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# Accounting for and reporting of postretirement medical benefit (401(h)) features of defined benefit pension plans : amendment to the AICPA audit and accounting guide, Audits of employee benefit plans; Statement of position 99-2;

American Institute of Certified Public Accountants. Employee Benefit Plans Committee

**STATEMENT OF POSITION 99-2**

AICPA

American Institute of Certified Public Accountants

*July 28, 1999*

# Accounting for and Reporting of Postretirement Medical Benefit (401(h)) Features of Defined Benefit Pension Plans

**Amendment to the AICPA Audit and Accounting Guide**
***Audits of Employee Benefit Plans***

*Prepared by the Employee Benefit Plans Committee and the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants*

# NOTE

Statements of Position on accounting issues present the conclusions of at least two-thirds of the Accounting Standards Executive Committee, which is the senior technical body of the Institute authorized to speak for the Institute in the areas of financial accounting and reporting. Statement on Auditing Standards No. 69, *The Meaning of* Present Fairly in Conformity With Generally Accepted Accounting Principles *in the Independent Auditor's Report*, identifies AICPA Statements of Position that have been cleared by the Financial Accounting Standards Board as sources of established accounting principles in category *b* of the hierarchy of generally accepted accounting principles that it establishes. AICPA members should consider the accounting principles in this Statement of Position if a different accounting treatment of a transaction or event is not specified by a pronouncement covered by rule 203 of the AICPA Code of Professional Conduct. In such circumstances, the accounting treatment specified by the Statement of Position should be used, or the member should be prepared to justify a conclusion that another treatment better presents the substance of the transaction in the circumstances.



*1 2 3 4 5 6 7 8 9 0 AccS 9 9*

# TABLE OF CONTENTS

# SUMMARY


This Statement of Position (SOP) would amend chapters 2 and 4 of the AICPA Audit and Accounting Guide, *Audits of Employee Benefit Plans* (the Guide). This SOP specifies the accounting for and disclosure of 401(h) features of defined benefit pension plans, by both defined benefit pension plans and health and welfare benefit plans.

The SOP requires—

*a.* Defined benefit pension plans to record the aggregate amount of net assets held in a 401(h) account related to health and welfare plan obligations for retirees as both assets and liabilities on the face of the statement of net assets available for pension benefits in order to arrive at net assets available for pension benefits

*b.* 401(h) account assets used to fund health benefits, and the changes in those assets, to be reported in the financial statements of the health and welfare benefit plan. Benefit obligations related to the 401(h) account are also required to be reflected in the health and welfare plan financial statements

*c.* Defined benefit pension plans to disclose the fact that the 401(h) account assets are available only to pay retirees' health benefits

*d.* Health and welfare benefit plans to disclose in the notes to the financial statements the fact that retiree health benefits are funded partially through a 401(h) account of the defined benefit pension plan.

This SOP is effective for financial statements for plan years beginning after December 15, 1998. Earlier application is encouraged. Accounting changes adopted to conform to the provisions of this SOP should be made retroactively by restatement of financial statements for prior periods.

# FOREWORD

The accounting guidance contained in this document has been cleared by the Financial Accounting Standards Board (FASB). The procedure for clearing accounting guidance in documents issued by the Accounting Standards Executive Committee (AcSEC) involves the FASB reviewing and discussing in public board meetings (1) a prospectus for a project to develop a document, (2) a proposed exposure draft that has been approved by at least ten of AcSEC's fifteen members, and (3) a proposed final document that has been approved by at least ten of AcSEC's fifteen members. The document is cleared if five of the seven FASB members do not object to AcSEC undertaking the project, issuing the proposed exposure draft or, after considering the input received by AcSEC as a result of the issuance of the exposure draft, issuing the final document.

The criteria applied by the FASB in its review of proposed projects and proposed documents include the following.

1. The proposal does not conflict with current or proposed accounting requirements, unless it is a limited circumstance, usually in specialized industry accounting, and the proposal adequately justifies the departure.
2. The proposal will result in an improvement in practice.
3. The AICPA demonstrates the need for the proposal.
4. The benefits of the proposal are expected to exceed the costs of applying it.

In many situations, prior to clearing the FASB will propose suggestions, many of which are included in the documents.

# Accounting for and Reporting of Postretirement Medical Benefit (401(h)) Features of Defined Benefit Pension Plans

## Introduction

1. Some defined benefit pension plans provide a postretirement medical-benefit component in addition to the normal retirement benefits of the plan, pursuant to Section 401(h) of the Internal Revenue Code (IRC). Employers may fund a portion of their postretirement medical-benefit obligations related to their health and welfare benefit plans through a health benefit account (401(h) account) in their defined benefit pension plans, subject to certain restrictions and limitations.

