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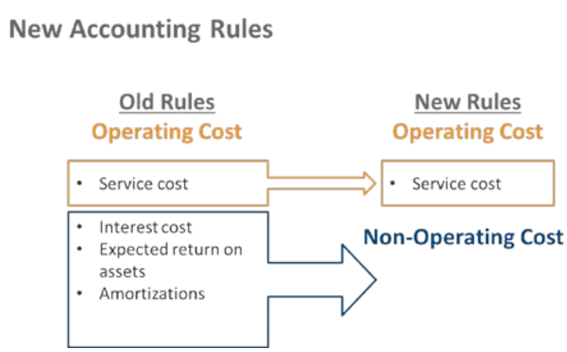
Pension Accounting Changes Reduce Volatility and Increase Flexibility

By Paul Gibbons

Reorganization of how portions of net periodic cost are recognized in a pension plan sponsor's income statement is effective for privately held entities beginning after December 15, 2018. Now that the items most sensitive to the interest rate environment are no longer recorded against operating income, the volatile impact of pension and retiree medical plan costs on day-to-day operations is reduced, except in times of extreme interest rate volatility.

These changes were released in March 2017 by the Financial Accounting Standards Board (FASB) in its Accounting Standards Update (ASU) 2017-07. These changes were effective a year earlier for publicly traded entities. This brings US GAAP accounting a little closer to international accounting standards.

Only the service cost component (the increase in the projected benefit obligation due to employees' service during the current year) is still reported in operating income with compensation-related costs. The other components will be reported in other income (expense), outside of any subtotal of income from operations.



This separation of some pension costs from operating costs may open the door to considering new strategies. Here are some examples:

- The administrative expenses move out of operating cost if the load is applied against expected asset return rather than added to service cost.
- A granular approach to determine discount rate can be considered, which could reduce service cost (and operating expense as well). The offsetting increases in loss amortization are not a concern since they no longer would affect operating income.
- For plans reporting expected return on assets, plan sponsors can evaluate asset allocations without concern for the impact on operating income.
- Risk transfer, plan freeze, and retirement windows could be more attractive since the one-time charges no longer will flow through the income statement.
- The ASU presented little difference in year-end disclosures as most of the changes are currently included in the presentation of items in those disclosures.

Early adoption is permitted, and many sponsors have adopted these changes already. If you need assistance with the new standards, contact the Findley consultant you normally work with or contact Paul Gibbons at Paul.Gibbons@findley.com or 216.875.1921.