Issue No. 15-C, “Employee Benefit Plan Simplifications”

EITF Education Session

January 22, 2015
Agenda

- Overview
- Project Background
- Issue 1 – Disclosure Simplifications
- Issue 2 – Measurement Simplification
- Next Steps
Overview
Objective of Plan Financial Statements and Types of Plans

- **Objective of plan financial statements:**
  - To provide information that is useful in assessing the plan’s present and future ability to pay benefits when they become due

- **Types of Employee Benefit Plans (EBPs) covered by the Codification***:
  - Defined Benefit Pension Plans (Topic 960)
  - Defined Contribution Pension Plans (Topic 962)
  - Health and Welfare Benefit Plans (Topic 965)

*Collectively referred to as Plan Accounting Topics
### Characteristics of the Plans

<table>
<thead>
<tr>
<th><strong>Defined Benefit Plan</strong>&lt;sup&gt;*&lt;/sup&gt;</th>
<th><strong>Defined Contribution Plan</strong>&lt;sup&gt;*&lt;/sup&gt;</th>
<th><strong>Health &amp; Welfare Plans</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Typically more complex</td>
<td>Typically less complex</td>
<td>Benefit provided can include medical, dental, vision, psychiatric, or long-term health care, severance benefits, unemployment, disability, tuition assistance, daycare, etc.</td>
</tr>
<tr>
<td>Promise to pay specified benefits determined by specific factors (e.g., age, years of service, compensation)</td>
<td>Individual accounts are provided for each participant</td>
<td>Plans can be either defined benefit or defined contribution</td>
</tr>
<tr>
<td>Investments are typically directed by sponsor (nonparticipant-directed investments)</td>
<td>Investments are typically directed by the participants (participant-directed investments)</td>
<td></td>
</tr>
<tr>
<td>Least popular type of retirement plan for sponsors because of investment risk and cost</td>
<td>Most popular type of retirement plan because sponsors do not hold investment risk</td>
<td></td>
</tr>
</tbody>
</table>

<sup>*</sup>Some plans have characteristics of both DB and DC plans. In these cases the plans normally are accounted for as DB plans. For example, cash balance plans.
Plans Hold a Variety of Investments

- Common stock
  - Public and nonpublic
- Corporate bonds
- U.S. government bonds
- Registered investment companies
- Bank collective trusts
- Limited partnerships
- Other alternative investment funds (for example, private equity funds, hedge funds, real estate funds, funds of funds)

- Real estate
- Derivatives
- Insurance company products
  - General account guaranteed investment contracts (GICs)
  - Pooled separate accounts (PSAs)
  - Group annuity contracts
  - Synthetic investment contracts
Regulatory Considerations

- The Employee Retirement Income Security Act of 1974 (ERISA)
  - Governs the operation, administration, and annual reporting for EBPs
  - Applies to most EBPs established by employers doing interstate commerce
  - Protects interests of participants and beneficiaries
  - Establishes a mechanism to detect and deter abusive practices
  - Department of Labor (DOL) has responsibility for the interpretation and enforcement of ERISA
ERISA Reporting Requirements

- Annual reporting via the Form 5500
- Form 5500 and audited financial statements available to the public on the DOL website
- Plans with 100 or more participants generally require a financial statement audit
- Plans with under 100 participants may require a financial statement audit if certain waiver conditions are not met
Filing Requirement for Audited Plans

<table>
<thead>
<tr>
<th>Requirement</th>
<th>Due Date</th>
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<tbody>
<tr>
<td>Form 5500</td>
<td>7 months after year-end</td>
</tr>
<tr>
<td>Audit Report*</td>
<td>Can be extended by 2 1/2 months</td>
</tr>
</tbody>
</table>

- **DOL**
- **SEC (11-K filers)**
  - DOL requirement
  - 11-K filing with SEC
- 90 days after the end of the fiscal year of the plan if filed under SEC format
- Plans subject to ERISA and using the ERISA format within 180 days (not 6 months) after the end of the fiscal year of the plan

* In certain instances investments are not required to be audited

** DC plans only – normally required if the plan allows investment in company stock
Primary User Considerations

- Users of plan financial statements include the DOL, IRS, Pension Benefit Guaranty Corporation (PBGC), and the SEC (when applicable), plan sponsors, trustees, and plan participants.

- While each type of user (participant, sponsor, and regulator) may use the financial statements to assess the plan’s present and future ability to pay benefits, they are all different from the user that is typically considered when setting accounting standards.
Primary User Considerations (cont.)

- Participants provide resources to the plan and receive benefits from the plan but do not buy or sell investments based on the plan’s financial statements
  - However, participants do not often obtain the financial statements

- Sponsors provide resources to the plan and have an interest in net cash flows, but are internal users
  - According to Concepts Statement 8, general purpose financial statements are not primarily directed towards internal users

- Regulators do not provide or receive resources from EBPs; however, they use financial statement disclosures to evaluate whether sponsors are fulfilling their fiduciary responsibilities
  - According to Concepts Statement 8, general purpose financial statements are not primarily directed towards regulators
2013 ERISA Plan Audits:

- 82,579 plan audits
- 7,358 CPA firms performing audits
- $6.3 trillion in plan assets subject to audit
Project Background
Project Background

- Agenda request submitted by the AICPA EBP Expert Panel
- Added to agenda at November 5, 2014 Agenda Prioritization meeting
- Project objective is to simplify certain measurement and disclosure requirements for the financial statements of EBPs
- Outreach to date has included discussions with the DOL, AICPA EBP Expert Panel, FASB Small Business Advisory Committee (SBAC), and the EITF Working Group formed to provide input to the staff
Issue 1 – Disclosure Simplifications
The Plan Accounting Topics primarily were derived from FASB Statement No. 35, *Accounting and Reporting by Defined Benefit Pension Plans*, which was issued in March of 1980.