2. Funding can be accomplished through a qualified transfer of excess pension plan assets (as defined in Section 420 of the IRC) or through additional contributions to the 401(h) account by the employer, employees, or both. Any assets transferred to a 401(h) account in a qualified transfer of excess pension plan assets (and any income allocable thereto) must be used only to pay qualified current retiree health benefits for the taxable year of the transfer (whether directly or through reimbursement). Any assets transferred to the 401(h) account to pay retiree medical expenses in a qualified transfer of excess pension plan assets (and any income allocable thereto) that are not used during the year must be transferred out of the account to the transferor plan and treated as an employer reversion for purposes of a 20 percent excise tax on reversions. The IRC allows employers to allocate up to 25 percent of total contributions to the plan, subject to certain limitations, to the 401(h) account. If the full amount of these contributions is not used during the year, they may be accumulated for future retiree medical expenses in the 401(h) account. The deductibility of employer contributions to a 401(h) account is subject to separate limitations and, there-

fore, such contributions have no effect on the amount of deductible contributions an employer can make to fund pension benefits under the plan. The earnings on the 401(h) account are ignored for minimum funding purposes. Additionally, under the IRC, qualified transfers are not treated as prohibited transactions for purposes of Section 4975.

3. The plan sponsor has discretion in making contributions to the 401(h) account. A pension or annuity plan may provide for payment of medical benefits for retired employees, their spouses, and their dependents if all of the following conditions are met.

   *a.* Benefits are subordinate (as defined in section 401(h) of the IRC) to the retirement benefits provided by the plan.

   *b.* A separate account is established and maintained for such benefits.

   *c.* The employer's contributions to the separate account are reasonable and ascertainable

   *d.* It is impossible, at any time prior to the satisfaction of all obligations under the plan to provide such benefits, for any part of the corpus or income of the separate account to be (within the taxable year or thereafter) used for or diverted to any purpose other than the providing of such benefits.

   *e.* Notwithstanding the provisions of certain IRC sections, upon satisfaction of all obligations under the plan to provide such benefits, any amount remaining in the separate account must, under the terms of the plan, be returned to the employer.

   *f.* In the case of an employee who is a key employee, (as defined in Section 416(i)), a separate account is established and maintained for such benefits payable to such employee (and the spouse and dependents) and such benefits (to the extent attributable to plan years beginning after March 31, 1984, for which the employee is a key employee) are payable only to such employee (and the spouse and dependents) from that separate account.

4. The 401(h) assets may be used only to pay current retiree health benefits, which are obligations of a separate health and welfare benefit plan or health benefit arrangement. They may not be used to satisfy pension obligations. Although the assets may be invested together with assets that are available to pay pension benefits, a separate accounting must be maintained for all qualified transfers, contributions, distributions and/or expenses, and income earned thereon.

5. Financial Accounting Standards Board (FASB) Statement No. 35, *Accounting and Reporting by Defined Benefit Pension Plans*, and the AICPA Audit and Accounting Guide *Audits of Employee Benefit Plans* (the Guide) provide guidance to preparers and auditors of financial statements of defined benefit pension plans. Neither document addresses accounting for and reporting of 401(h) features of those plans.

## Scope

6. Paragraphs 8 through 10 and paragraphs 13 and 14 of this SOP apply to all defined benefit pension plans that contain a 401(h) feature.

7. Paragraphs 11, 12, 15, and 16 of this SOP apply to health and welfare benefit plans if a portion or all of the benefits under such plans are funded through a 401(h) feature in a defined benefit pension plan.

## Conclusions

### Accounting and Reporting

#### *Defined Benefit Pension Plans*

8. Because the 401(h) net assets may not be used to satisfy pension obligations, the total of net assets available for pension benefits must not include assets held in the 401(h) account related to obligations of the health and welfare benefit plan. The 401(h) account assets less liabilities (net assets of the 401(h) account) are required to be shown in defined benefit pension plan financial statements as a single line item on the face of the statements (as illustrated in appendix B). Those net assets related to the 401(h) account

also must be deducted before arriving at the total of net assets available for pension benefits. In deducting those net assets, the amount relating to 401(h) features should be presented as a separate line item in the liabilities section of the statement of net assets available for pension benefits. The financial statement caption should clearly denote that the net assets held in the 401(h) account relate to obligations of the health and welfare plan or arrangement. The statement of changes in net assets should show only the changes in net assets of the pension plan and not any of the components of the changes in the net assets in the 401(h) account. The only amounts that should be reported in the statement of changes in net assets are qualified transfers to the 401(h) account and/or any unused or unspent amounts (including allocated income) in the 401(h) account at the end of the year that were qualified transfers of excess pension plan assets that should have been but were not transferred back to the defined benefit pension plan.

9. Information regarding accumulated plan benefits should relate only to pension obligations. Even in situations in which separate financial statements are not prepared for the health and welfare benefit plan, obligations related to retiree health benefits should not be reported in the statement of accumulated plan benefits of the defined benefit pension plan financial statements.

10. Illustrative financial statements for a defined benefit pension plan with a 401(h) feature are presented in appendix B.

## Health and Welfare Benefit Plans

11. The 401(h) account assets used to fund health benefits, and the changes in those assets, should be reported in the financial statements of the health and welfare benefit plan. The 401(h) account assets and liabilities and changes in them can be shown in the health and welfare benefit plan financial statements in one of two ways. An entity can present that information either as a single line item on the face of the statements (as illustrated in appendix C) or included in individual line items with separate disclosure in the footnotes about the 401(h) amounts included in those individual line items. If the assets and liabilities are shown as a

single line item in the statement of net assets, the changes in net assets also should be shown as a single line item in the statement of changes in net assets. If the assets and liabilities are included in individual asset and liability line items in the statement of net assets, the changes in individual 401(h) amounts should be included in the changes in the individual line items in the statement of changes in net assets, with separate disclosure in the footnotes about the 401(h) amounts included in those individual line items. The notes to the financial statements should disclose the significant components of net assets and changes in net assets of the 401(h) account. The 401(h) obligations are reported in the health and welfare benefit plan's statement of benefit obligations as required by SOP 92-6, *Accounting and Reporting by Health and Welfare Benefit Plans*. Likewise, the health and welfare benefit plan's statement of changes in benefit obligations should include claims paid through the 401(h) account.

