

Employee Benefit Plans Expert Panel
Observations About Current Employee
Benefit Plan Accounting

Objective

To provide FASB with observations regarding areas in current accounting affecting employee benefit plans that are conflicting, redundant, irrelevant, or incomplete due to the specialized characteristics of plans.

This discussion memorandum is intended to provide observations about difficulties encountered in practice with current plan accounting and does not suggest possible resolutions.

Background

On January 29, 2013 the chairs of the AICPA Employee Benefit Plans Audit Quality Center Executive Committee and Employee Benefit Plans Expert Panel (EBP Expert Panel) and AICPA staff met with certain FASB board members and staff members to discuss the specialized nature of employee benefit plans and how FASB can best incorporate considerations for employee benefit plans into their standard-setting process. In addition, the group provided FASB with their observations about areas in current accounting where the standards, when drafted, did not consider the specialized characteristics of plans.

FASB requested that we provide more details on the areas in U.S. GAAP that do not consider the specialized characteristics of employee benefit plans and where plans encounter difficulties in practice. When identifying and prioritizing these areas in accounting, the EBP Expert Panel was asked to consider relevance, operationality, and prevalence of the accounting areas included. With this in mind, the EBP Expert Panel has prepared this discussion memorandum to highlight for FASB the accounting issues that meet the criteria listed previously by grouping the accounting issues into two categories. Category A reflects areas that are considered to be pressing topics that apply to most plans, and standard-setter action is requested. Category B reflects areas that are considered to be important topics that apply to certain types of employee benefit plans and may need further standard-setter action. The categories are further explained later in this discussion memorandum. However, the EBP Expert Panel would also like to note that there are additional practice issues beyond what has been listed in this discussion memorandum of importance to plans. These additional issues have been excluded from this discussion memorandum because they did not meet the criteria for categories A or B.

Employee benefit plans have unique characteristics that differ from both private companies and public companies. Employee benefit plans follow accounting guidance that often is tailored to the unique nature of the plans.¹ As general accounting standards are developed and issued, FASB needs to consider the

¹ See paragraph B11 of the FASB Invitation to Comment, *Private Company Decision-Making Framework: A Framework for Evaluating Financial Accounting and Reporting Guidance for Private Companies*.

existing accounting guidance that is tailored to the unique nature of plans, as well as the specialized characteristics of plans, to avoid overburdening the reporting for plans.

This discussion memorandum highlights those areas in accounting that were tailored to the unique nature of plans that have been subsequently overridden by more recent standards. Further, this discussion memorandum explores the need for plans to be considered their own class of entity due to the specialized characteristics of plans and the differential factors that highlight how plans differ from both private companies and public companies.

In its [letter](#) dated December 19, 2011, FinREC strongly encouraged FASB to holistically review the required disclosures for plans, particularly the fair value disclosures, to determine whether there is a more efficient way for plans to meet their financial statement objectives. This request is further supported by the content that follows, which highlights how the disclosures for employee benefit plans that had been scaled back (through the issuance of Statement of Position (SOP) 99-3, *Accounting for and Reporting of Certain Defined Contribution Plan Investments and Other Disclosure Matters*, [AICPA, *Technical Practice Aids*, ACC sec. 10,790]) are now much more cumbersome due to the issuance of new fair value measurement standards (FASB ASC 820, *Fair Value Measurement*, requirements).

In addition, in February 2013, AICPA staff provided FASB with informal feedback on FASB's *Disclosure Framework* project to aid FASB in determining how employee benefit plans may fit within that framework. As written, the proposed framework does not exclude employee benefit plans from the scope of the framework. Therefore the EBP Expert Panel encourages FASB to consider including specific language within the disclosure framework project that considers the specialized characteristics of plans as they develop new accounting disclosures or to exclude employee benefit plans from the scope of the disclosure framework project. If FASB decides to exclude employee benefit plans from the scope of the project the EBP Expert Panel encourages FASB to develop a process in which the specialized employee benefit plan accounting and reporting is specifically considered when new standards are developed.

The 2013 AICPA Audit and Accounting Guide *Employee Benefit Plans* (2013 EBP Guide) has recently been overhauled to provide current, relevant guidance to preparers and auditors of employee benefit plans. The new guide reflects the changes that have occurred in the employee benefit plan industry and the types of investment vehicles being offered by plans. As part of the guide overhaul project, FinREC discussed various accounting issues specific to employee benefit plans, and, as a result, included numerous recommendations throughout the guide for financial statement presentation and disclosures in areas of accounting where no current requirements exist. These FinREC recommendations were posted for public comment as part of the working draft of the EBP guide and are believed to enhance employee benefit plan reporting. The EBP Expert Panel has included in this discussion memorandum (in categories A and B) the FinREC recommendations from the 2013 EBP Guide they believe are of such importance to warrant FASB consideration. However, they also encourage FASB to consider the guidance contained in the 2013 EBP Guide that has not been included in this discussion memorandum for inclusion in future projects to improve employee benefit plan accounting.

We would be glad to provide FASB with a list of all the FinREC recommendations from the 2013 EBP guide or share the additional issues of importance to plans with FASB upon their request.

Objective of Plan Financial Statements

The primary objective of a plan's financial statements is to provide information that is useful in assessing the plans' present and future ability to pay benefits.

Users of Plan Financial Statements

The users of a plan's financial statements include the Department of Labor (DOL), IRS, Pension Benefit Guaranty Corporation (PBGC), the Securities and Exchange Commission (SEC) (for Form 11-K filers), as well as plan sponsors, trustees, and plan participants. All Form 5500s are filed electronically with the audited financial statements, when applicable, and are available on the DOL website via the EFAST2 system.

Timing of Plan Financial Statements

Plan financial statements that are filed with the Form 5500 are due 7 months after year end and can be extended an additional 2 ½ months. ERISA plans that file with the SEC using the ERISA format are due 180 days after their year end (if filing under the SEC format, plan financial statements are due 90 days after year end). Because of the timing of the issuance of these financial statements, plan participants in defined contribution plans are not able to use them to make investment decisions. Similarly, plan sponsors of defined benefit pension plans do not use plan financial statements to make investment or funding decisions due to the timing of the financial statements.

Long-Term Perspective

Retirement plans are designed with a long-term perspective in mind. For example, in participant-directed defined contribution plans, participants need to determine their asset allocations that will take them to retirement based on risk tolerance and how many years they have left before retirement. This information is typically obtained from provider websites, information brochures, and prospectuses and not from the audited plan financial statements.

Accounting Areas for FASB Consideration

The following is a list of current accounting areas affecting employee benefit plans that are conflicting, redundant, irrelevant, incomplete, or difficult to apply in practice due to the specialized characteristics of plans. The EBP Expert Panel has grouped these areas into two categories:

- Category A — Areas in current accounting affecting most employee benefit plans that are conflicting, redundant, irrelevant, or incomplete due to the specialized characteristics of plans. These areas are considered to be pressing topics that apply to most plans, and standard-setter action is requested.
- Category B — Areas in accounting that are difficult to apply in practice due to the specialized characteristics of plans. These areas are considered to be important topics that apply to certain types of employee benefit plans and may need further standard-setter action.

Category A

Areas in current accounting affecting most employee benefit plans that are conflicting, redundant, irrelevant, or incomplete due to the specialized characteristics of plans. These areas are considered to be pressing topics that apply to most plans, and standard-setter action is requested.

1. Investments and Fair Value Disclosures

The EBP Expert Panel has considered the relevance of FASB ASC 820 disclosures and how they interplay with the required disclosures in FASB ASC 960, *Plan Accounting—Defined Benefit Pension Plans*; FASB ASC 962, *Plan Accounting—Defined Contribution Pension Plans*; and FASB ASC 965, *Plan Accounting—Health and Welfare Benefit Plans*. FASB Statement No. 35, *Accounting and Reporting by Defined Benefit Pension Plans* (now codified in FASB ASC 960), was originally issued over 30 years ago in March 1980. Much of the content found in FASB ASC 962 and 965 has been based on FASB Statement No. 35 content. Few changes have been made to this standard over time. As new accounting standards and updates have been issued, new disclosures are required for employee benefit plan financial statements, even though the effect of these new disclosures on the plan financial statements may not have been specifically considered. The result is a cumbersome set of required disclosures that are lengthy and not always useful to the plan's financial statement users.

