Plan Curtailments and Settlements Under FASB ASC Topic 715 Relating to Plan Terminations (Part 2)
By Daveyne C. Totten, MAAA, MSPA, EA

Under FASB ASC Topic 715, immediate recognition of amounts not previously recognized in the net periodic pension cost must be included in the pension expense when a curtailment occurs, or when there are settlements exceeding a certain threshold.

A curtailment is generally defined as an event that significantly reduces the expected years of future service for present employees, or eliminates benefit accruals for some or all future service for a significant number of employees. The most common curtailment event in the small plan arena is when benefit accruals are frozen.

A settlement is generally defined as an irrevocable action relieving the plan of primary responsibility for a pension benefit. The most common settlements occur when lump sum benefits are paid, or nonparticipating annuities are purchased to provide benefits. Immediate recognition is required in connection with settlements only if the cost of settlement (the lump sums and/or annuity premiums paid) during the fiscal year exceeds the sum of the service cost and interest cost components of the net periodic pension cost for the fiscal year.

If there is ever a case where both a curtailment and settlement occur on the same date, the codification states no preference for recognizing one before the other, although once an order has been established, it must be consistently applied in the event that it occurs again.

Before the FASB Accounting Standards Codification (referred to in this article as the “codification”), the treatment of curtailments and settlements was described in FAS Statement No. 88. The main provisions regarding the treatment of curtailments and settlements now reside in FASB ASC Topic 715, subtopic 715-30-35. Paragraphs 715-30-35-74 through 715-30-35-78 deal with the relationship of settlements and curtailments to other events, paragraphs 715-30-35-79 through 715-30-35-91 deal specifically with settlements, and paragraphs 715-30-35-92 through 715-30-35-96 deal specifically with curtailments.

While curtailments and settlements can occur in other situations, this two-part article will discuss how curtailments and settlements work specifically with regard to plan terminations. A plan termination generally involves a curtailment (when benefit accruals are frozen), and a subsequent settlement (when assets are distributed under the plan termination). Part 1 of this article (published in the January 2017 issue of ACOPA Monthly) describes the treatment of curtailments, and Part 2 below describes the treatment of settlements. The example used throughout the two-part article is a plan sponsor with a calendar year fiscal year, whose defined benefit plan terminates on 12/31/16 (with benefit accruals frozen effective on that date), and under which settlements occur on 12/31/17. The example is based on the assumption that pension benefits will not be provided under a successor pension plan.

Part 2 – Settlements

With regard to the timing of settlement recognition in general, if the total cost of all settlements occurring during a fiscal year is greater than the sum of the service cost and interest cost components of the net periodic pension cost for the year, each settlement during the year must be recognized on the date the settlement occurs. Since some settlements may occur early in the fiscal year and not exceed the service cost/interest cost total, you may not know until later in the fiscal year whether settlement accounting will be needed for the fiscal year disclosure. Except for settlements occurring on the first or last day of the fiscal year, each settlement date is treated as an interim measurement date (see Part 1 for an example of how interim measurement dates affect plan accounting). If the cost of settlements during a year is less than the sum of the service cost and interest cost components of the net periodic pension cost for the year, settlement recognition is optional; however, whether or not settlements are recognized in this case must be applied consistently from year to year.

The cost of settlement is the amount of the lump sum paid, the cost of a non-participating annuity contract, or the cost of a participating contract less the amount attributed to participation rights, depending on the type of settlement. With regard to the purchase of an annuity contract other than a non-participating contract purchased
from an insurance entity, which is both not controlled by the employer and reasonably expected to meet its obligations under the contract, special settlement accounting rules may apply and paragraphs 715-30-35-84 through 715-30-35-91 should be referenced. Those special accounting rules are beyond the scope of this article.

Under a plan termination, the settlement date is the date lump sums are paid and/or annuities are purchased to settle benefits in connection with the plan termination. Under the codification, if all settlements during the year do not occur on the same date, each settlement should technically be recognized on the date the settlement occurs (requiring interim measurements if settlement accounting is needed in the aggregate). However, in the case of a plan termination, where all benefits are being settled within one fiscal year and the plan accounting is essentially being zeroed out, most auditors in my experience find it acceptable to recognize the settlements as if they all occurred on the last settlement date, which greatly simplifies the calculations. If all of the settlements under the plan termination do not fall within one fiscal year, it may still be acceptable to auditors to combine multiple settlement dates within each year for plan accounting. If you are not technically following the codification, it is always recommended that you discuss your approach with plan auditors before completing any calculations, in order to avoid potential recalculations at a later date if the auditor were to disagree with the approach.

Continuing with the example in Part 1, we will be using 12/31/17 as the settlement date, and no interim measurement will be made. Note that if all benefits were settled on a date earlier in the fiscal year, say on 07/01/17, that date would be considered the settlement date. The net periodic pension cost on 01/01/17 would be pro-rated for the short measurement period between 01/01/17 and 07/01/17, and new measurements of the benefit obligations and assets would be made on 07/01/17 before recognizing the settlement. Assuming that all assets were distributed on 07/01/17, no further plan accounting would be required after that date. If there were residual assets distributed after benefits were settled on 07/01/17, additional plan accounting might be required beyond 07/01/17 and if so, 07/01/17 would technically be considered an interim measurement date; however, it is likely that auditors would accept treating the residual assets as having been distributed on 07/01/17, thus eliminating the need for additional plan accounting beyond 07/01/17. Again, if applicable, it is recommended that this approach be discussed with the auditors before completing the calculations.