12. Illustrative financial statements of a health and welfare benefit plan funded through a 401(h) account in a separate defined benefit pension plan are presented in appendix C.

## Disclosures

### *Defined Benefit Pension Plans*

13. Defined benefit pension plans should disclose in the notes to the financial statements the nature of the assets related to the 401(h) account, and the fact that the assets are available only to pay retiree health benefits.

14. The Employee Retirement Income Security Act of 1974 (ERISA) requires that the 401(h) assets be reported as assets of the defined benefit pension plan in regulatory filings with the U.S. government. Paragraph 12.27 of the Guide notes that ERISA requires a plan's financial statements to include a note explaining differences between amounts reported in the financial statements and the amounts reported in the Form 5500 Annual Return/Report. Because ERISA requires 401(h) accounts to be reported as assets of the pension plan, a reconciliation of the net assets reported in the financial statements to those reported in Form 5500 is required. The reconciliation should be accompanied by a discussion of

the 401(h) account, explaining clearly that the assets in the 401(h) account are not available to pay pension benefits.

### *Health and Welfare Benefit Plans*

15. Health and welfare benefit plans should disclose in the notes to the financial statements the fact that retiree health benefits are funded partially through a 401(h) account of the defined benefit pension plan. Those plans also should disclose the fact that the assets in the 401(h) account are available only to pay retiree health benefits. The notes to the financial statements should disclose the significant components of net assets and changes in net assets of the 401(h) account.

16. As noted in paragraph 14 above, ERISA requires that the 401(h) assets be reported as assets of the defined benefit pension plan and not as assets of the health and welfare benefit plan in regulatory filings with the U.S. government. Paragraph 12.27 of the Guide notes that ERISA requires a plan's financial statements to include a note explaining differences between amounts reported in the financial statements and the amounts reported in the Form 5500. Because ERISA requires 401(h) accounts to be reported as assets of the pension plan, a reconciliation of the net assets reported in the financial statements to those reported in the Form 5500 is required for the health and welfare benefit plan.

## Amendments to the Guide

17. The following is added to chapter 2, "Accounting and Reporting by Defined Benefit Pension Plans," of the Guide as paragraphs 2.36 through 2.42 under the section "Additional Financial Statement Disclosures:" The existing Guide paragraphs 2.36 through 2.42 will be renumbered to paragraphs 2.43 through 2.49 as a result of these amendments.

> 2.36 *401(h) Accounts.* Some defined benefit pension plans provide a postretirement medical-benefit component in addition to the normal retirement benefits of the plan, pursuant to Section 401(h) of the Internal Revenue Code (IRC). Employers may fund a portion of their postretirement medical-benefit obligations related to their health and welfare benefit plans through a health benefit account

(401(h) account) in their defined benefit pension plans, subject to certain restrictions and limitations. Funding can be accomplished through a qualified transfer of excess pension plan assets or through additional contributions. Any assets transferred to a 401(h) account in a qualified transfer of excess pension plan assets (and any income allocable thereto) must be used only to pay qualified current retiree health benefits for the taxable year of the transfer (whether directly or through reimbursement). Any assets transferred to a 401(h) account in a qualified transfer of excess pension plan assets (and any income allocable thereto) that are not used in the year must be transferred out of the account to the pension plan.

2.37 The IRC allows employers to allocate up to 25 percent of total contributions to the plan, subject to certain limitations, to the 401(h) account. If the full amount of these contributions is not used during the year, they may be accumulated for future retiree medical expenses in the 401(h) account. The deductibility of employer contributions to a 401(h) account is subject to separate limitations and, therefore, such contributions have no effect on the amount of deductible contributions an employer can make to fund pension benefits under the plan. The earnings on the 401(h) account are ignored for minimum funding purposes. Additionally, under the IRC, qualified transfers are not treated as prohibited transactions for purposes of Section 4975.

2.38 The plan sponsor has discretion in making contributions to the 401(h) account. A pension or annuity plan may provide for payment of medical benefits for retired employees, their spouses, and their dependents if all of the following conditions are met.

*a.* Benefits are subordinate (as defined in Section 401(h) of the IRC) to the retirement benefits provided by the plan.

*b.* A separate account is established and maintained for such benefits.

*c.* The employer's contributions to the separate account are reasonable and ascertainable.

*d.* It is impossible, at any time prior to the satisfaction of all obligations under the plan to provide such benefits, for any part of the corpus or income of the separate account to be (within the taxable year or thereafter) used for, or diverted to, any purpose other than the providing of such benefits.

*e.* Notwithstanding the provisions of certain IRC sections, upon satisfaction of all obligations under the plan to provide such benefits, any amount remaining in the separate account must, under the terms of the plan, be returned to the employer.

