



Financial Accounting and Reporting

2016 Smart Study Notes -
Pension

How To Use These Notes

These study notes are strategically broken down into 32 topics to help you study in the most efficient way for Financial Accounting and Reporting (FAR).

There are 3 popular ways people use these notes:

1. Read a section before watching your CPA review videos to get an understanding of the topic
2. Review a section periodically as a refresher to keep the material fresh
3. Review / rewrite all the notes in the 2 weeks leading up to your exam date to ensure the material is fresh in your mind

If you would like more helpful review materials, check out www.pedersoncpareview.com for HD online videos, MP3 audio notes, flashcards, and one-on-one email access to me.

If you find these notes valuable, please check out the full set of FAR Smart Study Notes and the other study materials at [Pederson CPA Review - Product Selector](#).

Best of luck with the exam.

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Pension

Defined Contribution (401(k) Plan) - The amount contributed by the employer or employee is fixed, but the payout at retirement is not. Employers expense contributions as incurred.

Defined Benefit (Pension Plan) - The payout upon retirement is fixed.

2 Defined Benefit Plan Entities - Employer that supports the pension and the pension plan itself.

Employer Entries	Pension Plan Entries
Pension expense	Projected benefit obligation
Deferred pension cost	Plan assets
Prepaid or accrued pension cost	Vested benefits
Minimum pension liability	Accumulated benefit obligation
Net loss not recognized as pension expense	
Unrecognized past service cost	
Unrecognized gains/losses	

Pension Expense - Unrelated to cash contributions. Recognize expense over the period of employee's employment (the service period).

Pension Expense Formula:

Service Cost
+ Interest on PBO
+ Amortization of Unrecognized Prior Service Cost
+ Deferred Gain
+ Loss Accrued
- Expected Return on Plan Assets
- Gain Recognized
- Deferred Loss
= Pension Expense

Projected Benefit Obligation (PBO) - Actuarial present value of the pension obligation using future anticipated salary levels.

Accumulated Benefit Obligation (ABO) - Actuarial present value of the pension obligation using current salary levels.

PBO – based on future salaries.

ABO – based on current salaries.

Service Cost - Actuarial present value of the benefits earned by employees during the current period, including adjustments for future salary increases or decreases.

Interest on PBO - Interest accrued on the PBO amount based on the settlement interest rate that is selected using rates of return on similar assets.

- The settlement rate should be explicitly stated, must be reasonable, and cannot include offsetting actuarial assumptions.

Actual Return on Plan Assets = FMV of Assets at End of Period - Beginning FMV of Assets - Contributions + Payouts

Prior Service Cost - Occurs when changes are made to an existing pension plan or a new plan is implemented that grants current employees additional credit for prior years of service.

- Gets amortized over future periods
- Amount is the change in the PBO from the plan change

Amortization of Prior Service Cost - 2 Methods

1. Expected future years of service (accelerated method)
 - a. Current Year Cost = $[\text{Number of Employees} / (\text{Number of Employees} \times \text{Number of Years Remaining Until Retirement})] \times \text{Prior Service Cost}$
2. Straight-line basis. Amortization period is based on a weighted average.
 - a. Current Year Cost = $[(\text{Number of Employees} \times \text{Number of Years to Retirement}) / \text{Number of Employees}] \times \text{Prior Service Cost}$

Gain or Loss = Actual Return - (Expected Return x Beginning FMV of Assets) x
Amortization of Unrecognized Gain - Amortization of Unrecognized Loss

Unrecognized Gain or Loss - Amortized only if the beginning of period unrecognized gain/loss is greater than 10% of the higher of the PBO or FMV of plan assets.

Amortization of Gain or Loss - Over the average remaining service period of active employees.

PBO Reconciliation - Analyzes changes between beginning PBO and ending PBO.

PBO Reconciliation Formula

Beginning PBO
 + Service Cost
 + Interest Cost on Beginning PBO
 +/- Prior Service Cost
 + Actuarial Loss
 - Actuarial Gains
 - Payments to Retirees
 Ending PBO

Change in Plan Assets Formula

Beginning FMV

+/- Actual Gain or Loss

+ Employer Contributions

-Benefits Paid Out

Ending FMV

Pension Disclosures

1. PBO reconciliation
2. Change in plan assets
3. Funded status
4. Amounts reported in balance sheet by line
5. Description of plan assets, investment strategy and determination of expected return
6. ABO
7. Benefit payouts for the next 5 years and for years 5-10
8. Estimated contributions for the remainder of period
9. Net periodic benefit cost
10. Gain or loss and prior service cost in OCI
11. Accumulated OCI not yet recognized as pension cost
12. Weighted average basis for rates - discount rate, compensation increases, return on assets
13. Health care cost rate
14. Effect of a 1% increase or decrease on service cost, interest and obligation for health care
15. Employer and related party securities held by pension
16. Transactions between employer and plan
17. Alternative methods to amortize prior service cost and gains/losses
18. Commitments to increase benefits obligation
19. Cost and description of termination benefits
20. Description of changes in plan assets or obligation
21. OCI amounts expected to impact future pension cost by item
22. Assets expected to be given back to the employer within a year

Funded Status = PBO - FMV of Plan Assets

Funded Status - Shown on the balance sheet as a long-term asset, current liability, or long-term liability.

- Assets or liabilities not in pension expense are booked to OCI net of tax.

Netting - Employers with multiple pension plans cannot net the funded status together.

- All overfunded plans are assets and underfunded plans are liabilities.

Pension Changes - Always recognized over time, not all at once.

Postretirement Benefits Other Than Pension (OPEB) - Health care and other benefits.

Substantive Plan - Established by historical practice or communications to employees. Takes priority if the terms are different than the contractual plan.

OPEB Cost - Matched to the periods in which they are earned by employees in the proportion provided by the plan. Typically, this is an equal amount per year for each year of employment.

Transition Obligation - When implementing a new plan, a transition obligation is calculated.

Expected Postretirement Benefit Obligation (EPBO) - Calculated by actuaries.

Accumulated Postretirement Benefit Obligation (APBO) - Can be recognized immediately, amortized over average years to retirement, or amortized over 20 years.

APBO = EPBO x (Years of Service to Date / Total Years of Service to Qualify)

Unrecognized Transition Obligation (UTO) = APBO - Amortized APBO

OPEB Cost = Service Cost + Interest Cost - Actual Return on Assets + Loss - Gain + Amortization of Unrecognized Prior Service Cost + Amortization of UTO

OPEB Service Cost - Only for employees who have not reached full retirement age.

OPEB Disclosures - Same as pension.

Nonretirement Postemployment Benefits - For employee terminations prior to retirement. Benefits include severance, continuation of health care, and disability. Accrual for these is the same as for compensated absences.

1. Service was already provided
2. Benefits vest or accumulate
3. Payment is probable
4. Amount is reasonably estimable

Deferred Compensation - Cost should be matched to the period the compensation is earned over, not the payment period.