As subsequent standards have been added or amended, additional disclosure requirements have been made applicable to EBP financial statements.

Stakeholders have asked whether the effects on EBPs were specifically considered at the time those additions and amendments were made.

- Topic 820, *Fair Value Measurement*, and the Plan Accounting Topics include investment disclosures for financial assets that sometimes require aggregation or organization of similar information in different ways.

Some believe that the benefit of providing detailed investment disclosures to plan participants is relatively minor because plan participants do not typically obtain the financial statements.
Issue 1 – Issues Raised

- Disclosure issues raised by stakeholders include:
  - Disaggregation of classes of assets
  - Details about plan assets
  - Disclosures of changes in plan assets

Should the requirements in Topic 820 or the Plan Accounting Topics be eliminated and/or amended? Should all types of investments (participant-directed and nonparticipant-directed) be subject to the same requirements?
### Issue 1A – Classes of Assets

#### Topic 820
Requires classes of assets to be disaggregated based on nature, characteristics, and risks

#### Plan Accounting Topics
Require classes of assets to be disaggregated based on general type
- Participant-directed investments may be shown in aggregate, as one-line item, on the statement of net assets available for benefit
- Nonparticipant-directed investments are disaggregated based on general type

#### Feedback from 15-C Working Group
- Classes of assets should be disaggregated only based on general type
  - Consider whether disaggregation should be required only in the notes and not on the face of the financials
- Clarify that self-directed brokerage accounts should be treated as one type of investment
  - Consistent with regulatory reporting requirements
**Issue 1B – Details About Plan Assets**

**Topic 820**
Requires an entity to disclose:
- Valuation methodologies
- Categorization of financial assets within the fair value hierarchy
- Quantitative information about significant unobservable inputs for Level 3 fair value measurements

**Plan Accounting Topics**
Require a plan to identify investments that are equal to or greater than 5 percent of the net assets available for benefits as of the end of the year

**Feedback from 15-C Working Group**
- Topic 820 disclosures can be useful but should be provided by general type
- Disclosure of investments over 5% is not useful
  - All assets are included in supplemental schedule
Issue 1C – Disclosures of Changes in Plan Assets

**Topic 820**
Requires an entity to disclose a rollforward of investments categorized as Level 3, which disaggregates the activity, including a breakout of realized gains/losses, unrealized gains/losses, sales, purchases and transfers

**Plan Accounting Topics**
Require a plan to disclose the net appreciation/depreciation for *all* plan assets by general type

**Feedback from 15-C Working Group**
- Some question the benefit of the Level 3 rollforward
  - Others note that the volume of Level 3 investments may significantly decrease depending on the decision for Issue 2 and on the finalization of the NAV proposals
- Disclosure of net appreciation/depreciation is not useful
Issue 2 – Measurement Simplification
Issue 2 – Background

- Fully Benefit-Responsive Investment Contracts
  - Defined in the Master Glossary
  - If realization of contract value by participants is not probable, an investment does not meet this definition
  - Discussed within AICPA Statement of Position 94-4
  - Are generally conservative, fixed income investment vehicles with the objective of preserving capital while providing a relatively stable rate of return
  - Very common in defined contribution plans
Issue 2 – Fully Benefit-Responsive Investment Contracts

- Current accounting:
  - Measured at fair value using the requirements in Topic 820
  - If fair value is different from contract value, a reconciliation of contract value and fair value is presented on the face of the financial statements
  - Plan Accounting Topics require additional disclosures for these investments
    - Disclosures include a description of events that limit the ability to transact at contract value

Should EBPs measure fully benefit-responsive investments at contract value? If so, should disclosures be affected?
Plan does not typically “transact” at fair value
- Contract value viewed as the relevant measurement attribute because it is the amount participants in the fund would receive if they were to initiate permitted transactions (for example, withdrawals) under the terms of the underlying plan

Most fully benefit-responsive investment contracts are reported on Form 5500 at contract value

Insurance companies that issue these investments often assert that fair value equals contract value
- Testing the validity of that assertion can sometimes be challenging
## Issue 2 – Feedback Received to Date (cont.)

### Feedback from 15-C Working Group

<table>
<thead>
<tr>
<th>Category</th>
<th>Feedback</th>
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<tbody>
<tr>
<td><strong>Measurement</strong></td>
<td>• Contract value is the relevant measurement attribute</td>
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</tbody>
</table>
| **Disclosure**      | • If measured at contract value, these investments should not be included in the fair value hierarchy table  
                      • Staff should further consider appropriateness of current disclosure requirements if measurement basis for these contracts is changed |
| **Transition Method** | • Retrospective |
Next Steps
Proposed Timeline for EBP discussions

- Target a consensus-for-exposure at March 19, 2015 EITF meeting
  - Issue exposure draft in mid-April with comment letter deadline in mid-June

- Discuss comment letters and target a final consensus at July 9, 2015 “Extra” EITF meeting
  - Issue final ASU in early third quarter 2015 in order to make simplifications available for many 2014 EBP financial statements
Questions or Comments?