Plan Curtailments & Settlements Under FASB ASC Topic 715 Relating to Plan Terminations (Part 1)

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.

Although curtailments and settlements can occur in other situations, this two-part article will discuss how curtailments & 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 the *ACOPA Monthly*) describes the treatment of curtailments, and Part 2 (in the February 2017 issue) 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 1 – Curtailments

With regard to the timing of curtailment recognition in general, if there is a net gain from the curtailment, it must be recognized when the plan suspension or amendment reducing future years of service is adopted. If there is a net loss from the curtailment, it must be recognized when it is probable that a curtailment will occur and the effects can be reasonably estimated. For benefit accrual freezes, this would generally be (for both a net gain and a net loss) a date earlier than the freeze effective date, due to 204(h) notice requirements. In my experience, however, at least for plans sponsored by nonpublic entities, it has been acceptable to the plan auditors to consider that the curtailment occurs on the freeze effective date, as long as it is disclosed and it can be reasonably expected that the results would not be materially different if an interim measurement had been made on the freeze adoption date. I recommend that the recognition date be discussed with the auditors prior to completing any calculations so as to avoid potential recalculations at a later date if the auditor were to disagree with the date selected.

In our example, the benefit accrual freeze date is 12/31/16 (the last day of the fiscal year), and we will be using 12/31/16 as the curtailment date, so no interim measurement will be made. If the curtailment date were earlier in the fiscal year, say on 07/01/16, an interim measurement would have to be made on that date. The net periodic pension cost in that case would be determined on 01/01/16 for the first half of the year by pro-rating the full year net periodic pension cost on 01/01/16. New measurements of benefit obligations and assets would be made on 07/01/16, and if appropriate, changes in the discount rate and other assumptions would be reflected on that date. Immediate recognition in connection with the curtailment would then be determined based on the 07/01/16 results. Once the effect of the curtailment has been recognized, the net periodic pension cost for the second half of the year would then be determined by pro-rating the full year net periodic pension cost on 07/01/16. The sum of the net periodic pension cost for the first half of the year, the curtailment immediate recognition, and the net periodic pension cost for the second half of the year, would represent the pension expense for the 2016 fiscal year.

In our example, we will be working with the following results for the plan on 12/31/16 before the curtailment is recognized:

1. Assets and Obligations	
a. Vested Benefit Obligation	(6,500,000)
b. Nonvested Benefits	(500,000)
c. Accumulated Benefit Obligation (a + b)	(7,000,000)
d. Effects of Projected Future Compensation Levels	(8,000,000)
e. Projected Benefit Obligation (c + d)	(15,000,000)
f. Fair Value of Assets	6,000,000
2. Amounts Remaining in Accumulated Other Comprehensive Income (Loss)	
a. Remaining Transition (Obligation) Asset	(200,000)
b. Remaining Prior Service (Cost) Credit	(300,000)
c. Remaining Net Gain (Loss)	(4,500,000)
3. (Accrued) Prepaid Pension Cost (1e + 1f - 2a - 2b - 2c)	(4,000,000)
4. Pension (Liability) Asset (1e + 1f)	(9,000,000)
5. Accumulated Other Comprehensive Income (Loss) (4 – 3, or 2a + 2b + 2c)	(5,000,000)

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

Other relevant information:

Net Periodic Pension Cost for 2016 before curtailment	1,300,000
Projected Benefit Obligation on 12/31/16 after curtailment	7,000,000

Under a curtailment, a portion of the Prior Service Cost remaining in the AOCI(L), if any, is immediately recognized in the pension expense. For this purpose, any Transition Obligation remaining in the AOCI(L) is considered Prior Service Cost. In our example, $300,000 Prior Service Cost and $200,000 Transition Obligation remain in the AOCI(L).

Generally, the portion of each Prior Service Cost (or Transition Obligation) to be immediately recognized is the portion associated with the estimated remaining future years of service that are no longer expected to be rendered due to the curtailment. For example, if a curtailment eliminates half of the estimated remaining future years of service for employees who were expected to receive benefits on the date a Prior Service Cost (or Transition Obligation) was established, half of the Prior Service Cost (or Transition Obligation) would be immediately recognized. Note that the applicable portion of each Prior Service Cost and/or Transition Obligation remaining in the AOCI(L) would be determined separately.

