date is the employer's fiscal year-end statement of financial position. The PA and PBO are measured as of this date.

110203. Net Periodic Pension Cost (NPPC)

The NPPC is the annual expense incurred by the employer because of the pension plan. The NPPC is composed of the SC, interest cost, actual return on assets, amortization of prior SC, transition obligations, and unrecognized gains or losses.

110204. Pension Provider

The pension provider is the organization that administers a Military Department's pension plan.

110205. PA

The PA are the amounts a pension plan could reasonably expect to receive for a current sale of assets held for pension benefits.

110206. PBO

The PBO is the actuarial present value, as of a specified date, of all employees' vested and non-vested pension benefits.

110207. Statement of Financial Position

The statement of financial position is another term for the balance sheet. The term "balance sheet" is used in this volume.

1103 BASIC PENSION ACCOUNTING PRINCIPLES

110301. Disclosure

Pension accounting principles require the disclosure of the components of net pension costs and of the PBO. [FAS No. 87](#), "Employers' Accounting for Pensions" prescribes the [disclosure requirements](#) that a NAFI must [follow](#) to reflect the cost of pension plans on income statements and balance sheets.

110302. Measurement Date

[FAS No. 87](#) requires that PA and benefit obligations be measured as of the date of the fiscal year-end balance sheet. As of that date, each NAFI sets assumptions, gathers the participant data used to measure the obligations, and determines the fair value of assets in the pension trust. Each

NAFI uses these amounts to calculate the cost of the plan in the future year and determines if additional amounts must be recorded on the balance sheet.

*110303. Basis for Calculations

A. Calculation of NPPC. The basis for calculations is the benefit obligations, i.e., PBO and the accumulated benefit obligation (ABO), SC, and the market related value of PA. These values are used in the calculation of the NPPC, which is the annual accounting expense or income each NAFI must recognize in its income statement. The NPPC is comprised of the following components.

1. SC. The SC is the annual accrual of benefits. ASC Topic 715 requires a NAFI to disaggregate the SC component from the other components of net benefit cost on the income statement. Only the SC component of net benefit cost is eligible for capitalization.

2. Market Related Value of PA. The market related value of PA is either fair value or a calculated asset value that recognizes changes in fair value in a systematic and rational manner over not more than five years.

3. Interest Cost. The interest cost is an increase in PBO associated with the passage of time during the year. This is generally the discount rate multiplied by the beginning of year PBO adjusted for expected benefit payments.

4. Expected Return on Assets. The expected return on assets is an increase in PA associated with the passage of time during the year. This is offset against the other cost items and is generally the expected long-term rate of return on assets multiplied by the beginning of year market related value of PA adjusted for expected benefit payments, contributions, and possibly for expected administrative expenses paid from the trust.

5. Amortization Amounts. Amortization amounts are the systematic recognition of certain changes in value.

a. Transition Obligation or Asset. Amortization of a transition obligation or asset allows phased recognition on the income statement of the difference between the plan's funded status (PBO less PA) and accrued or prepaid cost on the balance sheet when the NAFIs first transitioned to this statement.

b. Prior SC. Amortization of prior SC allows phased recognition on the income statement of changes in the PBO associated with a plan amendment. This amount is generally amortized over the average remaining service period of the plan participants.

c. Unrecognized Net Gain or Loss. Amortization of an unrecognized gain or loss allows phased recognition of actuarial gains or losses. Actuarial gains and losses that have not yet been reflected on the income statement are accumulated each year and amortized over the average remaining service period of plan participants only to the extent their

total exceeds a threshold. The threshold may be up to 10 percent of the greater of the plan's PBO or [market related value of PA](#).

B. Accrued or Prepaid Pension Cost. The accrued or prepaid pension cost is the amount on the balance sheet that is equal to the accumulated difference between past NPPC and past plan contributions. A prepaid pension cost arises when the plan contributions exceed the NPPCs or the NPPCs are less than zero. An accrued pension cost arises when the NPPCs exceed plan contributions or the NPPCs are greater than zero. For certain plans whose fair value of assets is less than the ABO, there will be an increase in liabilities that must be reflected on the balance sheet. Note that these amounts are reflected on the balance sheet only and do not affect the income statement.

1104 BALANCE SHEET CLASSIFICATIONS

The Military Departments will calculate the funded status of a benefit plan. The funded status should be determined as of the year-end statement date (measurement date) and is defined as the difference between the PBO and PA. Depending on the differences between the PBO and PA, several areas of the balance sheet could be affected. The following examples are provided.

110401. PA greater than PBO

An overfunded plan exists when the PA is greater than the PBO. The difference would be classified as a non-current asset in the balance sheet.

110402. PA less than PBO

An underfunded plan exists when the PA is less than the PBO. The difference would be classified as a liability (current or long-term) in the balance sheet. The classification of the liability as a current or long-term liability will be determined and provided by the [pension provider](#).

110403. Adjustments

Once the funded status of a benefit plan is determined, adjustments may need to be made to existing pension balances in the balance sheet. These adjustments will be posted as an offset to the equity account in the balance sheet and can be either an addition or reduction to the equity section. These temporary adjustments are treated in the equity section of the balance sheet in the same manner as the "unrealized gains/losses on investments," pursuant to [FAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities."](#) In addition, these temporary adjustments are not calculated in the net worth determination. The final result of these entries will result in the funded status equaling either a non-current asset or a liability based on the difference of the PA and PBO. The provisions of FAS No. 158 eliminate the accounting for [any](#) potential additional minimum liability.