In addition, prior to the issuance of SOP 99-3 (now codified in FASB ASC 962 and 965), plans that provided participant-directed investment programs were required to disclose amounts relating to each such program as a separate fund, either in columnar form in the financial statements or in the related disclosures, or through separate financial statements for each investment fund option. SOP 99-3 concluded that a defined contribution plan that provides participant-directed investment programs is no longer required to disclose amounts relating to those individual programs as a separate fund in the financial statements in columnar form, or in the related disclosures, or by separate financial statements for each program as previously required by Practice Bulletin 12, *Reporting Separate Investment Fund Option Information of Defined-Contribution Pension Plans*. SOP 99-3 further concluded that defined contribution plans are not required to present participant-directed plan investments in the statement of net assets available for benefits by general type. Participant-directed plan investments may be shown in the aggregate, as a one-line item, in the statement of net assets available for benefits.

The conclusions reached in SOP 99-3, in effect, reduced the amount of information that needed to be presented in the plan's financial statements for participant-directed plan investments. These conclusions were based on the fact that financial information about many investment fund options had become widely available, often with more frequency and timelier than the issuance of plan financial statements. In addition, financial information is publicly available for many investment fund options throughout the year, including upon request from fund distributors and the SEC. In each instance, participants and other interested parties are provided with financial information that is similar in many respects to the information required to be disclosed. In addition, plan participants receive information about the plan in the form of at least annual (often quarterly) individual account statements and summary annual reports.

Also, plan administrators and the trustees regularly provide plan participants with information on the investment fund options, such as prospectuses on mutual funds.²

This reduction in the amount of information presented in the plan's financial statements for participant-directed investments has now been overshadowed by many of the disclosure requirements in FASB ASC 820 that essentially revert the disclosures about participant-directed investments back to pre-SOP 99-3 because FASB ASC 820 disclosures are required for each class of assets.

The following are specific areas in the FASB ASC applicable to employee benefit plans that are conflicting, redundant, irrelevant, or incomplete.

Accounting Conflicts

- a. The hierarchy disclosures in FASB ASC 820-10-50-2 are generally reflective of the participant-directed investment programs because the aggregated, one-line item classification of investments is not applicable for these disclosures. Therefore, although paragraphs 2–4 of FASB ASC 962-325-45 (SOP 99-3) allows participant-directed investments to be shown in the aggregate, FASB ASC 820 requires these investments to be broken out by level for each class of investment. FASB ASC 820 disclosure requirements are in addition to the disclosure of the fair value for individual investments greater than 5 percent of net assets required by FASB ASC 962-325-50-1A.
- b. The classes of assets in FASB ASC 820-10-50-2B and for plan sponsors in FASB ASC 715-20-50 are based on nature, characteristics, and risk, whereas FASB ASC 962-325-45-5 and 965-325-45-2 requires the presentation of plan investments to be detailed by general type, including registered investment companies, government securities, common collective trusts, pooled separate accounts, short-term securities, corporate bonds, common stocks, mortgages, and real estate. These types may be inconsistent with the nature and risk of the investments, resulting in plans grouping their investments in two different ways.
- c. Realized and unrealized gains or losses are required to be presented in FASB ASC 820 level 3 reconciliation, whereas these amounts are netted in the statement of changes in net assets available for benefits.
- d. Many participant-directed investments allow unrestricted sales for participant-directed transactions so the requirement to disclose the restrictions under Accounting Standards Update (ASU) No. 2009-12, *Fair Value Measurements and Disclosures (Topic 820): Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*, is not relevant to participants. For example, participant-directed withdrawal or transfers for certain common or collective trusts (CCTs) are not restricted; however, plan level initiated liquidations may have restrictions. Plan level initiated liquidations may result from unusual events such as changes in service provider, mergers, or terminations.
- e. FASB ASC 962-325-35-1 states that plan investments should generally be presented at their fair value at the reporting date (see paragraph 965-325-35-3 for special provisions concerning the

² See the –Basis for Conclusions in SOP 99-3, *Accounting for and Reporting of Certain Defined Contribution Plan Investments and Other Disclosure Matters*.

valuation of insurance contracts and paragraph 962-325-35-5 for special provisions concerning the valuation of fully benefit-responsive investment contracts). Consideration should be given for allowing these investment contracts to be reported at contract value, consistent with the Form 5500.

For unallocated funds held in insurance company general account and guaranteed investment contracts, the Form 5500 allows them to be presented in the same manner as specified in the annual report filed by the plan with certain governmental agencies pursuant to the Employee Retirement Income Security Act; that is, either at fair value or at amounts determined by the insurance entity (contract value) (similar to the special provision for insurance contracts in ASC 965-325-35-3). The Form 5500 instructions for Schedule H allow the same method for determining the value of these funds as used for line 3 of Schedule A, or, if line 3 is not required, line 6 of Schedule A. Line 3 of Schedule A instructs the plan to enter the current value of the plan's interest at year end in the contract reported on line 6. Line 6 reflects contract value of contracts with unallocated funds. Contracts that are not required to be presented on line 3 (current value) include contracts in a defined contribution plan that are fully benefit responsive. In other words, fully benefit responsive contracts in unallocated funds held in insurance company general account are reported on Schedule A (line 6) at contract value, are not required to be reported on Schedule A (line 3), and are reported on Schedule H at the same value as Schedule A (line 6).

Synthetic investment contracts issued by banks or insurance companies and investments in funds that hold fully benefit-responsive investment contracts would continue to be reported at fair value as required by FASB ASC 962-325-35-5.

Redundant Accounting

- a. The classes of assets in FASB ASC 820 are based on nature and risk, which is often determined based on the prospectus of the investments or other financial information already available to participants.
- b. Disclosure of the investment strategy of investments under ASU No. 2009-12 (codified in FASB ASC 820) is duplicative of the information already available to participants.
- c. The DOL requires a supplemental schedule listing each investment of the plan, including the issuer, a description (including maturity date, rate of interest, collateral, par, or maturity value), cost (if applicable), and current value. This schedule provides the DOL with the investment details they require, thereby providing investment information to the DOL through another means.
- d. FASB ASC 960-30-45-2 and 965-20-45-3 requires disclosure of the net appreciation or depreciation for each significant class of investments, segregated between investments whose fair values have been measured by quoted prices in an active market and those whose fair values have been otherwise determined. FASB ASC 962-205-45-7 requires disclosure of the change in fair value of each significant type of investment, including participant-directed and self-directed investments held in brokerage accounts. The FASB ASC 820 leveling table provides the fair value for each class of investment. In addition, the Form 5500 does not require net appreciation

and depreciation by type for self-directed accounts, whereas under U.S. GAAP, this disclosure is required. Further, the FASB ASC 820 level 3 roll forward provides the same information about net appreciation or depreciation.

Information Not Relevant for Plans

- a. Most participant-directed investments are daily valued (for example, mutual funds, CCTs, and pooled separate accounts [PSAs]), so the hierarchy level is not relevant to participants.
- b. The level 3 reconciliation for investments in stable value funds, insurance company general accounts, and guaranteed investment contracts (GICs) is not relevant because these investments are presented at contract value in the statement of net assets available for benefits, so gains and losses are not recognized in the statement of changes of net assets available for benefits.
- c. Fully benefit-responsive stable value funds/investment contracts are presented at fair value and included in the hierarchy table, but the relevant measurement is contract value, so presenting the fair value measurement disclosures for these investments (except, perhaps, for synthetic GICs) is not relevant to participants.
- d. Certain plans provide for self-directed brokerage accounts in which participants' investments are not restricted to only those funds offered by the plan. Fair value measurement disclosures for these investments are not meaningful to anyone other than the specific participant who owns the investment, and the participant would not use the plan's financial statements to obtain this information.
- e. Fair value measurements for certain investment contracts issued by insurance companies are not useful information for the DOL or the plan participants. These investment contracts include a promise to pay and are backed by the insurance company's general account that pays a guaranteed interest rate, typically reset periodically (monthly, quarterly, or annually) with a minimum guaranteed rate and GICs. However, there are no specific assets pledged to fund this obligation or promise to pay. They are very similar to bank savings accounts. The participants' accounts reflect these investment contracts at their contract value (contributions, plus interest, less expenses and distributions). Participant transactions also occur at contract value. Plan administrators, auditors, and the issuers may spend significant time determining fair value for such contracts; however, the DOL and the plan participants are only focused on contract value. Other disclosure requirements related to restrictions, such as early termination or surrender charges, and insurance company rates are provided to the participants on a timely basis.
- f. The time and cost of presenting the additional disclosures under FASB ASC 820 is not justified by the benefit to participants for many of the same reasons as presented in the —Basis of Conclusions for SOP 99-3.
- g. The DOL has indicated that the disclosures required by FASB ASC 820 are useful to them for certain investments, and although information about participant-directed investments is available to participants on a more timely basis, the DOL only has access to this information through the disclosures in the plan's financial statements. The DOL has indicated that the fair value

measurements for certain investment contracts and fair value measurements for daily valued funds, such as mutual funds and certain CCTs and PSAs, that do not have significant restrictions is not useful information.