*f.* In the case of an employee who is a key employee (as defined in Section 416(i)), a separate account is established and maintained for such benefits which are payable to such employee (and the spouse and dependents), and such benefits (to the extent attributable to plan years beginning after March 31, 1984, for which the employee is a key employee) are payable only to that employee (and the spouse and dependents) from the separate account.

2.39 The 401(h) assets may be used only to pay current retiree health benefits, which generally are obligations of a separate health and welfare benefit plan or health benefit arrangement. They may not be used to satisfy pension obligations. Although the assets may be invested together with assets that are available to pay pension benefits, a separate accounting must be maintained for all qualified transfers, contributions, distributions and/or expenses, and income earned thereon.

2.40 Because the 401(h) net assets may not be used to satisfy pension obligations, the total of net assets available for pension benefits must not include net assets held in the 401(h) account related to obligations of the health and welfare benefit plan. The 401(h) account assets less liabilities (net assets of the 401(h) account) are required to be shown in defined benefit pension plan financial statements as a single line item on the face of the statements (as illustrated in appendix B). Those net assets related to the 401(h) account also must be deducted before arriving at the total of net assets available for pension benefits. In deducting those net assets, the amount related to the 401(h) features should be presented as a separate line item in the liabilities section of the statement of net assets available for pension benefits. The financial statement caption should clearly denote that the net assets held in the 401(h) account relate to obligations of the health and welfare benefit plan or arrangement. The statement of changes in net assets should show only the changes in net assets of the pension plan and not any of the components of the changes in the net assets in the 401(h) account. The only amounts that should be reported in the statement of changes in net assets are qualified transfers to the 401(h) account and/or any unused or unspent amounts (including allocated income) in the 401(h) account at the end of the year that were qualified transfers of excess pension plan assets that should have been, but were not, transferred back to the defined benefit pension plan.

2.41 Information regarding accumulated plan benefits should relate only to pension obligations. Even in situations in which separate financial statements are not prepared for the health and welfare benefit plan, obligations related to retiree health benefits should not be reported in the statement of accumulated plan benefits of the defined benefit pension plan financial statements.

2.42 Defined benefit pension plans should disclose in the notes to the financial statements the fact that the 401(h) account assets are available only to pay retiree health benefits.

18. The following is added to chapter 4, "Accounting and Reporting by Health and Welfare Benefit Plans," of the Guide as paragraphs 4.54 and 4.55 under the section "Postretirement Benefit Obligations:" The existing Guide paragraphs 4.54 through 4.55 are renumbered to paragraphs 4.56 through 4.57 as a result of these amendments.

4.54 Certain retiree health benefits may be funded through a 401(h) account in a defined benefit pension plan, pursuant to Section 401(h) of the Internal Revenue Code (IRC). Refer to paragraphs 2.36 through 2.42 of this Guide for a detailed discussion of 401(h) accounts. The 401(h) account assets and liabilities used to fund retiree health benefits, and the changes in those assets and liabilities, should be reported in the financial statements of the health and welfare benefit plan. The 401(h) account assets used to fund health benefits, and the changes in those assets, should be reported in the financial statements of the health and welfare benefit plan. The 401(h) account assets and liabilities and changes in them can be shown in the health and welfare benefit plan financial statements in one of two ways. An entity can present that information either as a single line item on the face of the statements or included in individual line items with separate disclosure in the footnotes about the 401(h) amounts included in those individual line items. If the assets and liabilities are shown as a single line item in the statement of net assets, the changes in net assets also should be shown as a single line item in the statement of changes in net assets. If the assets and liabilities are included in individual asset and liability line items in the statement of net assets, the changes in individual 401(h) amounts should be included in the changes in the individual line items in the statement of changes in net assets, with separate disclosure in the footnotes about the 401(h) amounts included in those individual line items. The notes to the financial statements should disclose the significant components of net assets and changes in net assets of the 401(h) account. The 401(h) obligations are reported in the health and welfare benefit plan's statement of benefit obligations. Likewise, the health and welfare benefit plan's statement of changes in benefit obligations should include claims paid through the 401(h) account.

4.55 If retiree health benefit obligations are funded partially through a 401(h) account of the defined benefit pension plan, the plan should also disclose the fact that the assets are available only to pay retiree health benefits. The notes to the financial statements should disclose the significant components of net assets and changes in net assets of the 401(h) account. Additionally, the notes should include a reconciliation of amounts reported in the financial statements to the amounts reported in the Form 5500 (see paragraph 12.27).

19. The illustrative financial statements examples in appendix B of this SOP are added to the Guide as exhibits D-9 through D-11. The illustrative financial statements examples in appendix C of this SOP are added to the Guide as exhibits F-9 through F-13.

## Effective Date and Transition

20. This SOP is effective for financial statements for plan years beginning after December 15, 1998. Earlier application is encouraged. Accounting changes adopted to conform to the provisions of this SOP should be made retroactively by

restatement of financial statements for prior periods. If financial statements for prior periods are not presented, the financial statements for the year in which this SOP is first applied should disclose the effect of any restatement on the beginning balance of net assets.

