

Statutory Issue Paper No. 13

Employers' Accounting for Postemployment Benefits

STATUS

Finalized March 16, 1998

Original SSAP and Current Authoritative Guidance: SSAP No. 11

Type of Issue:

Common Area

SUMMARY OF ISSUE

1. Current statutory practices and procedures do not address accounting for the estimated cost of benefits provided by an employer to former or inactive employees or agents after employment but before retirement (referred to as "postemployment benefits"). Postemployment benefits are all types of benefits provided to former or inactive employees or agents, their beneficiaries, and covered dependents. Those benefits include, but are not limited to, salary continuation, supplemental unemployment benefits, severance benefits, disability-related benefits (including workers' compensation), job training and counseling, and continuation of benefits such as health care benefits and life insurance coverage.
2. The purpose of this issue paper is to establish statutory accounting principles for postemployment benefits that are consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts).

SUMMARY CONCLUSION

3. Employers shall accrue a liability for the reporting entity's obligation to provide postemployment benefits if all of the following conditions are met:
 - a. The obligation is attributable to employees' or agents' services already rendered,
 - b. The obligation relates to rights that vest or accumulate,
 - c. Payment of the benefits is probable, and
 - d. The amount of the benefits can be reasonably estimated.
4. If those four conditions are not met, the employer must account for postemployment benefits when it is probable that a liability has been incurred and the amount can be reasonably estimated. In the unlikely situation in which a reporting entity does not accrue a liability in accordance with paragraph 3 only because the amount cannot be reasonably estimated, that fact and the reasons therefore shall be disclosed in the notes to the financial statements.
5. Postemployment benefits provided to employees or agents in connection with their termination can include special termination benefits and contractual termination benefits. Special termination benefits are defined as those that are offered only for a short period of time; contractual termination benefits are defined as those required by the terms of a plan only if a specified event, such as a facility closing, occurs. An employer that offers special termination benefits to employees or agents shall recognize a liability and an expense when the employees or agents accept the offer and the amount can be reasonably estimated. An employer that provides contractual termination benefits shall recognize a liability and an expense when it is probable that employees or agents will be entitled to benefits and the amount can be reasonably estimated. The cost of such termination benefits shall include the amount of any lump-sum payments and the present value of any expected future payments.

6. Accounting changes adopted to conform to the provisions of this issue paper shall be accounted for in accordance with *Issue Paper No. 3—Accounting Changes*. In the year the principle is adopted, recognition of the liability for postemployment benefits at the time of adoption that has not previously been recorded shall be recognized through a direct charge to surplus.

Consolidated/Holding Company Plans

7. The employees of many reporting entities are eligible for certain postemployment benefits granted by a parent company or holding company. An entity with employees who are eligible for those benefits and is not directly liable for those related obligations shall recognize an expense equal to its allocation from the parent company or holding company of the benefits earned during the period. A liability shall be established for any such amounts due, but not yet paid. Furthermore, the reporting entity shall disclose in the notes to the financial statements that its employees participate in a plan sponsored by the holding company for which the reporting entity has no legal obligation. The amount of expense incurred and the allocation methodology utilized by the provider of such benefits shall also be disclosed. If the reporting entity is directly liable for postemployment benefit obligations, then the requirements outlined in paragraphs 3 to 6 above shall be applied.

DISCUSSION

8. Paragraphs 3 - 6 of the Summary Conclusion above adopt *FASB Statement No. 112, Employers' Accounting for Postemployment Benefits: an amendment of FASB Statements No. 5 and 43* (FAS 112), and the provisions of *FASB Statement No. 88, Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits* (FAS 88), that address termination benefits, both with a modification to adopt the principles in accordance with *Issue Paper No. 3—Accounting Changes*.

9. The Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts) states under the concept of recognition that "*Liabilities require recognition as they are incurred*" and "*Accounting treatments which tend to defer expense recognition do not generally represent acceptable SAP treatment*". In addition, the Statement of Concepts states under the concept of conservatism that "*In order to provide a margin of protection for policyholders, the concept of conservatism should be followed when developing estimates as well as establishing accounting principles for statutory reporting*". Requiring reporting entities to follow the guidance in FAS 112 and the termination benefit provisions of FAS 88 is consistent with the recognition and conservatism concepts in the Statement of Concepts.

