

## Case 89-10

### **Is Overfunding an Asset?**

Global Products Inc. (GPI) is a publicly held diversified company domiciled in a European country. Because its shares are traded on a U.S. exchange, GPI is required to present financial statements based on U.S. GAAP in addition to those based on the GAAP of the country in which it operates (local GAAP).

Substantially all of GPI's 20,000 employees participate in its noncontributory defined benefit pension plans. These plans are administered by the Company's independent pension trust or by insurance companies and provide benefits based on years of service and final salary levels, subject to an upper limit for salary, which is determined by regulations in that country. As a minimum, annual funding contributions to these plans are made in accordance with the individual level premium actuarial cost method. Under local regulations, additional contributions are permissible up to specified annual limits. As of the year end, GPI had made additional voluntary contributions for the year of approximately \$7 million. That amount may be used to fund future minimum contributions to these pension plans or to improve the pension benefits provided.

Under that entity's GAAP, annual pension costs are recognized as equal to actual contributions to the trust and the assets or obligations of the trust are not recognized in GPI's balance sheet. In addition, under the country's law, GPI cannot terminate a pension plan as long as the Company has any employees or there are other beneficiaries of the plan. Further, the amount by which the plan is overfunded does not revert to the Company in the normal course of operations or to the shareholders in the event of the liquidation of the Company. All assets of the overfunded plan belong to the employees. However, as long as the plan is kept in existence, the Company can use excess plan assets to fund pensions for new employees, to fund additional benefits, or to fund early retirement benefits if the plan is amended.

Plan assets currently exceed the projected benefit obligation by about 40%. Based on current assumptions about future pension costs and return on assets, plan assets will continue to exceed the obligation even if the company makes no future contributions.

Global Products is a profitable entity and is likely to continue as a going concern over the foreseeable future. Because Global operates in diversified markets, it is likely to continue its growth as a result of acquisitions of other companies that operate in the same or similar markets. If so, the employee population for which pensions must be funded will increase. Pension assets in excess of the current projected benefit obligation would help offset any obligation.

#### **Required:**

- Should GPI'S U.S. GAAP financial statements present an asset for prepaid pension costs as required by SFAS No. 87, *Employers' Accounting for Pensions*?
- What are the conceptual arguments for the recognition of an asset for prepaid pension costs under the requirements of SFAS No. 87?
- Recognizing the environment in which this company operates, is it relevant to apply the requirements of SFAS No 87 in Global's GAAP financial statements?

- Will the financial statements be misleading?
- What additional disclosures would you recommend?