- h. FASB ASC 962 and 965 were amended to reflect the definition of fair value in FASB ASC 960 to include –less cost of sales,|| rather than to eliminate that fair value measure from FASB ASC 960. The EBP Expert Panel questions the usefulness of including –less cost of sales|| when calculating fair value for these investments. In addition, such costs to sell are frequently material in employee stock ownership plans (ESOPs) because these are nontraded equity securities. It is rare, however, that the plan has to pay such costs, at least not directly. It is not clear how this change in definition affects ESOPs (for example, whether such costs need to be considered by the fiduciary if they believe it is unlikely that the plan would incur such costs).

Incomplete Guidance in Presentation or Disclosure for Plans

- a. *Evergreen insurance products.* There is a lack of accounting guidance on how to fair value evergreen insurance products, causing issues in practice, particularly in the use of the guidance in FASB ASC 820-10-50-2bbb that says an entity is not required to create quantitative information to comply with this disclosure requirement if quantitative unobservable inputs are not developed by the plan when measuring fair value (for example, when a plan uses prices from prior transactions or third-party pricing information without adjustment).

Plans sometimes invest in insurance company general account evergreen group annuity products or other similar insurance company products. These products are sometimes referred to as *deposit liabilities* without defined maturities. (Note: Deposit liability is a phrase used by insurance companies and is not how plans would refer to them.). Although evergreen group annuity contracts may have diverse features, these contracts generally have the following characteristics.

For general account evergreen group annuity products, the plan owns a series of promises or guarantees that are embedded in the insurance contract. The insurance contract is issued to the plan sponsor or their trustee (contract holder). The contractual guarantees are backed up by the full faith and credit of the contract issuer. The ability to satisfy the contractual guarantees is dependent upon the issuer’s claims-paying ability. The insurance company owns all securities and other investments held in its general account. The plan’s asset is the contract not the underlying assets in the general account of the issuer. Specific securities within the general account are not carved out and attributed to any specific contract holder. An insurer’s general account is used to fund liabilities associated with various (and sometimes disparate) insurance products (for example, annuities, life insurance, disability insurance, and so on). An insurer’s general account also funds many general operating expenses of the insurer, including, but not limited to, employees’ salaries. In the event that an insurer were unable to satisfy the guarantees provided for in its insurance contracts, contract holders would line up in a legally predetermined priority order to seek fulfillment of any outstanding guarantees or return of premiums, or both, if applicable. It is for this reason that an insurer’s claims-paying rating plays an important role in a plan sponsor’s decision to purchase an insurance contract. These products are used extensively in smaller and

mid-sized defined contribution plans. Although insurers offer several variations of these insurance products, group annuity contracts all tend to include contractual guarantees such as

- the promise to credit interest at crediting rates that are declared in advance and reset from time to time.
- the guarantee that such crediting rates will not be less than the contractual minimum crediting rate, which is never less than zero, regardless of the performance of the general account assets.
- a means for the contract holder to initiate a discontinuation of the contract. The methodology for determining the amounts payable by the insurance company upon a contractual discontinuance is detailed (and guaranteed) in the contract.

These products are similar conceptually to a savings account. However, the crediting rate is determined at the discretion of the insurer.

- b. *Master trusts.* According to the DOL's Form 5500 instructions, a *master trust* is a trust for which a regulated financial institution (bank, trust company, or similar financial institution that is regulated, supervised, and subject to periodic examination by a state or federal agency) serves as trustee or custodian and in which assets of more than one plan sponsored by a single employer or by a group of employers under common control are held. A company that sponsors more than one employee benefit plan or a group of corporations under common control may place assets relating to some or all of the plans into one combined trust account, sometimes referred to as a master trust. Each plan has an interest in the assets of the trust, and ownership is represented by a record of proportionate dollar interest or by units of participation. Plan interests in master trusts may be divided interests, undivided interests, or a combination thereof. A bank or trust company ordinarily serves as the trustee for a master trust, acts as custodian, and may or may not have discretionary control over the assets.

According to FASB ASC 960-30-45-11, a plan's investments in a master trust (whether divided interest, undivided interest, or a combination thereof) are presented in a single line item in the statement of net assets available for benefits. In addition, FASB ASC 960-30-50-1 states that in the notes to the financial statements the investments of a master trust shall be detailed by general type, such as government securities, short-term securities, corporate bonds, common stocks, mortgages, and real estate, as of the date of each statement of net assets available for benefits presented. FASB ASC 960-30-50-2 and 962-325-50-7 state that the net change in the fair value of each significant type of investment of the master trust and total investment income of the master trust by type, including interest and dividends, should also be disclosed in the notes for each period for which a statement of changes in net assets available for benefits is presented. According to FASB ASC 960-30-50-3 and 962-325-50-8, the notes to the financial statements should also disclose (whether divided interest, undivided interest, or a combination thereof) a description of the basis used to allocate net assets, net investment income, gains and losses to

participating plans, and the plan's percentage interest in the master trust as of the date of each statement of net assets available for benefits presented.

In addition, the following AICPA technical questions and answers³ address accounting questions affecting master trusts:

Technical Questions and Answers (TIS) section 6931.09, "Financial Statement Presentation When a Plan Invests in a Common Collective Trust Fund or in a Master Trust That Holds Fully Benefit-Responsive Investment Contracts" (AICPA, *Technical Practice Aids*), provides nonauthoritative guidance for when a plan invests in a CCT (or similar vehicle) or a master trust that holds fully benefit-responsive investment contracts. It states that

the fair value of the investment in the CCT or master trust should be reported in investments on the face of the statement of net assets available for benefits. The amount representing the difference between the fair value and the contract value of the fully benefit-responsive investment contracts held by the CCT or master trust should be presented on the face of the statement of net assets available for benefits and calculated as the sum of the amounts necessary to adjust the portion of net assets attributable to the plan's investment in the CCT or master trust from fair value to contract value. For the master trust, the adjustment only relates to the plan's portion of the master trust invested in the fully benefit-responsive investment contracts.

TIS section 6931.10, "Financial Statement Disclosure Requirements When a Plan Invests in a Common Collective Trust Fund or in a Master Trust That Holds Fully Benefit-Responsive Investment Contracts" (AICPA, *Technical Practice Aids*), provides nonauthoritative guidance for plans that directly invest in CCTs or similar vehicles that hold fully benefit-responsive investment contracts. Those plans do not need to include the disclosures detailed in FASB ASC 962-205-45 in the plan's financial statements. Such disclosures would be included in the financial statements of the CCT, in accordance with FASB ASC 946-210-50-14.

For plans that invest in a master trust that holds fully benefit-responsive investment contracts, the notes to the financial statements should include the disclosures required in paragraphs 2–3 of FASB ASC 962-205-45 related to the fully benefit-responsive investment contracts held by the master trust. These disclosures are necessary because, unlike a CCT, master trust financial statements are not required, and the related disclosure information would not be readily available.

TIS section 6931.11, "Fair Value Measurement Disclosures for Master Trusts" (AICPA, *Technical Practice Aids*), provides guidance on the required fair value measurement disclosures to be made when a plan holds investments in a master trust. This question and answer assists with the implementation of FASB ASC 820 for employee benefit plans that have investments in a master trust. This guidance states that the disclosure requirements of FASB ASC 820 are required for individual investments under a master trust arrangement. In addition, consideration should be

³ See AICPA Publication *Technical Practice Aids*.

given to combining or reconciling, or both, the master trust FASB ASC 820 disclosures with the master trust disclosures as required by paragraphs 1–3 of FASB ASC 960-30-50.

