Title: Determining the Classification and Benefit Attribution Method for a “Cash Balance” Pension Plan

Dates Discussed: March 20, 2003; May 15, 2003

References:
FASB Statement No. 87, Employers’ Accounting for Pensions
FASB Statement No. 106, Employers’ Accounting for Postretirement Benefits Other Than Pensions
FASB Special Report, A Guide to Implementation of Statement 106 on Employers’ Accounting for Postretirement Benefits Other Than Pensions: Questions and Answers

ISSUE

1. In recent years, so-called hybrid pension plans have become more popular among employers. Typically, those arrangements describe the pension benefit by reference to an account balance rather than a monthly annuity at retirement. Such plans are often referred to as "cash balance" pension plans (or cash balance plans). For purposes of this Issue, a cash balance plan communicates to employees a pension benefit in the form of a current account balance based on current and past principal credits, and interest credits over time based on those principal credits. Authoritative literature currently does not specifically address that type of plan.

2. For purposes of this Issue, the Task Force considered a plan (referred to hereinafter as "the cash balance plan") with the following characteristics:

- A defined principal-crediting rate as a percentage of salary
- A defined, non-contingent interest-crediting rate that entitles participants to future interest credits at a stated, fixed rate until retirement.

3. The issues are:
Issue 1—Whether, for the purposes of applying Statement 87, the cash balance plan should be considered a defined benefit plan or defined contribution plan.

Issue 2—If that cash balance plan is determined to be a defined benefit plan, the nature of the benefit promise and the appropriate benefit attribution approach based on that promise.

**EITF DISCUSSION**

4. The Task Force reached a consensus on Issue 1 that the cash balance plan should be considered a defined benefit plan for purposes of applying Statement 87. In light of the definitions of a defined contribution plan and a defined benefit plan in Statement 87, the Task Force based that consensus on the following attributes of the cash balance plan:

- The cash balance plan communicates the pension benefit to be provided as a function of principal credits based on salary and future interest credits thereon at a stated rate.\(^1\)
- The employer's financial obligation to the plan is not satisfied by the prescribed principal and interest credit contributions—as hypothetical additions to participants' accounts—for the period; rather, the employer must fund, over time, amounts that can accumulate to the benefits due at the time of distribution to each participant pursuant to the plan's terms.
- A defined contribution plan, under Statement 87, is a plan that provides an individual account for each participant and each participant's benefit is based solely on the assets invested and the return on those assets. In the cash balance plan, individual account balances are determined by reference to a hypothetical account rather than specific invested assets, and the benefit is dependent upon the employer's promised interest-crediting rate, not the actual return on any plan assets. The definition of a defined benefit plan under Statement 87 includes any plan that is not a defined contribution plan.
- The employer's contributions to a cash balance plan trust and the earnings on the invested plan assets may be unrelated to the principal and interest credits to participants' hypothetical accounts.

\(^1\)Paragraph 11 of Statement 87 states, "For purposes of this Statement, a defined benefit pension plan is one that defines an amount of pension benefit to be provided, usually as a function of one or more factors such as age, years of service, or compensation."
5. The Task Force reached a consensus on Issue 2 that the benefit promise in the cash balance arrangement is not pay-related as contemplated by Statement 87 and its related interpretive guidance. Accordingly, use of a projected unit credit method is neither required nor appropriate for purposes of measuring the benefit obligation and annual cost of benefits earned under Statement 87. The appropriate cost attribution approach, therefore, is the traditional unit credit method.

6. The Task Force observed that the consensuses relate to the plan described in this Issue. The determination of whether a plan is pay-related and the appropriate benefit attribution approach for a "cash balance" plan with other characteristics or for other types of defined benefit pension plans depend on an evaluation of the specific features of those benefit arrangements. [Note: See STATUS section.]

Transition

7. If an enterprise had been accounting for the cash balance pension plan addressed in this Issue as a defined contribution plan, the effect of applying the consensuses (that is, the difference between the funded status as a defined benefit plan and any existing prepaid or accrued pension cost) should be reported as the effect of adopting a new accounting principle (in a manner similar to a cumulative-effect-type adjustment) as of the beginning of the year containing the next reporting period beginning after May 28, 2003.

8. If an enterprise had been accounting for a cash balance pension plan as a defined benefit plan, the effect of remeasuring the pension obligation using the guidance in this
consensus should be calculated as of the plan's next measurement date after May 28, 2003. Any difference in the measurement of the obligation as a result of applying the consensus should be reported as a component of actuarial gains and losses under Statement 87. For an enterprise that has an accounting policy of immediate recognition of all gains and losses, or all gains and losses outside the 10-percent corridor described in paragraph 32 of Statement 87, the component of such gain or loss that can be attributed to the adoption of the guidance in this consensus, using a with-and-without calculation, should be reported as the effect of adopting the consensus (in a manner similar to a cumulative-effect-type adjustment) as of the measurement date.

**Board Ratification**

9. At its May 28, 2003 meeting, the Board ratified the consensuses reached by the Task Force in this Issue.

**STATUS**

10. At the July 31, 2003 meeting, an FASB staff member announced that the staff would recommend that the Board address the measurement of costs and obligations under “cash balance” pension plans with variable interest-crediting rates that were not resolved by this Issue. At its September 24, 2003 agenda decision Board meeting, the Board agreed to add this project to its agenda. At its November 10, 2005 meeting, the Board added a project to its agenda to reconsider the existing guidance on accounting for postretirement benefits including pension benefits. The Board agreed to include the measurement issues in the comprehensive project on pensions and other postretirement benefits so that it is no longer a separate project.
11. No further EITF discussion is planned.