When benefit accruals are frozen, however, it's much simpler. Since the freeze eliminates all future years of service for benefit accruals, the portion of the Prior Service Cost and Transition Obligation required to be immediately recognized is 100%. Accordingly, in our example, the remaining Prior Service Cost immediately recognized in the pension expense would be $300,000, and the remaining Transition Obligation immediately recognized would be $200,000. If the freeze were applicable to only a portion of the group and/or the benefit accruals were being reduced but not frozen, the pro-rata determination of the portion recognized of the Transition Obligation / Prior Service Cost is more complex with such determination beyond the scope of this article.

According to the codification, the Projected Benefit Obligation may be decreased (a gain) or increased (a loss) by a curtailment. When there is a gain from the curtailment, to the extent that the gain exceeds any Net Loss included in the AOCI(L) before the curtailment (or the entire gain, if a Net Gain exists), there will be a Curtailment Gain, which gets immediately recognized in the pension expense. When there is a loss from the curtailment, to the extent that the loss exceeds any Net Gain included in the AOCI(L) (or the entire loss, if a Net Loss exists), there will be a Curtailment Loss, which gets immediately recognized in the pension expense. For this purpose, any Transition Asset remaining in the AOCI(L) is considered Net Gain, and is combined with the net gain or loss arising thereafter.

In our example, the Projected Benefit Obligation is $7,000,000 after the curtailment, resulting in a gain from the curtailment of $8,000,000. Since there is no remaining Transition Asset to consider in our example, our Net Loss before the curtailment is $4,500,000, and the gain of $8,000,000 from the curtailment exceeds that Net Loss by $3,500,000. Accordingly, we have a Curtailment Gain of $3,500,000, which is immediately recognized in the pension expense.

So, in summary, the pension expense due to the curtailment is the $500,000 immediate recognition of the remaining Prior Service Cost (including the Transition Obligation), offset by the $3,500,000 Curtailment Gain, for a net pension expense of -$3,000,000 due to the curtailment. Given the net periodic pension cost of $1,300,000 before the curtailment, the total pension expense for the 2016 fiscal year would be -$1,700,000 (considered pension income).

Note that the AOCI(L) must be reconciled between the AOCI(L) immediately before the curtailment, and the AOCI(L) after the curtailment. For purposes of flowing the curtailment through the AOCI(L), I would consider the $8,000,000 gain from the curtailment a gain arising due to curtailment during the year, and I would consider the $200,000 remaining Transition, the $300,000 remaining Prior Service Cost, and the $3,500,000 remaining Net Gain immediately recognized, as Other Comprehensive Income (Loss) due to recognition in the net periodic pension cost. To be honest, I'm not sure if there is a right way or wrong way to flow the curtailment 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 curtailment.

Note that any worksheets and schedules included with your report would generally have to be adjusted to reflect the curtailment. I also include two additional worksheets with reports that include curtailments, detailing the calculations in connection with the curtailment. These are worksheets 5 and 6 in my report, and would look as follows using the information from our example:

Worksheet 5 – Accounting for Plan Curtailment

Plan Curtailment Date 12/31/16

1. Prior Service Cost included in AOCI(L) Prior to Plan Curtailment	
a. Prior service cost	300,000
b. Transition obligation [treated as prior service cost for this purpose]	200,000
c. Net prior service cost included in AOCI(L) prior to plan curtailment (a + b)	500,000
2. Prior Service Cost Loss	
a. Estimated remaining future years of service before plan curtailment (N/A for benefit freeze)	N/A
b. Estimated remaining future years of service no longer expected (N/A for benefit freeze)	N/A
c. Percentage reduction (b / a, or 100% for benefit freeze)	100.00%

d. Net prior service cost loss (1c x c) 500,000

NOTE: The net prior service cost loss is immediately recognized in the pension expense