Because audited financial statements are not required for master trusts, the 2013 EBP Guide includes a FinREC recommendation that the notes to the financial statements include the following disclosures that are considered meaningful to the users of the financial statements:

- A statement of net assets of the master trust.
- A statement of changes in net assets of the master trust. To present the plan's activity at the plan level and the master trust's activity at the master trust level, FinREC recommends that the plan's activity, such as contributions (and related accruals) and benefit payments be recorded at the plan level, not the master trust level. Such activity should be recorded as a transfer in or out of the master trust. Plan level expenses that are plan specific (such as actuary, legal, and audit fees) and related accruals should be recorded at the plan level. Master trust investment expense (such as trustee, custodian, and investment management fees) and related accruals should be recorded at the master trust level.
- Investments greater than 5 percent of master trust net assets (only required if the plan holds an undivided interest in the master trust).

To present the investment risk specific to each plan, FinREC recommends that the following additional disclosures be made for plans with a specific interest (not an undivided interest) in master trust investments:

- The plan's percentage interest in each investment type
 - Investments in the master trust which represent greater than 5 percent of the plan's net assets
- c. *Trust-owned life insurance.* Certain plans invest in trust-owned life insurance (TOLI). There is no accounting guidance in FASB ASC about how plans should account for these policies. The 2013 EBP Guide provides the following background about how these policies are typically accounted for:

The TOLI is an investment vehicle designed to increase the tax efficiency of the plan's investments through an arrangement that has the tax benefits of insurance and rate of returns and risk of mutual fund investments. The insurance entity issues life insurance policies on a portion of the plan participants in which the plan is the owner and beneficiary of the policy. The insurance premiums are paid out of the investment in the TOLI to the insurance entity, and the death payments are either reinvested in the TOLI or paid to the plan (at the plan's discretion). Under the terms of these arrangements, the premiums paid to the insurance entity (less certain fees) are held in a separate account by the insurance entity to pay death benefits estimated to be paid during the year. At the end of each year, the insurance entity calculates the actual amount that should have been charged in the previous year using the actual experience rate of the policy. This amount is

compared to the amount held in the separate account, and the investment account is either increased for any amounts due the plan or deducted for any amounts due the insurance entity. Typically, the TOLI investment, if invested in single premium whole life policies, is recorded at contract value (cash surrender value) as provided by the issuer. The cash surrender value of the TOLI is the value that could be received by the trust at the balance sheet date if the contract were terminated. If invested in a policy other than a single premium whole life insurance policy, then the TOLI investment is reported at fair value based upon the underlying assets held in the contract. These contracts generally have no surrender charges and no significant withdrawal limitations other than it may take two to three weeks for the insurance company to cash out from the various investments.

- d. *Allocated and unallocated contracts.* A plan may invest assets with an insurance company pursuant to any number of different types of contracts. The nature of the contract will determine the related accounting and regulatory reporting requirements. Essentially, allocated contracts are excluded from, and unallocated contracts are included in, plan assets. *Allocated contracts* are contracts with an insurance company under which related payments to the insurance company are currently used to purchase immediate or deferred annuities for individual participants. *Unallocated contracts* are contracts with an insurance company under which related payments to the insurance company are accumulated in an unallocated fund to be used to meet benefit payments when employees retire, either directly or through the purchase of annuities. Funds in an unallocated contract may also be withdrawn and otherwise invested.

In recent years, a number of insurance companies have begun marketing —hybrid products that seemingly have characteristics of both an allocated and unallocated contract. Inconsistency in practice occurs when accounting for these hybrid products. The extent to which the assets and transactions related to these hybrid insurance arrangements are recorded in the plan's financial statements in accordance with U.S. GAAP requires careful consideration and depends on the terms of the contract with the insurance company.

The term *allocated* insurance contract has been consistently defined in the instructions to Form 5500. Under that definition, contracts are not *allocated* unless the insurance company or organization that issued the contract has unconditionally guaranteed, upon receipt of the required premium or consideration, to provide a retirement benefit of a specified amount to each covered participant without adjustment for fluctuations in the market value of the underlying assets of the company or organization, and each participant has a legal right to such benefits, which is legally enforceable directly against the insurance company or organization. The reporting exemption for allocated insurance contracts is premised on the fact that under such contracts the plan has effectively transferred the risk for the payment of benefits accrued to that date to the insurer and, accordingly, limited reporting is appropriate.

2. Nonpublic Entity Considerations

As noted in the FASB Invitation to Comment *Private Company Decision-Making Framework—A Framework for Evaluating Financial Accounting and Reporting Guidance for Private Companies*, dated July 2012, the FASB tentatively decided that employee benefit plans should not be considered private

companies for financial reporting purposes. The Invitation to Comment noted that employee benefit plans have unique characteristics that differ from both private companies and public companies. The needs of users of employee benefit plan financial statements are specific and more focused when compared with the needs of financial statement users of both public companies and private companies. Employee benefit plans follow accounting guidance that often is tailored to the unique nature of the plans. The FASB also considered an alternative that would differentiate an employee benefit plan that is sponsored by a private company from an employee benefit plan that is sponsored by a public company. The FASB rejected that alternative because it concluded that the factors that differentiate a private company from a public company, particularly related to the types of users and their financial reporting needs, are not applicable to an employee benefit plan, regardless of whether the plan is sponsored by a private company or a public company. Also, most users of employee benefit plan financial statements do not have different financial reporting needs based on the ownership structure of the plan sponsor. Furthermore, employee benefit plans apply a form of specialized accounting and reporting guidance for which FASB determined no differences should be permitted. The EBP Expert Panel agreed with FASB's conclusion that employee benefit plans should not be considered private companies for financial reporting purposes because plans have unique characteristics.

The next two sections of this discussion memorandum, –Definition of Nonpublic Entity¹¹ and –Employee Benefit Plans Considered Their Own Form of Entity,¹² are intended to point out the confusion that exists in current practice when applying the definition of a nonpublic entity to an employee benefit plan and to highlight why employee benefit plans differ from both private companies and public companies.

Definition of Nonpublic Entity

The definition of a nonpublic entity (as defined in FASB ASC 820) and how all employee benefit plans (those that file with the SEC and those that do not) fit within that definition is causing inconsistencies in practice. The question of whether all plans are considered nonpublic entities for financial reporting purposes has arisen due to the exclusion in ASU No. 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*, for nonpublic entities to make certain required disclosures. The definition of a nonpublic entity in FASB ASC for ASU No. 2011-04 would consider an entity to be a nonpublic entity if it is not controlled by an entity that meets certain criteria. The EBP Expert Panel submitted an issue paper to FASB on May 14, 2012 to address this topic.

Subsequently, the transition guidance in ASU No. 2013-09, *Fair Value Measurement (Topic 820): Deferral of the Effective Date of Certain Disclosures for Nonpublic Employee Benefit Plans in Update No. 2011-04* states that ASU No. 2013-09 applies to plans other than those plans that are subject to the SEC's filing requirements. ASU No. 2013-09 has not included a definition of a nonpublic employee benefit plan in the master glossary and, therefore, does not provide further clarity to the ASU No. 2011-04 requirements.

Currently, there is uncertainty in practice about whether certain plans should be treated as public or nonpublic entities (in particular, employee benefit plans whose plan sponsors are public companies; however, the plan does not file a Form 11-K). The EBP Expert Panel believes there is an urgent need for FASB to address this issue for consistency in reporting for plans.

Employee Benefit Plans Considered Their Own Class of Entity

As noted previously, employee benefit plans differ from both private companies and public companies, and the needs of users of employee benefit plan financial statements are specific and more focused when compared with the needs of financial statement users of both public companies and private companies. The EBP Expert Panel believes consideration should be given to whether employee benefit plans should be treated as a separate class other than public, nonpublic, or private entities. To support this view, the EBP Expert Panel considered the differential factors that were cited in the FASB Invitation to Comment *Private Company Decision-Making Framework—A Guide for Evaluating Financial Accounting and Reporting for Private Companies*, issued April 13, 2013, and the FASB Invitation to Comment *Private Company Decision-Making Framework—A Framework for Evaluating Financial Accounting and Reporting Guidance for Private Companies*, dated July 2012. The following are the six significant factors that were considered to differentiate the financial reporting considerations of private companies and public companies. The EBP Expert Panel has included relevant information relating to employee benefit plans to highlight how employee benefit plans differ from both private and public companies.

