Pension Obligation

- Discounted to present value
- Employee is vested if entitled to benefits, even without future service
- Accounting for pension obligation has three choices:
  - Vested benefit obligation: \( \text{current salary for vested employees} \)
  - Accumulated benefit obligation: both vested and non-vested at current salaries
  - Projected benefit obligation: both vested and non-vested \( \text{at future salaries} \)
- FASB #87 chose the projected benefit obligation and non-capitalization approach (off-balance sheet financing)
  - Economic substance: only employer’s promise and employee’s services affect liability
- Pension liability is reduced through benefit payments

Pension expense has five components

- Service Cost - increase in payable for current year’s services \([+]\)
- Interest on liability: interest expense on pension benefit obligation \([+]\)
  - Uses a settlement rate; obligation is at present value, discounted
- Actual return on plan assets: earnings reduce employer’s cost \([-\])
  - \([\text{Ending assets-beginning assets}] – [\text{contributions – benefits paid}]\)
- Amortization of unrecognized prior service cost \([+]\)
  - When plan is initiated, benefits are retroactive and amortized over remaining service life
- Gain or loss: arises from- \([+ or -]\)
  - Actual vs. expected return on plan assets
  - Amortization of unrecognized net gain or loss
  - The corridor approach of recognition is used for amortizing accumulated balance in unrecognized gain or loss
    - Must exceed 10% of the larger of beginning balance in the PBO or FMV of plan assets: excess is amortized \(\rightarrow\) expense

Minimum liability

- If amount funded in cash < annual expense \(\rightarrow\) pension liability
- If amount funded in cash > annual expense \(\rightarrow\) prepaid pension cost
- Recognize a minimum liability if: accumulated benefit obligation is greater than FMV of plan assets
  - Must compare this to prior service cost and reduce comprehensive income if additional liability is not enough to cover prior service cost

Notes in financials

- Show a schedule of pension expense components
- Show a reconciliation of: PBO \(\leftarrow\rightarrow\) FMV of plan assets and changes
- Funded status of plan
- The rates used (discount rate, expected return, rate of compensation increase)