Continuing with the example used in Part 1, we will be working with the following results for the plan on 12/31/17 before the settlement is recognized:

1. Assets and Obligations
   a. Vested Benefit Obligation .......................................................... 8,110,000
   b. Nonvested Benefits ................................................................. 0
   c. Accumulated Benefit Obligation (a + b) ...................................... 8,110,000
   d. Effects of Projected Future Compensation Levels .......................... 0
   e. Projected Benefit Obligation (c + d) .......................................... 8,110,000
   f. Fair Value of Assets ................................................................. 8,400,000

2. Amounts Remaining in Accumulated Other Comprehensive Income (Loss)
   a. Remaining Transition (Obligation) Asset ..................................... 0
   b. Remaining Prior Service (Cost) Credit ....................................... 0
   c. Remaining Net Gain (Loss) ...................................................... 610,000

3. (Accrued) Prepaid Pension Cost (1e + 1f - 2a - 2b - 2c) .................... 900,000
4. Pension (Liability) Asset (1e + 1f) .................................................. 290,000
5. Accumulated Other Comprehensive Income (Loss) (4 – 3, or 2a + 2b + 2c) .................................................. 610,000

NOTE: Accumulated Other Comprehensive Income (Loss) is referred to as AOCI(L) in the following discussion.

Other relevant information:

Total Cost of Settlement .................................................................... 8,400,000
Under the codification, there is a maximum gain or loss subject to immediate full or partial recognition in the pension expense when a settlement occurs. The maximum gain or loss includes the Net Gain or Loss remaining in the AOCI(L) and any Transition Asset remaining in the AOCI(L), as well as the gain or loss due to settlement.

The entire maximum gain or loss is immediately recognized if the entire Projected Benefit Obligation is settled. If, however, only part of the Projected Benefit Obligation is settled, a pro-rata portion of the maximum gain or loss is recognized, equal to the percentage reduction in the Projected Benefit Obligation. The percentage reduction is determined by dividing (a) the cost of settlement by (b) the Projected Benefit Obligation before settlement. For this purpose, the Projected Benefit Obligation before settlement is adjusted by the gain or loss due to settlement. If there is a gain due to settlement, the adjustment is made by subtracting the gain from the Projected Benefit Obligation before settlement. Similarly, if there is a loss due to settlement, the adjustment is made by adding the loss.

With regard to the gain or loss due to settlement component of the maximum gain or loss, a gain will occur if the cost of settlement is less than the decrease in the Projected Benefit Obligation due to the settlement. Likewise, a loss will occur if the cost of settlement is greater than the decrease in the Projected Benefit Obligation due to the settlement. In our example, the cost of settlement is $8,400,000, and the decrease in the Projected Benefit Obligation due to the settlement is $8,110,000. Since the cost of settlement is greater than the decrease in the Projected Benefit Obligation due to the settlement, we have a loss due to settlement of $290,000 ($8,400,000 minus $8,110,000).

Since there is no Transition Asset remaining in the AOCI(L), the maximum gain or loss in our example consists of the Net Loss remaining in the AOCI(L) of $610,000 and the loss due to settlement of $290,000, for a total maximum loss of $900,000. Since the entire Pension Benefit Obligation is being settled, the entire maximum loss of $900,000 is immediately recognized in the pension expense for the year. When combined with the net periodic pension cost before settlement of -$100,000, the total pension expense for the year is $800,000.

As with plan curtailments, the AOCI(L) must be reconciled between the AOCI(L) immediately before the settlement, and the AOCI(L) after the settlement. For purposes of flowing the settlement through the AOCI(L), I would consider the $290,000 loss due to settlement as a loss arising during the year due to settlement, and I would consider both the $610,000 remaining Net Loss immediately recognized and the $290,000 loss due to settlement immediately recognized as Other Comprehensive Income due to recognition in the net periodic pension cost. If there had been any remaining Transition Asset immediately recognized, I would include that as Other Comprehensive Income due to recognition in the net periodic pension cost as well. As with flowing the curtailment information through the AOCI(L), I’m not sure if there is a right way or wrong way to flow the settlement information through the AOCI(L), but I haven’t gotten complaints from auditors when illustrating it this way, so they must be able to glean what they need for their financial statements from this, along with the other information included in the report regarding the settlement.