1. Types and number of financial statement users

Financial statements of private companies typically have a much smaller number of users than financial statements of many public companies. Public company equity and debt investors and analysts typically are the most common types of users of public company financial statements, while lenders and other creditors and equity investors typically are the most common users of private company financial statements.

Employee benefit plan financial statements are used primarily by the DOL, IRS, PBGC, and SEC (for Form 11-K filers), as well as plan sponsors, trustees, and plan participants. However, plan financial statements that are filed with the Form 5500 are due 7 months after year end and can be extended an additional 2 ½ months. ERISA plans that file with the SEC, using the ERISA format, are due 180 days after their year end (if filing under the SEC format, plan financial statements are due 90 days after year end). Because of the timing of the issuance of these financial statements, plan participants, plan sponsors, and trustees are not able to use them to make investment decisions.

2. Access to management

Private company users have direct access to management to obtain additional material financial information and analysis. Private companies have discretion when determining the nature, extent, and timing of additional financial information to be provided to any of their financial statement users. Generally, private company investors can request and often obtain additional material information beyond what is included in the financial statements from management. In contrast, public companies often have a larger data base of financial statement users. In addition, public company management must consider that their disclosure of nonpublic information to certain types of investors may give rise to an obligation to make full public disclosure of that information; therefore, public companies may have compliance programs in place to guide those who make communications with investors or other users on the company's behalf.

Information related to employee benefit plans is available to plan participants in timelier ways other than the financial statements, such as through the provider websites, periodic participant statements, summary annual report, or prospectuses. Much of the reporting is driven by ERISA regulations.

3. Investment strategies

Investment strategies often vary between private and public company investors. Public company investors are more likely to hold their equity ownership interests for a shorter duration than many private company investors. In addition, investment return and exit strategies generally vary between public and private company investors.

Employee benefit plans do not have investees in the traditional sense of the term because the participant does not purchase a unit of ownership of the plan; rather, it is the collection of investments intended to provide benefits at a future date. Employee benefit plans are designed with a long-term perspective in mind. As noted earlier, in participant-directed defined contribution plans, participants need to determine their asset allocations that will take them to retirement, based on risk tolerance and how many years they have left before retirement. This information is typically obtained from provider websites, information brochures, and prospectuses. As noted previously in the –Background section of this discussion memorandum, the EBP Expert Panel encourages FASB to consider including specific language within FASB’s *Disclosure Framework* project that considers the specialized characteristics of plans as they develop new accounting disclosures.

4. Ownership and capital structures

The capital structure and capital funding of private companies vary from that of public companies, in part, because of the strong focus by private companies on income taxes, estate taxes, succession planning, restrictions on who can hold their stock and the transferability of that stock, and limitations on their exposure to personal liability and loss. Many private companies have multiple entities under common ownership, which often results in transactions with affiliates and other related parties, as well as guarantees and cross-collateral arrangements with lenders. In contrast, the most common form of public company structure is the C corporation.

Employee benefit plans are tax-exempt entities that are established for a different purpose than either a private company or a public company. The objective of the plan financial statements is to provide information that is useful in assessing the plans’ present and future ability to pay benefits. In addition, in a defined contribution plan environment, the amount invested in the plan is generally at the discretion of the participant, based on their level of participation and their own retirement planning.

5. Accounting resources

Private companies generally have fewer and less specialized accounting personnel than public companies. Consequently, many private companies are less likely than public companies to actively participate in the standard-setting process and to closely monitor changes in accounting guidance.

This is especially true for employee benefit plans because the plans are often managed by human resources personnel, rather than personnel who are skilled in finance or accounting. In addition, because of their specialized characteristics, plan sponsor management frequently lack the specialized financial

reporting knowledge needed for plans. Many are hands-off, relying heavily on third-party administrators for satisfying reporting requirements. When an audit is not required by regulations, financial statements are rarely prepared.

6. Learning about new financial reporting guidance

Many preparers of private company financial statements said that they primarily learn about new financial accounting and reporting guidance from their public accountants and that those educational updates generally coincide with planning procedures of an audit or review of year-end financial statements. In contrast, because of the complexity of public company reporting requirements and their quarterly financial reporting requirements, preparers of public company financial statements commonly learn about new guidance more continuously throughout the year.

Employee benefit plans are similar to private companies in that most preparers of plan financial statements learn about new financial accounting and reporting guidance from their public accountants and that those educational updates generally coincide with planning procedures of the audit of the plan's year-end financial statements.

3. Holistic Review of Plan Disclosures

As noted previously in the –Background section of this discussion memorandum, the FinREC comment letter to FASB dated December 19, 2011, strongly encouraged FASB to holistically review the required disclosures for plans, particularly the fair value disclosures, to determine whether there is a more efficient way for plans to meet their financial statement objectives.

Category B

Areas in accounting that are difficult to apply in practice due to the specialized characteristics of plans. These areas are considered to be important topics that apply to certain types of plans and may need further standard-setter action.

1. Defined Benefit Plan Observations

Differences Between Plan Sponsor Accounting and Plan Accounting, Particularly as It Relates to Actuarial Assumptions

Several economic and demographic assumptions are used in actuarial valuations for defined benefit pension plans to determine the actuarial present value of accumulated plan benefits in accordance with the guidance in FASB ASC 960. One of the most significant economic assumptions is the interest rate used to discount future benefit payments (interest rate). FASB ASC 960 addresses two approaches that can be used to select the interest rate. FASB ASC 960-20-35-1 states that assumed rates of return should reflect the expected rates of return during the period for which payments of benefits is deferred and should be

consistent with returns realistically achievable on the types of assets held by the plan and the plan's investment policy (referred to as the *long-term expected rate of return on plan assets*). FASB ASC 960-20-30-1A states that when selecting certain assumptions to be used in determining the actuarial present value of accumulated plan benefits, an acceptable alternative to the long-term expected rate of return on plan assets is to use those assumptions that are inherent in the estimated cost at the benefit information date to obtain a contract with an insurance entity to provide participants with their accumulated plan benefit (referred to as the *settlement rate*).

The most commonly used approach under FASB ASC 960 is to reflect the long-term expected rate of return on plan assets. This rate is generally stable from one year to the next. In accordance with FASB ASC 960-20-35-8, various factors, including the following, should be considered in estimating rates of return to be used in determining the actuarial present value of accumulated plan benefits:

- Rates of return expected from investments currently held or available in the marketplace
- Rates of return expected from the reinvestment of actual returns from those investments
- The investment policy of the plan, including the diversity of investments currently held and expected to be held in the future

Many employers are changing the mix of the types of securities in which they have been historically invested. For employers that are changing their mix of assets, the actual history of returns is not as relevant as new expectations for the new mix of assets.

The second approach (the settlement rate approach) that may be used to select the interest rate and determine the present value of accumulated plan benefits under FASB ASC 960 is to select a rate that reflects an insurance entity's interest basis for determining annuity purchase rates as of the benefit information date. Because this is a —settlement type¹ of rate, it may be similar to (but not necessarily the same as) the FASB ASC 715 discount rate used for the financial statements of the plan sponsor. It should be noted that the most common approach to selecting a settlement type discount rate pursuant to FASB ASC 715, *Compensation—Retirement Benefits*, is by reference to corporate high-quality (AA or better) investment-grade bonds whose payments streams can be used to approximate the cost of settling expected future cash flows from the plan. In practice, however, the cost of a contract with an insurance entity would likely consider more variables than the yields on high-quality fixed income securities, which are available to pay benefits to plan participants. An interest rate selected on a settlement type rate basis can be expected to change from year to year to reflect changes in the long-term fixed income rate markets.

In addition, the actuary will need to use different rates for different purposes. For example, the rate to calculate funding requirements will differ from the rate used to estimate the accumulated plan benefits under FASB ASC 960. The discount rate used in accordance with FASB ASC 715 to measure the vested, accumulated, and projected benefit obligation may also be a different rate. Further, the PBGC uses different rates when calculating the distribution amounts due to participants. The fact that there are different obligation amounts for corporate reporting and separate plan reporting (which differ from those

for determining funding requirements and the PBGC premiums) creates a disconnect for users of the financial statements.