# APPENDIX A

## Background Information and Basis for Conclusions

A.1 Practice in the area of accounting and reporting for 401(h) features of defined benefit pension plans was diverse. Some defined benefit pension plans reported all defined benefit and 401(h) account assets together in the statement of net assets available for benefits, and disclosed information about the 401(h) account in the notes to the defined benefit pension plan and health and welfare benefit plan financial statements. Others displayed the assets separately in multicolumnar format in the defined benefit pension plan financial statements, with note disclosures in the defined benefit plan and health and welfare benefit plan financial statements. The content of note disclosures varied significantly. Still others did not include the 401(h) assets in the defined benefit pension plan financial statements at all. Instead, the assets were reported in the financial statements of the related health and welfare benefit plan.

A.2 401(h) account assets are used to pay benefits promised by a separate health and welfare benefit plan. Payments for retiree health benefits are made directly from the 401(h) account to the participant or his or her designee or as reimbursements to the sponsoring company. The pension plan basically is a funding vehicle for payment of those benefits. The AICPA Accounting Standards Executive Committees (AcSEC) believes the reporting of those 401(h) assets should be similar to financial statement reporting of separate accounts of life insurance companies, where the assets in the separate accounts are shown as a single line item described as "assets held in separate accounts." The same amount also is shown as a liability captioned "liabilities related to the separate accounts." The Industry Audit Guide *Audits of Stock Life Insurance Companies* states in the glossary that "separate accounts constitute a separate operation under which the assets fund the liabilities to variable annuity contractholders, pension funds, and others."

A.3 In substance, those 401(h) assets are assets of the health and welfare benefit plan because they will be used to pay retiree health benefits promised by that plan. Paragraph 25 of FASB Statement of Financial Accounting Concepts Statement No. 6, *Elements of Financial Statements*, defines assets as "probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events." FASB Concepts Statement No. 6 further states in paragraph 172 that "Future economic benefit is the essence of an asset. An asset has the capacity to serve the entity by being exchanged for something else of value to the entity, by being used to produce something of value to the entity, or by being used to settle its liabilities."

A.4 This document was exposed for public comment for a period of ninety days. Some respondents to the exposure draft questioned the need for a detailed disclosure of 401(h) net assets in a defined benefit pension plans financial statements. The 401(h) assets legally are assets of the defined benefit pension plan. In addition, the Employee Retirement Income Security Act of 1974 (ERISA) requires that for regulatory filings with the U.S. government, 401(h) assets be reported in the financial statements of the defined benefit pension plan. Accordingly, AcSEC believes the legal status of the assets should be reflected in the defined benefit pension plan's statement of net assets available for benefits.

A.5 Because the 401(h) account assets are available only to pay retiree health and welfare benefits, it would be misleading to report them as assets in the statement of net assets available for plan benefits in a defined benefit pension plan without also reporting the same amounts as obligations in the liabilities section of the statement of net assets available for pension benefits. AcSEC also believes the net amount of 401(h) assets held in the pension plan should be included in the net assets of the health and welfare benefit plan and the changes in those net assets should be reflected in the statement of changes in net assets available for benefits, with note disclosure of the nature of the 401(h) account assets and activity.

A.6 Some respondents commented that the 401(h) account assets should only be displayed as a single line item on the face of the benefit plan's financial statements and not included in the individual asset and liability line items with a separate footnote disclosure. AcSEC considered two alternative presentations of the 401(h) account net assets in defined benefit pension plan financial statements—either single line item treatment on the face of the financial statements (single line presentation) or including the individual asset and liability line items with other defined benefit plan assets and liabilities and disclosing in the footnotes the 401(h) amounts included in those individual line items (broad presentation). Because those 401(h) assets are not available to defined benefit pension plan participants for the payment of benefits, AcSEC believes the broad presentation method may confuse the users of defined benefit pension plan financial statements. Therefore, AcSEC agreed to the single line presentation method of reporting 401(h) account assets and liabilities in defined benefit pension plan financial statements.

A.7 In health and welfare benefit plans, the proceeds from 401(h) account assets can be used only to pay retiree health and welfare benefits. They are not available to pay benefits for active employees. Legal title to such assets is held by the defined benefit pension plan. Therefore, some believe the single line presentation is most appropriate. Others believe such factors do not prevent the broad presentation which they believe is more useful. Because paragraph 11 of this SOP requires disclosure regarding the significant components of net assets and changes in net assets of the 401(h) account, AcSEC concluded it did not need to resolve this issue at this time and agreed to allow health and welfare benefit plans the option of reporting either the single line presentation or the broad presentation of the 401(h) account assets in the health and welfare benefit plan's financial statements.

# APPENDIX B

## Illustrative Defined Benefit Pension Plan Financial Statements and Related 401(h) Account Disclosures

B.1 This Appendix illustrates certain applications of the provisions of this SOP that apply for the annual financial statements of a hypothetical defined benefit pension plan that has been amended to include a 401(h) account. It does not illustrate other provisions of this SOP that might apply in circumstances other than those assumed in this illustration. It also does not illustrate all disclosures required for a fair presentation in conformity with generally accepted accounting principles (GAAP). The formats presented and the wording of accompanying notes are only illustrative and are not necessarily the only possible presentations.

B.2 Although GAAP does not require comparative financial statements, Employee Retirement Income Security Act (ERISA) requires a comparative statement of net assets available for benefits. The illustrative financial statements are intended to comply with the requirements of ERISA.