10. Without guidance on accounting for the cost of postemployment benefits, reporting entities' accounting for such benefits can vary. FAS 112 notes in paragraph 2 that:

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

11. FAS 112 does not provide employers with an option to recognize the effect of adoption over future periods. Paragraph 25 of FAS 112 includes the following statements:

The Board considered whether a provision for delayed recognition of the transition amount was needed. A major objective of transition is to minimize implementation costs and mitigate disruption without unduly compromising the ability of financial statements to provide useful information. An important factor considered by the Board was the potential magnitude of the unrecorded postemployment benefit obligation. Information made available to the Board indicated

that postemployment benefits are generally not as significant as pension or other postretirement benefits. The Board concluded that a provision for delayed recognition was not needed to mitigate the financial statement impact of immediately recognizing the transition amount when this Statement is adopted. That provision would have added unnecessary complexity to the application of this Statement, reduced financial statement comparability, and been inconsistent with Statements 5 and 43, which do not provide for delayed recognition at transition.

This issue paper adopts this immediate recognition concept.

Drafting Notes/Comments

- Accounting for postemployment benefits incurred in connection with a restructuring is addressed in a separate issue paper addressing restructuring costs and EITF 94-3.
- Accounting for pensions is discussed in *Issue Paper No. 8—Accounting for Pensions*.
- Accounting for compensated absences is addressed in *Issue Paper No. 11—Compensated Absences*.
- Accounting for postretirement benefits other than pensions is addressed in *Issue Paper No. 14—Employers' Accounting for Postretirement Benefits Other Than Pensions*.
- Holding company obligations are addressed in a separate issue paper.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

Statutory Accounting

12. The Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies, Chapter 17, *Other Liabilities*, contains the following with respect to liabilities for benefits for employees and agents:

Liabilities for Benefits for Employees and Agents

A company may be required or desire to establish a liability for certain benefits to employees and agents which are not provided for in other accounts. Examples include:

1. It may be desirable to hold the liability on a nonqualified pension plan in this category in order to assist the tax department in adjusting their tax deductions.
2. The company may wish to set up a liability for the salary for accrued but unused vacation hours since vacation hours can legitimately be viewed as "earned" at the end of the work periods for which they are granted.

Generally Accepted Accounting Principles

13. FAS 112, requires employers to recognize the obligation to provide postemployment benefits in accordance with *FASB Statement No. 43, Accounting for Compensated Absences* (FAS 43), if the obligation is attributable to employees' services already rendered, employees' rights to those benefits accumulate or vest, payment of the benefits is probable, and the amount of the benefits can be reasonably estimated. If those four conditions are not met, the employer should account for postemployment benefits when it is probable that a liability has been incurred and the amount can be reasonably estimated in accordance with *FASB Statement No. 5, Accounting for Contingencies* (FAS 5). If an obligation for postemployment benefits is not accrued in accordance with FAS 5 or FAS 43 only because the amount cannot be reasonably estimated, the financial statements shall disclose that fact.

14. FAS 88 has provisions that address accounting for benefits provided to employees in connection with their termination of employment. Special termination benefits are defined as those that are offered only for a short period of time and contractual termination benefits are defined as those required by the terms of a plan only if a specified event, such as a plant closing, occurs. FAS 88 requires an employer that offers special termination benefits to employees to recognize a liability and a loss when the employees accept the offer and the amount can be reasonably estimated. It also requires an employer that provides

contractual termination benefits to recognize a liability and loss when it is probable that employees will be entitled to benefits and the amount can be reasonably estimated. The cost of the termination benefits recognized shall include the amount of any lump-sum payments and the present value of any expected future payments.

OTHER SOURCES OF INFORMATION

15. The draft discussion material from previous Life codification projects, Chapter 17, *Other Liabilities*, modified the above language:

Liabilities for Benefits for Employees and Agents

A company must establish a liability for certain benefits to employees and agents which are not provided for in other accounts. Examples include deferred compensation and nonqualified benefit plans for employees and agents.

16. The NAIC Technical Resource Group proposed draft Life codification Chapter 22, *General Expenses and Taxes, Licenses and Fees*, contains the following guidance:

Employee Termination Benefits

For a variety of reasons, companies pay compensation to employees at termination. Such benefits include disability benefits, death benefits, severance payments, unemployment benefits, etc. These benefits are paid after an employee terminates but are typically based on service previously rendered.