Beginning-of-Year Valuation Issues

The actuarial present value of accumulated plan benefits may be presented as of the beginning or the end of the plan year; under FASB ASC 960-205-45-4, however, an end-of-year benefit information date is considered preferable. The presentation of the financial statement information and the notes are affected by the benefit information date selected for disclosure. If end-of-year is presented, the present value of accumulated plan benefits will be as of the same date as the net assets. In this case, at a minimum, two statements of net assets available for benefits and one statement of changes in net assets are presented. In addition, two corresponding statements (or disclosure in the notes) of the present value of accumulated plan benefits and one statement of changes also are presented.

However, if beginning-of-year benefit information is used, the date of the benefit information in the actuarial report may not match the date that net assets are presented. For example, for financial statements presented as of December 31, 2011 and December 31, 2010, the actuarial valuation will be as of January 1, 2011. For the benefit information to match the statement of net assets, the present value of accumulated plan benefits should be presented as of December 31, 2010 (one day earlier). Typically, this will not cause a material misstatement unless a plan amendment was adopted on or after January 1, 2011, with a January 1, 2011 effective date. In that case, the effect of the amendment must be removed. When beginning-of-year benefit information is used, comparative statements of net assets and comparative statements of changes would be presented. Only a single-year presentation of accumulated plan benefits is required, with a roll forward of the change from the prior year.

The use of the beginning-of-year benefit information is still commonly used and causes much confusion in practice. Furthermore, in a terminating plan, beginning-of-year benefit information becomes irrelevant.

The conclusions reached in FASB Statement No. 35 explain that although the initial exposure draft required end-of-year benefit information, a number of respondents expressed the view that the determination of end-of-year benefit information on a timely basis was not practical and would cause increased actuarial fees. They indicated that most actuarial valuations are performed during the year using data as of the beginning of the year and that changing that practice, at that time, might create significant timing problems in terms of scheduling the actuaries' workload and, in some cases, obtaining necessary end-of-year data. In addition, they noted that the Form 5500 Schedule B also requires both net asset and benefit information to be presented as of the beginning of the year. After considering the letters of comment received on the exposure draft, FASB concluded that, at that time, the perceived costs of requiring end-of-year benefit information may exceed the potential benefits of such information. Therefore, FASB Statement No. 35 provided for the presentation of benefit information as of either the beginning or end of the year.⁴

The conclusions reached in FASB Statement No. 35 also noted, however, that although FASB decided not to require end-of-year benefit information, it considers presentation of such information to be a desirable goal. Plans are encouraged to develop procedures to enable them to use an end-of-year benefit

⁴ See paragraphs 205–211 in the –Basis For Conclusions in FASB Statement No. 35, *Accounting and Reporting by Defined Benefit Pension Plans*.

information date. In that regard, FASB Statement No. 35 noted that projecting to the end of the year detailed employee service-related data as of a date within the year may be acceptable in approximating end-of-year benefit information.⁵

Currently, many plans have not achieved the goal of presenting the accumulated plan benefit information as of the end of the year, even though they are able to estimate the amount for plan reporting purposes. This estimate may be based on end-of-year census data due to the timing of the audit or beginning-of-year census data that is rolled forward to the end of the year.

Recording of Contributions Receivable

Currently, there are many questions related to the recording of a contribution receivable for plans, in particular, the interpretation of what a –formal commitment means under U.S. GAAP. Because of the later-filing deadline for the Form 5500, many plan sponsors prefer to wait until September 15th (tax-related deadline for making a tax-deductible contribution) to determine the contribution receivable so that the financial statements are consistent with the Form 5500 Schedule SB (but not necessarily U.S. GAAP). The 2013 EBP Guide provides the following guidance to promote consistency in practice when determining a –formal commitment:

For defined benefit pension plans, FinREC recommends that the ERISA minimum required contribution determined by the actuary be recorded as a contribution receivable in the plan’s financial statements if not paid by year-end. Sometimes, a contribution made after year-end that was not the result of a formal commitment at year-end is later recharacterized for funding and tax purposes by the plan sponsor as a contribution attributable to the plan year being reported on. This recharacterization may constitute a nonrecognized (type 2) subsequent event (an event occurring after the reporting date that is indicative of conditions [for example, a formal commitment] that did not exist at the reporting date) and, consequently, would not be recorded as a contribution receivable.

In certain situations of business hardship, plan sponsors may be unable to satisfy the minimum funding standard for a plan year without temporary substantial hardship. In these cases, the plan sponsor may apply to the Secretary of the Treasury for a waiver of the minimum funding standard. Such application must be filed no later than 2 ½ months after the plan’s year-end. The Secretary of the Treasury cannot waive the minimum funding standard with respect to a plan for more than 3 of any 15 consecutive plan years. If granted, waivers generally permit a plan sponsor to amortize the ERISA minimum contribution, including interest, as defined under the Internal Revenue Code (IRC) over a period of 5 years. FinREC recommends that a receivable be recorded for the minimum required contribution that is not received within the statutory funding deadline and consider whether an allowance for estimated uncollectable amounts is necessary.

Presentation of Plans That Have Both Defined Benefit and Defined Contribution Features

Certain employee benefit plans (other than cash balance plans) often have features of both defined contribution and defined benefit plans as a result of former plans merging into current plans or changes in

⁵ See footnote 4.

benefit provisions. For these plans, certain assets in the plan are often designated to fund the benefits under the defined benefit provisions and other assets that are defined contribution assets. Currently, there is no specific reporting and accounting requirements under U.S. GAAP for these types of plans, leading to diversity in practice. For example, should there be additional presentation regarding which assets are designated to fund the specific benefits, as well as information regarding the value of the specific benefits?

2. Health and Welfare Plan Observations

Defining the Reporting Entity

The reporting entity for a health and welfare plan can take many forms and can be very challenging to determine. Employers may sponsor multiple individual welfare benefit plans, and others may sponsor individual health and welfare benefit programs, which are included in a single plan (for example, medical, dental, and vision). For ease of regulatory reporting, some plan sponsors may decide to combine their individual plans or programs into a single plan using a wrapper plan document (wrapper plans are also known as *omnibus*" or *umbrella* plans). Although the wrapper plan document generally does not define plan terms or describe plan benefits, it does provide the important documentation backbone shared by the plans wrapped therein. Once the reporting entity has been established, all plan transactions, including contributions, benefit payments, and expenses, whether paid through a trust or otherwise (for example, some plans may pay only a portion of the plan's benefit payments and expenses through a trust), should be recorded in the plan's financial statements.

To promote consistency in practice, the 2013 EBP Guide contains a FinREC recommendation that such wrapped plans or programs be accounted for similar to a merger of two or more plans at the time the plans or programs are combined.

Health and Welfare Plans That Have Features of Both Defined Benefit and Defined Contribution Plans

Health and welfare plans may also have benefit provisions that include features of both defined benefit and defined contribution plans and would have some of the same issues regarding accounting and reporting as described previously for defined benefit plans. Health and welfare plans may have unfunded account balances that meet the definition of a defined contribution plan, but the plan has defined benefit features. For example, some health and welfare benefit plans may have unfunded notional participant accounts. Therefore, the net assets available for benefits do not represent the obligations associated with the plan. There are inconsistencies in practice with respect to whether there is a need to present an obligation associated with the notional account balances.

Health Savings Accounts That Run Through the Voluntary Employees' Beneficiary Association Trust Account

The Internal Revenue Code (IRC) provides for certain types of tax-advantaged financial arrangements, such as flexible spending accounts (FSAs), health savings accounts (HSAs), and health reimbursement arrangements (HRAs). When an FSA, HSA, or HRA is wrapped into a health and welfare plan that

requires an audit, consultation with the plan's legal counsel may be needed to aid in the determination about whether the FSA, HSA, or HRA activity should be included in the plan's financial statements. Considerations in that determination may include the sources of funding (for example, employer, participants, or both), who has legal title to the amounts in the accounts, how the claims are adjudicated (for example, by employer, self-adjudicated by participant, or other), or whether a carry-forward provision exists in the next plan year for unused amounts. Currently, there are many questions related to the proper accounting for FSA, HSAs, and HRAs. The 2013 EBP Guide provides the following guidance to promote consistency in practice. If an FSA or HRA are wrapped or a component of the health and welfare plan, FinREC recommends that unused amounts available to participants at year-end be included in the plan's statement of net assets available for benefits, and the associated activity (for example, contributions and benefits paid) be included in the plan's statement of changes in net assets available for benefits. Claims incurred before plan year-end that are submitted after year-end (but before the date defined by the plan), along with the amount and ultimate disposition of forfeited amounts, are typically disclosed. If an HSA is a component of the health and welfare plan, FinREC recommends disclosure that the arrangement exists, but that the associated activity be excluded from the plan's financial statements because the plan is not obligated to pay the benefits.