B.3 ERISA and the Department of Labor (DOL) regulations require that certain information be included in supplemental schedules, which are not required under GAAP, and reported on by the independent auditor. See appendix A of *Audits of Employee Benefit Plans* for a further discussion of the ERISA and DOL requirements.

## EXAMPLE 1
## C&H Company Pension Plan
## Statement of Net Assets Available for Pension Benefits

| | December 31, 20X1 | December 31, 20X0 |
|---|---|---|
| *Assets* | | |
| Investments, at fair value (Note A): | | |
| Plan interest in C&H Master Trust | $2,000,000 | $1,660,000 |
| C&H Company common stock | 600,000 | 800,000 |
| Investment contract with insurance company | 850,000 | 800,000 |
| Corporate bonds and debentures | 3,000,000 | 3,170,000 |
| U.S. government securities | 300,000 | 200,000 |
| Mortgages | 480,000 | 460,000 |
| Money market fund | 270,000 | 240,000 |
| Total investments | 7,500,000 | 7,330,000 |
| Net assets held in 401(h) account (Note H) | 1,072,000 | 966,000 |
| Receivables: | | |
| Employer's contribution | 20,000 | 10,000 |
| Securities sold | 310,000 | 175,000 |
| Accrued interest and dividends | 70,000 | 70,000 |
| Total receivables | 400,000 | 255,000 |
| Cash | 180,000 | 80,000 |
| Total assets | 9,152,000 | 8,631,000 |
| *Liabilities* | | |
| Due to broker for securities purchased | — | 400,000 |
| Accounts payable | 70,000 | 60,000 |
| Accrued expenses | 70,000 | 25,000 |
| Amounts related to obligation of 401(h) account | 1,072,000 | 966,000 |
| Total liabilities | 1,212,000 | 1,451,000 |
| Net assets available for pension benefits | $7,940,000 | $7,180,000 |

The accompanying notes are an integral part of the financial statements.

## EXAMPLE 2
## C&H Company Pension Plan
## Statement of Changes in Net Assets Available for Pension Benefits

| | For the Year Ended December 31, 20X1 |
|---|---|
| Investment income: | |
| Net appreciation in fair value of investments | $ 233,000 |
| Interest | 293,000 |
| Dividends | 4,000 |
| | 530,000 |
| Less investment expenses | 30,000 |
| | 500, 000 |
| Plan interest in C&H Master Trust investment income (Note F) | 117,000 |
| | 617,000 |
| Contributions (Note C): | |
| Employer | 740,000 |
| Employees | 450,000 |
| | 1,190,000 |
| Total additions | 1,807,000 |
| Benefits paid directly to participants | 740,000 |
| Purchases of annuity contracts (Note G) | 257,000 |
| | 997,000 |
| Administrative expenses | 50,000 |
| Total deductions | 1,047,000 |
| Net increase | 760,000 |
| Net assets available for pension benefits: | |
| Beginning of year | 7,180,000 |
| End of year | $7,940,000 |

The accompanying notes are an integral part of the financial statements.

### A. 401 (h) Account

Effective January 1, 19X0, the Plan was amended to include a medical-benefit component in addition to the normal retirement benefits to fund a portion of the postretirement obligations for retirees and their beneficiaries in accordance with Section 401(h) of the Internal Revenue Code (IRC). A separate account has been established and maintained in the Plan for the net assets related to the medical-benefit component (401(h) account). In accordance with IRC Section 401(h), the Plan's investments in the 401(h) account may not be used for, or diverted to, any purpose other than providing health benefits for retirees and their beneficiaries. Any assets transferred to the 401(h) account from the defined benefit pension plan in a qualified transfer of excess pension plan assets (and any income allocable thereto) that are not used during the plan year must be transferred out of the account to the pension plan. The related obligations for health benefits are not included in this Plan's obligations in the statement of accumulated plan benefits but are reflected as obligations in the financial statements of the health and welfare benefit plan. Plan participants do not contribute to the 401(h) account. Employer contributions or qualified transfers to the 401(h) account are determined annually and are at the discretion of the Plan Sponsor. Certain of the Plan's net assets are restricted to fund a portion of postretirement health benefits for retirees and their beneficiaries in accordance with IRC Section 401(h).

### H. Reconciliation of Financial Statements to Form 5500[1]

The following is a reconciliation of net assets available for pension benefits per the financial statements to the Form 5500:

| | December 31, | |
|---|---|---|
| | 20X1 | 20X0 |
| Net assets available for pension benefits per the financial statements | $7,940,000 | $7,180,000 |
| Net assets held in 401(h) account included as assets in Form 5500 | 1,072,000 | 966,000 |
| Net assets available for benefits per the Form 5500 | $9,012,000 | $8,146,000 |

The net assets of the 401(h) account included in Form 5500 are not available to pay pension benefits but can be used only to pay retiree health benefits.

1. The reconciliation of amounts reported in the plan's financial statements to amounts reported in Form 5500 is required by ERISA.