The cost of such post-employment benefits must be spread over the working lives of those expected to receive the benefit. These benefits include all benefits paid to or for former or inactive employees (including their beneficiaries and/or dependents) after employment.

Such compensation must be accrued during an employee's working life if:

- a. the benefit to be paid is earned for service previously rendered;
- b. the right to those benefits accumulates, vests or;
- c. the payment of the benefits is probable; and
- d. the amount can be reasonably estimated.

17. The draft discussion material from previous Property/Casualty codification projects, Chapter 23, *Non-Claim Operating Expenses*, contains the following language:

Salaries, and Employee Relations and Welfare (Including Post Employment Retirement and Other Benefits)

Salaries and payroll related expenses are usually the second largest expense for most insurance companies. SAP requires that salaries and related expenses be accounted for under the accrual basis of accounting (i.e., expense recorded when incurred and not when paid). Pensions and other post retirement benefit plans for which there is no promulgated SAP should be accounted for in accordance with GAAP as promulgated by the Financial Accounting Standards Board (FASB). (The preceding may need revision based on final outcome of the FASB 106 Task Force.)

Employee compensation and post retirement benefits include, among other things, the following:

1. Salaries and wages
2. Pension plans.
3. Post retirement benefits other than pensions.
4. Compensated absences.
5. Stock purchase and option plans.
6. Other deferred compensation

18. In addition, the draft discussion materials from previous Property/Casualty codification projects discusses deferred compensation and special termination benefits specifically and states the following:

Other Deferred Compensation

The accounting for other deferred compensation arrangements, which do not constitute pension plans is governed by APB Opinion No. 12, "Omnibus Opinion." APB 12 provides that deferred compensation contracts should be accounted separately for each employee on the accrual basis. The amount of each accrual cannot be less than the present value of the benefits to be provided (including benefits to beneficiaries) by the terms of the contract. The accruals should be made over the employee's employment period.

Special Termination Benefits

FASB 74 "Accounting for Special Termination Benefits Paid to Employees" [FAS 74] provides that,

... an employer that offers for a short period of time special termination benefits to employees shall recognize a liability and an expense when the employees accept the offer and the amount can be reasonable estimated. The amount shall include any lump sum payments and the present value of any expected future payments.

These arrangements may also effect the estimated costs of pension benefits.

19. It should be noted that although FAS 74 has been superseded by FAS 88, the conclusions reached in FAS 74 were incorporated into FAS 88 (i.e., the cost of special termination benefits should be recognized as a liability and a loss when the employees accept the offer and the amount can be reasonable estimated). See paraphrasing from FAS 88 in the Generally Accepted Accounting Principles section of this paper.

RELEVANT LITERATURE

Statutory Accounting

- Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy
- *Issue Paper No. 3—Accounting Changes*
- *Issue Paper No. 4—Definition of Assets and Nonadmitted Assets*
- *Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets*
- Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies, Chapter 17, *Other Liabilities*, subcaption—Liabilities for Benefits for Employees and Agents, page 17-1
- Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies, Chapter 17, *Other Liabilities*, subcaption—Postretirement Benefits Other Than Pensions, page 17-3
- Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies, Chapter 13, *Other Liabilities*, subcaption—Postretirement Benefits Other Than Pensions, page 13-3

Generally Accepted Accounting Principles

- *FASB Statement No. 112, Employers' Accounting for Postemployment Benefits an amendment of FASB Statements No. 5 and 43*
- *FASB Statement No. 5, Accounting for Contingencies*
- *FASB Statement No. 43, Accounting for Compensated Absences*
- *FASB Statement No. 88, Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*

State Regulations

- No additional guidance obtained from state statutes or regulations.

Other Sources of Information

- NAIC Technical Resource Group proposed draft Life codification, Chapter 22, *General Expenses and Taxes*, Licenses and Fees
- Draft discussion material from previous Property/Casualty codification projects, Chapter 23, *Non-Claim Operating Expenses*, subcaption - Pension Plans
- Draft discussion material from previous Life codification projects, Chapter 17, *Other Liabilities*, subcaption - Liabilities for Benefits for Employees and Agents, page 17.2