Recording Contributions Receivable

Currently, there are many questions related to the recording of a contribution receivable for plans. For example, the 2013 EBP Guide provides the following guidance to promote consistency in practice for defined benefit health and welfare plans. FinREC recommends that a receivable from the employer be accrued equal to the liability for claims incurred but not reported (IBNR) for participant claims if, as of the date of the financial statements, there is a legal or contractual requirement for the employer to fund the specific amount. This legal or contractual requirement generally does not exist for single employer plans.

Recording Claims IBNR For Postemployment and Postretirement Benefits

Consolidated Omnibus Budget Reconciliation Act (COBRA) benefits typically become a postemployment obligation of the plan when the participant terminates employment and enrolls in COBRA benefits. Depending on how the obligation for claims IBNR is estimated, a portion of the COBRA obligation may be included in the obligation for claims IBNR; however, this obligation will typically not include the entire postemployment obligation for COBRA. For example, the postemployment obligation for COBRA benefits should include the employer's portion of the claims expected to be incurred and paid for all participants on COBRA as of the plan's year-end through the date their COBRA benefits cease. Any claims incurred after the plan's year-end for these participants would not be included in the obligation for claims IBNR. It is important for plan sponsors to ensure claims IBNR for postemployment have been properly included in the obligations reported (that is, that it has not been double-counted or omitted entirely) and consider disclosure of where it has been recorded.

Claims IBNR may be computed in the aggregate for active participants and retirees. Alternatively, if claims IBNR are not calculated in the aggregate for active participants and retirees, the claims IBNR for retirees are included in the postretirement benefit obligation. It is important for plan sponsors to determine

that claims IBNR for retirees have been properly reported (that is, have not been double-counted or omitted entirely) and consider disclosure regarding where they are recorded.

Stop-Loss Premiums

Currently, there are many questions related to the accounting for stop-loss premiums. The 2013 EBP Guide provides the following guidance to promote consistency in practice. In a stop-loss insurance arrangement, a plan's obligation for any plan participant's claim may be limited to a fixed dollar amount (specific stop-loss coverage), or the plan's total obligation may be limited to a maximum percentage (for example, 125 percent) of a preset expected claims level (aggregate stop-loss coverage). Accordingly, the insurance company assumes the benefit obligation in excess of the defined limits. Consistent with the presumption of the reporting entity, FinREC recommends that capturing all activity associated with providing the health program is most meaningful to financial statement users, and that in order for financial statement users to fully understand the costs of such health programs and appropriately reflect the true plan obligations, amounts due from stop-loss insurers should be included in the plan's financial information.

As such, FinREC recommends that stop-loss premiums paid, whether paid by the plan or plan sponsor, be recorded as an expense of the plan. Stop-loss amounts due to the plan or trust from insurers should be recorded as an asset with a corresponding offset to benefit payments if the benefit has been paid. Appropriate disclosure should be made regarding the amount of stop-loss recoveries that have been netted against benefits paid.

Although not commonplace, FinREC recognizes that there may be instances when recording stop-loss activity in the plan's financial statement may not be appropriate given the numerous variations and extensions of coverage that are available in the marketplace. Amounts payable to the plan sponsor that do not reduce the amount of benefits that need to be covered by the plan's assets and future employer contributions may not need to be reflected in the plan's financial statements. In such circumstances, the plan should consider disclosure of the existence of such stop-loss arrangements and the fact that the plan's financial statements do not reflect any amounts associated with such arrangements.

Numerous factors should be considered when determining if such activity should be included in the plan's financial statements including, but not limited to, the following:

- How the document is written (individual versus aggregate coverage)
- How the amounts are reimbursed (for example, to the plan sponsor or through the claims processor)
- Who the named insured is (for example, the plan sponsor or plan)
- Who is entitled to receive the reimbursement (plan or plan sponsor)

Other Receivables—Refunds, Rebates, and Subsidies

Health and welfare plans can have other receivables, including those associated with contractual relationships. Whether a rebate or refund is due to the employer or the plan is determined based upon the service provider agreements. There is diversity in practice in accounting for rebates. The 2013 EBP Guide includes the following guidance to promote consistency in practice. When a rebate or refund from service

providers is contractually due to the plan, FinREC recommends that such rebates or refunds be recorded as plan assets if collection is probable, and the amount can be reasonably estimated. If the amount cannot be reasonably estimated, such amounts should be recorded when received with appropriate disclosure. If the associated benefit has been paid, rebates and refunds should be recorded as an offset to benefit payments or premium payments, as applicable, with appropriate disclosure. In circumstances in which the plan sponsor is contractually due the rebate or refund, the plan should consider disclosing the existence of such programs.

When a plan sponsor has a health and welfare plan, the benefits may qualify for certain subsidies from a government agency, for example, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 subsidy, the COBRA Premium subsidy included in the American Recovery and Reinvestment Act of 2009, and reimbursements received under the Patient Protection and Affordable Care Act's (PPACA) Early Retirement Reinsurance Program (ERRP). The subsidy or reimbursements may be paid in various ways (for example, directly to the plan sponsor, rather than the plan, or as a deduction on the plan sponsor's payroll tax return). Each subsidy should be evaluated separately. There is no consistency in practice on how to evaluate and account for such subsidies.

The 2013 EBP Guide states that if the subsidy is legally due the plan, the recording of a receivable may be appropriate. The primary objective of the financial statements of a health and welfare plan is to provide financial information that is useful in assessing the plan's present and future ability to pay its benefit obligations when due. Therefore, an amount to be paid to the plan sponsor that does not reduce the amount of benefits that need to be covered by the plan's assets and future employer contributions should not be reflected in the plan's financial statements. If the plan sponsor is not required to use the subsidy to fund benefits and may use it for any valid business purpose, the amount should not be recorded as a receivable on the plan's financial statements.

The following AICPA technical questions and answers address plan accounting for certain subsidies.

Medicare Subsidy

TIS section 6931.05, –Accounting and Disclosure Requirements for Single-Employer Employee Benefit Plans Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003, (AICPA, *Technical Practice Aids*), states that the effects of the employer's Medicare subsidy should not be reflected in the plan's obligations. The primary objective of the financial statements of a health and welfare benefit plan is to provide financial information that is useful in assessing the plan's present and future ability to pay its benefit obligations when due. The Medicare subsidy amount is paid to the plan sponsor and does not flow into the plan. The plan sponsor is not required to use the subsidy amount to fund the postretirement benefits and may use the subsidy for any valid business purpose. As a result, the Medicare subsidy does not reduce the amount of benefits that need to be covered by plan assets and future employer contributions. Therefore, the accumulated plan benefit obligation (APBO), without reduction for the Medicare subsidy, is a more meaningful measure of the benefits. Further, the information necessary to calculate the gross measure should be readily available for sponsors who are subject to income taxes because those plan sponsors should maintain gross and net measures of the APBO in order to properly account for income taxes under FASB ASC 740. This question and answer does, however, suggest the following disclosures be made by the plan: (a) The existence of the Act; (b) the fact that the

APBO and the changes in the benefit obligation do not reflect any amount associated with the Medicare subsidy because the plan is not directly entitled to the Medicare subsidy; and (c) Until the plan sponsor (employer) is able to determine whether benefits provided by its plan are actuarially equivalent to Medicare Part D.1, that the employer is not able to determine whether the benefits provided by its plan are actuarially equivalent to Medicare Part D.1. If the plan sponsor (employer) has included the effects of the Medicare subsidy in measuring its APBO and changes in benefit obligation, the plan should disclose the fact that the amount of the APBO differs from that disclosed by the plan sponsor (employer) because the plan sponsor's amounts are net of the Medicare subsidy.