The following is a reconciliation of the changes in net assets per the financial statements to the Form 5500:

| | For the Year Ended December 31, 20X1 | | |
|---|---|---|---|
| | **Amounts per Financial Statements** | **401(h) Account** | **Amounts per Form 5500** |
| Net appreciation in fair value of investments | $233,000 | $ 10,800 | $243,800 |
| Interest income | 293,000 | 80,200 | 373,200 |
| Employer contributions | 740,000 | 40,000 | 780,000 |
| Benefits paid to retirees | 740,000 | 10,000 | 750,000 |
| Administrative expenses | 50,000 | 15,000 | 65,000 |

# APPENDIX C

## Illustrative Health and Welfare Benefit Plan Financial Statements and Related 401(h) Account Disclosures—Single Line Presentation Approach

C.1 This appendix illustrates certain applications of the provisions of this SOP that apply to the financial statements of a health and welfare benefit plan that includes retiree health benefits that are funded partially through a 401(h) account in the plan sponsor's defined benefit pension plan. It illustrates the single line approach to presenting information about the 401(h) account permitted by paragaraph 11 of this SOP. It does not illustrate other provisions of this SOP that might apply in circumstances other than those assumed in this illustration. It also does not illustrate all disclosures required for a fair presentation in conformity with generally accepted accounting principles (GAAP). The formats presented and the wording of accompanying notes are only illustrative and are not necessarily the only possible presentations.

C.2 Although GAAP does not require comparative financial statements, the Employee Retirement Income Security Act (ERISA) requires a comparative statement of net assets available for benefits. The illustrative financial statements are intended to comply with the requirements of ERISA.

C.3 ERISA and the Department of Labor (DOL) regulations require that certain information be included in supplemental schedules, which are not required under GAAP, and reported on by the independent auditor. See appendix A of *Audits of Employee Benefit Plans* for a further discussion of the ERISA and DOL requirements.

**EXAMPLE 1**
**C&H Company Welfare Benefit Plan**
**Statement of Net Assets Available for Plan Benefits**

| | December 31, 20X1 | December 31, 20X0 |
|---|---|---|
| *Assets* | | |
| Investments, at fair value | | |
| U.S. government securities | $5,000,000 | $4,000,000 |
| Corporate bonds and debentures | 2,000,000 | 1,600,000 |
| Common stock | 1,000,000 | 600,000 |
| Total investments | 8,000,000 | 6,200,000 |
| Net assets held in C&H Company defined benefit plan—restricted for 401(h) account (Notes A and E) | 1,072,000 | 966,000 |
| Receivables | | |
| Employer contribution | 500,000 | 430,000 |
| Employee contributions | 100,000 | 80,000 |
| Accrued interest and dividends | 50,000 | 40,000 |
| Total receivables | 650,000 | 550,000 |
| Cash | 110,000 | 115,000 |
| Total assets | 9,832,000 | 7,831,000 |
| *Liabilities* | | |
| Due to broker for securities purchased | 250,000 | 240,000 |
| Accounts payable for administrative expenses | 25,000 | 25,000 |
| Total liabilities | 275,000 | 265,000 |
| Net assets available for plan benefits | $9,557,000 | $7,566,000 |

The accompanying notes are an integral part of the financial statements.

**EXAMPLE 2**
**C&H Company Welfare Benefit Plan**
**Statement of Changes in Net Assets Available for Plan Benefits**

| | For the Year Ended December 31, 20X1 |
|---|---|
| *Additions* | |
| Contributions | |
| Employer contributions | $15,000,000 |
| Employee contributions | 3,000,000 |
| Total contributions | 18,000,000 |
| Investment income | |
| Net appreciation in fair value of investments | 300,000 |
| Interest | 500,000 |
| Dividends | 50,000 |
| Total investment income | 850,000 |
| Less investment expense | 15,000 |
| Net investment income | 835,000 |
| Net increase in 401(h) account (Note E) | 106,000 |
| Total additions | 18,941,000 |
| *Deductions* | |
| Benefits paid directly to participants: | |
| Health care | 16,000,000 |
| Disability and death | 770,000 |
| Total benefits paid | 16,770,000 |
| Administrative expenses | 180,000 |
| Total deductions | 16,950,000 |
| Net increase during the year | 1,991,000 |
| Net assets available for benefits: | |
| Beginning of year | 7,566,000 |
| End of year | $ 9,557,000 |

The accompanying notes are an integral part of the financial statements.

**EXAMPLE 3**
**C&H Welfare Benefit Plan**
**Statement of Benefit Obligations**

| | For the Year Ended December 31, 20X1 | For the Year Ended December 31, 20X0 |
|---|---|---|
| *Amounts currently payable to or for participants, beneficiaries, and dependents* | | |
| Health claims payable | $ 1,100,000 | $ 975,000 |
| Death and disability benefits payable | 100,000 | 75,000 |
| Total amounts currently payable | 1,200,000 | 1,050,000 |
| *Other obligations for current benefit coverage, at present value of estimated amounts* | | |
| Claims incurred but not reported | 425,000 | 390,000 |
| Long-term disability benefits | 925,000 | 610,000 |
| Total other obligations for current benefit coverage | 1,350,000 | 1,000,000 |
| Total obligations other than postretirement benefit obligations | 2,550,000 | 2,050,000 |
| *Postretirement benefit obligations* | | |
| Current retirees | 3,900,000 | 3,500,000 |
| Other participants fully eligible for benefits | 2,100,000 | 2,000,000 |
| Other participants not yet fully eligible for benefits | 5,000,000 | 4,165,000 |
| Total postretirement benefit obligations | 11,000,000 | 9,665,000 |
| Total benefit obligations | $13,550,000 | $11,715,000 |

The accompanying notes are an integral part of the financial statements.