Note that any worksheets and schedules included with your report would generally have to be adjusted to reflect the settlement. I also include two additional worksheets with reports that include settlements, detailing the calculations in connection with the settlements. I will label them worksheets 7 and 8 here to differentiate them from the curtailment worksheets illustrated in Part 1; however, I would label these worksheets 5 and 6 in my report unless both a curtailment and a settlement occurred during the year, in order to ward off the inevitable question about why there appear to be worksheets missing. These worksheets would look as follows using the information from our example:

**Worksheet 7 – Accounting for Settlements**

Settlement Date ............ 12/31/17

1. Net (Gain) Loss Remaining in AOCI(L) Before Settlement ............................................................... 610,000
2. (Gain) Loss Due to Settlement
   a. PBO before settlement ........................................................................................................ 8,110,000
   b. PBO after settlement ........................................................................................................... 0
   c. Decrease in PBO (a – b) ....................................................................................................... 8,110,000
   d. Cost of settlement .............................................................................................................. 8,400,000
   e. (Gain) Loss due to settlement (d – c) .................................................................................. 290,000

3. Net (Gain) Loss Remaining in AOCI(L) at Settlement (1 + 2e) ........................................... 900,000

4. Transition (Asset) Remaining in the AOCI(L) [zero, if transition obligation] ....................... 0

5. Maximum (Gain) Loss (3 + 4) .................................................................................................. 900,000

6. Percentage Reduction in the PBO
   a. Cost of settlement (2d) ........................................................................................................ 8,400,000
   b. PBO before settlement, adjusted for (gain) loss due to settlement (2a + 2e) .................... 8,400,000
   c. Percentage reduction in the PBO (a / b) ............................................................................. 100.00%

7. Amounts Immediately Recognized in Pension Cost due to Settlement
   a. Net (gain) loss remaining in AOCI(L) before settlement (6c x 1) ....................................... 610,000
   b. (Gain) loss due to settlement (6c x 2e) ............................................................................... 290,000
   c. Transition (asset) remaining in AOCI(L) before settlement (6c x 4) ................................. 0
   d. Total amounts immediately recognized in pension cost (a + b + c) .................................... 900,000

Worksheet 8 – Pension Cost Due to and Effect of Settlement

Pension Cost Due to Settlement

1. Immediate Recognition of Amounts Remaining in AOCI(L) Before Settlement
   a. Immediate recognition of transition (asset) ......................................................................... 0
   b. Immediate recognition of net (gain) loss ............................................................................ 610,000
   c. Total immediate recognition of amounts remaining in AOCI(L) before settlement ............ 610,000

2. Immediate Recognition of (Gain) Loss Due to Settlement .................................................... 290,000

3. Pension Cost Due to Settlement (1c + 2) ................................................................................ 900,000

Effect of Settlement

<table>
<thead>
<tr>
<th>Assets and Obligations</th>
<th>Before Settlement</th>
<th>Effect of Settlement</th>
<th>After Settlement</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Vested Benefit Obligation</td>
<td>(8,110,000)</td>
<td>8,110,000</td>
<td>0</td>
</tr>
<tr>
<td>b. Nonvested Benefits</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>c. Accumulated Benefit Obligation</td>
<td>(8,110,000)</td>
<td>8,110,000</td>
<td>0</td>
</tr>
<tr>
<td>d. Effects of Projected Future Compensation Levels</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>e. Projected Benefit Obligation</td>
<td>(8,110,000)</td>
<td>8,110,000</td>
<td>0</td>
</tr>
<tr>
<td>f. Fair Value of Assets</td>
<td>8,400,000</td>
<td>(8,400,000)</td>
<td>0</td>
</tr>
</tbody>
</table>

2. Amounts Remaining in AOCI(L)
   a. Remaining Transition (Obligation) Asset ...................................................................... 0
   b. Remaining Prior Service Cost ......................................................................................... 0
   c. Remaining Net Gain (Loss) .............................................................................................. (610,000)

3. (Accrued) Prepaid Pension Cost ......................................................................................... 900,000

4. Pension (Liability) Asset .................................................................................................... 290,000

5. Accumulated Other Comprehensive Income (Loss) ............................................................ (610,000)
Note that the cost of settlement in our example equals the value of assets. In bringing my example forward to 12/31/17, I have assumed that assets were insufficient to satisfy all benefit obligations and that the employer made a contribution just prior to the settlement date in order to make the plan sufficient to settle all benefits on the settlement date. Accordingly, the results before settlement incorporate that contribution.

The cost of settlement would also equal the value of assets if the plan had excess assets that were being reallocated to plan participants by way of increasing benefits. In that case, there would be a loss equal to the increase in the Projected Benefit Obligation resulting from the benefit increases provided under the reallocation, which would have to be immediately recognized. I have never had this situation, so I’m not sure how that loss would be categorized, but one option would be to simply include it in the gain or loss due to settlement. Regardless of how it is illustrated, the pension expense for the year should include the immediate recognition of that loss.

If there are excess assets being reverted to the employer, the cost of settlement will equal the value of assets minus the amount of the reversion. Note that in this case, you would have to make adjustments to the above worksheets, as well as to any other affected information included in your report, to reflect that some of the assets were used to settle benefits and some were reverted to the employer.

Finally, note that when all benefits are being settled under a plan termination, all values are reconciled to zero once the plan termination settlements have been recognized. If you get to the end of your calculations and that is not the case, you have made an error somewhere. Errors often occur when the wrong sign (+ or -) is assigned to a value, and that is where I would start looking if you’re not ending up in the right place.