TIS section 6931.06, –Accounting and Disclosure Requirements for Multiemployer Employee Benefit Plans Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (AICPA, *Technical Practice Aids*), states that in the case of a multiemployer plan, yes, the multiemployer plan's benefit obligations should be reduced by the effects of the Medicare subsidy because the multiemployer plan trust receives the subsidy amount directly and not the individual employers. Because the primary objective of the financial statements of a health and welfare benefit plan is to provide financial information that is useful in assessing the plan's present and future ability to pay its benefit obligations when due, and because the Medicare subsidy amount flows into the multiemployer plan trust, the APBO net of the Medicare subsidy is a more meaningful measure of those benefits. This question and answer also suggests the following disclosures be made by the plan: Until the multiemployer plan is able to determine whether benefits provided by its plan are at least actuarially equivalent to Medicare Part D.1, the plan should disclose the following in the notes to its financial statements: (a) The existence of the act; and (b) The fact that measures of the APBO and changes in the benefit obligation do not reflect any amount associated with the subsidy because the plan is unable to conclude whether the benefits provided by the plan are actuarially equivalent to Medicare Part D under the act. If the multiemployer plan has included the effects of the Medicare subsidy in measuring its APBO and changes in the benefit obligation, the plan should disclose the following: (a) The existence of the act; (b) The reduction in the APBO for the subsidy related to benefits attributed to past service; (c) The effect of the subsidy on the changes in the benefit obligation for the current period; (d) An explanation of any significant change in the benefit obligation or plan assets not otherwise apparent in the other disclosures; and (e) The gross benefit payments (paid and expected, respectively) including prescription drug benefits, and separately the gross amount of the subsidy receipts (received and expected, respectively).

COBRA Premium Subsidy

TIS section 6931.12, –Accounting and Disclosure Requirements for Health and Welfare Plans Related to the COBRA Premium Subsidy Included in the American Recovery and Reinvestment Act of 2009 (AICPA, *Technical Practice Aids*), states that when calculating a health and welfare plan's postemployment benefit obligation, the COBRA premium subsidy should be considered a replacement of a portion of the employee COBRA contribution and, therefore, should be recorded consistent with how employee contributions are currently required to be recorded. The amount of the present value of the former employee contributions, along with the present value of the COBRA premium subsidy, would have an offsetting effect on the COBRA liability when calculating the COBRA postemployment obligation to be included in the plan's financial statements. Also, disclosure should be made about the portion of the plan's estimated cost that is funded by the COBRA premium subsidy. The accounting for

the COBRA subsidy in a single employer plan differs from the accounting for the Medicare Part D subsidy for prescription drugs in TIS section 6931.05 because under the Medicare Part D subsidy, the employer is not obligated to transfer the subsidy to the plan, whereas with the COBRA subsidy, the employer has already incurred the cost of providing COBRA benefits (either by payment of a premium to an insurance company or by paying future claims if self-insured) and has paid benefits prior to receiving the subsidy. The COBRA premium subsidy is intended to subsidize the former employee's cost, not the employer's cost. Further, the COBRA premium subsidy is temporary, but the Medicare Part D subsidy can be anticipated for many years into the future. Actuarial valuations of postretirement medical plans make projections for 50 years or more. The COBRA subsidy has a maximum projection period of 15 months following the expiration date of the Recovery Act provision. Changing the measurement of the COBRA postretirement obligation for the periods impacted by the COBRA premium subsidy would affect comparability of the financial statements.

ERRP Reimbursement

TIS sections 6931.13–.17 address questions related to how a health and welfare plan accounts for reimbursements received under the PPACA's ERRP when the reimbursement is not remitted to the trust, how it affects the postretirement benefit obligation, and recommended disclosures. The TIS sections state that if a reimbursement is received under the ERRP, the employer must use the proceeds to reduce (a) the employer's health benefit premiums or costs; (b) plan participants' health benefit premium contributions, copayments, deductibles, coinsurance, or other out-of-pocket costs or any combination of these costs; or (c) any combination of the costs specified in (a) and (b). As stated in paragraph 7.10 of the 2013 EBP Guide, all plan transactions, including contributions, benefit payments, and expenses, whether paid through a trust or otherwise (for example, some plans may pay only a portion of the plan's benefit payments and expenses through a trust), should be recorded in the plan's financial statements. Reimbursements from the ERRP, although used to reduce contributions from the employer or participants (or a combination of both), are considered contributions from other identified sources. FASB ASC 965 states that the statement of changes in net assets available for benefits shall be presented in enough detail to identify the significant changes during the year, and it includes contributions from other identified sources (for example, state subsidies or federal grants). The questions and answers also state that the health and welfare plan should not reflect a receivable when the employer filed for reimbursement under the ERRP prior to year-end but did not receive approval of the reimbursement request until after year-end because realization of the reimbursement request is subject to approval, and approval is contingent upon the availability of funds in the ERRP. Consulting with the plan actuary is important in determining the effect of the reimbursed amounts on the health and welfare plan's postretirement benefit obligation, and the questions and answers recommends various disclosures be made.

Recognizing Postemployment Benefits

Many plans require that participants pay the estimated full cost of health benefits provided under COBRA. In such situations, the plan would not recognize a postemployment obligation provided the premiums cover the claims and related costs incurred. If the plan sponsor subsidizes the cost of health benefits provided under COBRA, a postemployment obligation should be recognized by the plan to the extent that all criteria required by FASB ASC 715 and 712, as applicable, are satisfied. There is no specific guidance in FASB ASC 965 for health and welfare plans on this topic.

As illustrated by a similar example in FASB ASC 712-10-25-5, in the event that health benefits provided under COBRA are self-funded, FinREC recommends that the cost of those postemployment benefits be recognized when the event causing the plan to become obligated to pay COBRA benefits occurs, and a reasonable estimate can be made. COBRA benefits typically become a postemployment obligation of the plan when the participant terminates employment and enrolls in COBRA benefits.

Changes in Laws and Regulations (Such as the Affordable Care Act)

In March 2010, the president signed into law a sweeping overhaul of the health care system that affects individuals, insurance companies, health care providers, and employers. Although many of the provisions of the Affordable Care Act took effect when it was signed into law in 2010, the bulk of the major provisions will phase in by January 2014, and any remaining provisions will be phased in by 2018. In addition to many new tax rules to help offset the overall cost of the reform, the new laws contain many changes for employers to consider that may affect plan operations, internal controls, and financial reporting. For example, patient-centered outcome research fees, insurance exchanges, transitional reinsurance fees, Cadillac tax, retiree prescription drug benefits, and medical loss ratio rebates. It is expected that these changes will affect plan reporting, including the actuarial calculation of plan obligations.

3. Challenges for ESOPs

Differences in Accounting Between Plan Sponsor and Plan Accounting

FASB ASC 718, *Compensation — Stock Compensation*, applies to all employers of ESOPs, both leveraged and nonleveraged. FASB ASC 718 does not apply to the ESOP. The employer accounting uses the concept of allocated, released, or committed to be released shares. ESOPs do not use these concepts when accounting for shares. There is little accounting guidance available today for these types of plans with much diversity in practice, including how unallocated shares are defined, the presentation of employer's advances to the plan to cover liquidity issues (interest free loans), transferring of participant balances into plan sponsor 401(k) plans to satisfy diversification requirements, floor-price protection on certain ESOP securities, and the presentation of allocated and unallocated shares in the plan's financial statements. The EBP Expert Panel believes accounting guidance for ESOPs is needed and should align with the plan sponsor accounting.

Presentation of Allocated and Unallocated Shares in the Financial Statements

Currently, there is no requirement for how an ESOP should present allocated and unallocated shares in a leveraged ESOP. The 2013 EBP Guide includes the following guidance to promote consistency in practice. For leveraged ESOPs, FinREC recommends the financial statement presentations reflect allocated and unallocated amounts as separate columns on both the statement of net assets available for benefits and the statement of changes in net assets available for benefits. For nonleveraged ESOPs, FinREC recommends the presentation reflect only the total column without the segregation between allocated and unallocated. Allocated and unallocated designations distinguish between assets that belong to plan participants and those that are still available as collateral for the ESOP loan.