**EXAMPLE 4**
**C&H Company Welfare Benefit Plan**
**Statement of Changes in Benefit Obligations**

| | For the Year Ended December 31, 20X1 |
|---|---|
| *Amounts currently payable to or for participants, beneficiaries, and dependents* | |
| Balance, beginning of year | $ 1,050,000 |
| Claims reported and approved for payment | 16,930,000 |
| Claims paid (including disability) | (16,770,000) |
| Claims paid through 401(h) account (Note E) | (10,000) |
| Balance, end of year | 1,200,000 |
| *Other obligations for current benefit coverage, at present value of estimated amounts* | |
| Balance, beginning of year | 1,000,000 |
| Net change during year: | |
| Long-term disability benefits | 315,000 |
| Other | 35,000 |
| Balance, end of year | 1,350,000 |
| Total obligations other than postretirement benefit obligations | 2,550,000 |
| *Postretirement benefit obligations* | |
| Balance, beginning of year | 9,665,000 |
| Increase (decrease) during the year attributable to: | |
| Benefits earned and other changes | 1,250,000 |
| Plan amendment | (175,000) |
| Changes in actuarial assumptions | 260,000 |
| Balance, end of year | 11,000,000 |
| Total benefit obligations, end of year | $ 13,550,000 |

The accompanying notes are an integral part of the financial statements.

**A. 401(h) Account**

Effective January 1, 19X0, the [*Company's defined benefit pension plan*] was amended to include a medical-benefit component in addition to normal retirement benefits to fund a portion of the postretirement obligations for retirees and their beneficiaries in accordance with Section 401(h) of the Internal Revenue Code (IRC). A separate account has been established and maintained in the [*defined benefit pension plan*] for such contributions. In accordance with IRC Section 401(h), the Plan's investments in the 401(h) account may not be used for, or diverted to, any purpose other than providing health benefits for retirees and their beneficiaries. The related obligations for health benefits are not included in the [*defined benefit pension plan's*] obligations in the statement of accumulated plan benefits but are reported as obligations in the financial statements of the [*health and welfare benefit plan*].

**E. 401(h) Account**

A portion of the Plan's obligations are funded through contributions to the Company's [*defined benefit pension plan*] in accordance with IRC Section 401(h). The following table presents the components of the net assets available for such obligations and the related changes in net assets available.

**Net Assets Available for Postretirement Health and Welfare Benefits in 401(h) Account**

| | December 31, 20X1 | December 31, 20X0 |
|---|---|---|
| Investments at fair value: | | |
| U.S. government securities | $ 14,000 | $ 150,000 |
| Money market fund | 900,000 | 800,000 |
| | 1,040,000 | 950,000 |
| Cash | 20,000 | 10,000 |
| Employer's contribution receivable[2] | 20,000 | 15,000 |
| Accrued interest | 7,000 | 6,000 |
| Total assets | 1,087,000 | 981,000 |
| Accrued administrative expenses | (15,000) | (15,000) |
| Net assets available | $1,072,000 | $ 966,000 |

2. A receivable from the employer must meet the requirements of paragraph 10 of FASB Statement No. 35, *Accounting and Reporting by Defined Benefit Pension Plans*.

**Changes in Net Assets in 401(h) Account**

| | For the Year Ended December 31, 20X1 |
|---|---|
| Net appreciation in fair value of investments: | |
| U.S. government securities | $ 10,800 |
| Interest | 80,200 |
| | 91,000 |
| Employer contributions | 40,000 |
| Health and welfare benefits paid to retirees | (10,000) |
| Administrative expenses | (15,000) |
| Net increase in net assets available | $ 106,000 |

## H. Reconciliation of Financial Statements to Form 5500[3]

The following is a reconciliation of net assets available for benefits per the financial statements to the Form 5500:

| | |
|---|---|
| Net assets available for benefits per the financial statements | $ 9,557,000 |
| Claims payable | (1,200,000) |
| Net assets held in defined benefit plan-401(h) account | (1,072,000) |
| Net assets available for benefits per Form 5500 | $ 7,285,000 |

The following is a reconciliation of claims paid per the financial statements and net investment income related to the changes in the investments of the 401(h) assets to the Form 5500:

| | |
|---|---|
| Claims paid per the financial statements | $16,770,000 |
| Add: Amounts payable at December 31, 20X1 | 1,200,000 |
| Less: Amounts payable at December 31, 20X0 | (1,050,000) |
| Claims paid per Form 5500 | $16,920,000 |
| Net investment income per the financial statements | $ 835,000 |
| Less: Net investment income related to the changes in the investments of the 401(h) assets | 91,000 |
| Net investment income per Form 5500 | $ 744,000 |

3. The reconciliation of amounts reported in plan financial statements to amounts reported in Form 5500 is required by ERISA.

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The Employee Benefit Plans Committee gratefully acknowledges the contributions of the Office of Chief Accountant, Pension and Welfare Benefits Administration of the U. S. Department of Labor.