3. (Gain) Loss from Plan Curtailment
   a. PBO before plan curtailment 15,000,000
   b. PBO after plan curtailment 7,000,000
   c. Value of special termination benefits to be paid from plan assets 0
   d. Adjusted PBO after plan curtailment (b - c) 7,000,000
   e. (Gain) loss from plan curtailment (d - a) .... (8,000,000)
4. Net (Gain) Loss Included in AOCI(L) Prior to Plan Curtailment
   a. Net (gain) loss 4,500,000
   b. Transition (asset) [treated as net gain for this purpose] 0
   c. Net (gain) loss prior to plan curtailment (a + b) 4,500,000
5. Curtailment (Gain) [Applicable if there is a gain from plan curtailment]
   a. (Gain) from plan curtailment .... (8,000,000)
   b. Net (gain) loss included in AOCL(I) prior to plan curtailment 4,500,000
   c. Curtailment (gain) .... (3,500,000)

   NOTE: If there is a net loss included in the AOCI(L) and the gain from curtailment exceeds the net loss, the excess is considered a curtailment gain; If there is a net gain included in the AOCI(L), the entire gain from curtailment is considered a curtailment gain; The curtailment gain (if any) is immediately recognized in the pension cost
6. Curtailment Loss [Applicable if there is a loss from plan curtailment]
   a. Loss from plan curtailment .... N/A
   b. Net (gain) loss included in AOCL(I) prior to plan curtailment .... N/A
   c. Curtailment loss .... N/A

   NOTE: If there is a net gain included in the AOCI(L) and the loss from curtailment exceeds the net gain, the excess is considered a curtailment loss; If there is a net loss included in the AOCI(L), the entire loss from curtailment is considered a curtailment loss; The curtailment loss (if any) is immediately recognized in the pension cost

Worksheet 6 – Pension Cost Due to and Effect of Plan Curtailment

Pension Cost Due to Plan Curtailment

1. Pension Cost Due to Plan Curtailment
   a. Prior Service Cost Loss 500,000
   b. Curtailment (Gain) Loss .... (3,500,000)
   c. Pension Cost due to Plan Curtailment (a + b) .... (3,000,000)
2. Immediate Recognition of Unrecognized Amounts in Pension Cost Due to Plan Curtailment
   a. Immediate recognition of transition obligation (asset) 200,000
   b. Immediate recognition of prior service cost 300,000
   c. Immediate recognition of net (gain) loss .... (3,500,000)
   d. Total Immediate recognition (a + b + c) .... (3,000,000)

Effect of Plan Curtailment	Before Curtailment	Effect of Curtailment	After Curtailment
1. Assets and Obligations			
a. Vested Benefit Obligation	(6,500,000)	(500,000)	(7,000,000)
b. Nonvested Benefits	(500,000)	500,000	0

c. Accumulated Benefit Obligation	(7,000,000)	0	(7,000,000)
d. Effects of Projected Future Compensation Levels	(8,000,000)	8,000,000	0
e. Projected Benefit Obligation	(15,000,000)	8,000,000	(7,000,000)
f. Fair Value of Assets	6,000,000	0	6,000,000
2. Amounts Remaining in AOCI(L)			
a. Remaining Transition Obligation	(200,000)	200,000	0
b. Remaining Prior Service Cost	(300,000)	300,000	0
c. Remaining Net Loss	(4,500,000)	4,500,000	0
3. (Accrued) Prepaid Pension Cost	(4,000,000)	3,000,000	(1,000,000)
4. Pension (Liability) Asset	(9,000,000)	8,000,000	(1,000,000)
5. Accumulated Other Comprehensive Income (Loss)	(5,000,000)	5,000,000	0

Note that it has been assumed above that all non-vested benefit obligations became vested on the curtailment date. This is not necessarily always the case when benefit accruals are frozen. Note also that the above worksheets would have to be individualized for curtailments other than for benefit freezes if there are multiple Prior Service Costs remaining in the AOCI(L), including the situation where there is a remaining Prior Service Cost and a remaining Transition Obligation.