1105 INCOME STATEMENT CLASSIFICATIONS

110501. Presenting NPPC

The NPPC is the annual expense incurred by the employer because of the pension plan. Under FAS No. 158, the pension expense will continue to be recognized as a component of the income statement similar to the previous reporting process. Accounting rules can produce a negative expense, which appears as income on the financial statements. While the expense (debit) is recognized through the income statement, the second part of the entry (credit) results in adjustments to the balance sheet accounts, which have been expanded to include the adjustment to the equity account. The net of the SC, interest cost, and expected return on PA will continue to be an adjustment as a component of either the non-current asset or the liability, whichever component the NAFI is reflecting in the financial statements due to the new funded status. The amounts of the net gain or loss, net prior SC or credits, and net transition asset or obligation will be offset against the equity account.

*110502. Presenting SC

A NAFI must report the SC component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost defined in ASC Topic 715 are required to be presented in the income statement separately from the SC component. If a separate line item or items are used to present the other components of net benefit cost, that line item or items must be appropriately described.

1106 DISCLOSURES

The CPA firm or external auditors receive annual valuation reports from outside actuaries to prepare the financial statement disclosures. At a minimum, the CPA firm will provide additional information about certain effects on net periodic benefit cost, and the amount and timing of any PA expected to be returned to the Military Departments and NAFIs. In addition, amounts recorded as adjustments to the equity section of the balance sheet will result in an adjustment to the income statement. The actuaries should provide this information to the CPA firm for inclusion in the audited financial statements. See FAS No. 158 and FAS No. 87 for more information on disclosure requirements.

1107 BASIC PENSION FUNDING (LIABILITY) PRINCIPLES

110701. Calculation of Liabilities

A pension plan's liabilities can be calculated in different ways, but the same principles always apply. However, accounting and funding calculation principles are different. The actuary calculates the expected future pension payments for each participant in the plan using the entity's participant data and plan provisions. These future benefit payments consider the individual's compensation and service history, and when that individual might be expected to die, quit, become disabled, or retire. Each future payment is discounted from the date of payment to present day using the actuarial assumptions. Actuaries call this discounted amount the present value of future

benefits (PVFB) and it represents the present value of all benefits expected to be paid from the plan to current plan participants. If assumptions are correct (and if it were allowed), then the NAFI could theoretically set aside that amount of money in a plan today and it would cover payments from the plan, including those for service not yet rendered. Note, this amount considers future service the participant is expected to earn and future pay increases.

110702. Cost Methods

Actuaries developed the following cost methods to be used to determine the amount of the liabilities (current and long-term) to be reported on the balance sheet. These cost methods divide the PVFB into [actuarial liability \(AL\)](#), [normal cost \(NC\)](#), and [present value of future normal costs \(PVFNC\)](#).

A. [AL](#). AL is the portion of the PVFB that is attributed to past service. This is the current value of the compensation that was deferred in prior years. For pension accounting purposes, the AL is referred to as the PBO. Different cost methods calculate the AL differently, but it always reflects past service only. Sometimes the AL reflects expected future pay increases because many pension plans are designed so that the retirement benefit is based on the pay at retirement. To allow the plan sponsor to recognize the cost of the plan gradually over the participant's lifetime, the actuary considers the portion of the future benefit due to past service to already include expected future pay increases. The portion of the PVFB that only recognizes benefits accrued to date (i.e., without future pay increases) is called the present value of accumulated benefits (PVAB). This reflects current service and current salary. For pension funding, the PVAB may also be called the current liability; however, the current liability is calculated using Internal Revenue Service mandated interest and mortality assumptions. For pension accounting purposes, the PVAB is referred to as the ABO.

B. [NC](#). NC is the portion of the PVFB that is attributed to the current year of service. This is the current value of the compensation that is being deferred this year. Different cost methods calculate the NC differently, but generally it reflects the current year of service and may reflect expected future pay increases. For pension accounting purposes, the NC is referred to as the SC.

C. [PVFNC](#). PVFNC is the portion of the PVFB that will be attributed to future years of service. It covers compensation that has not yet been earned. This number is not disclosed and is rarely used in any cost calculations. However, it is disclosed in valuation reports for plans that use the [entry average normal \(EAN\)](#) funding method.

110703. Methods Used for [PVFB](#)

PVFB can be divided into the AL, NC, and PVFNC under many different actuarial cost methods. The three most common cost methods are the [projected unit credit \(PUC\) cost method](#), [unit credit \(UC\) cost method](#), and the [EAN cost method](#).

A. [PUC Cost Method](#). The PUC cost method considers expected future pay increases in the calculation of the liability and [NC](#).

B. UC Cost Method. The UC cost method does not reflect expected future pay increases in the liability, and only reflects one year's expected growth in pay in the **NC**.

C. EAN Cost Method. The EAN cost method tends to generate a **NC** from year-to-year that is a level percentage of payroll for each individual on the system with a single date of retirement, not multiple dates of retirement.