

FINANCIAL ACCOUNTING SERIES



ACCOUNTING STANDARDS UPDATE

No. 2010-25
September 2010

Plan Accounting—Defined Contribution Pension Plans (Topic 962)

Reporting Loans to Participants by Defined
Contribution Pension Plans

a consensus of the FASB Emerging Issues Task Force

An Amendment of the *FASB Accounting Standards Codification*[™]

Financial Accounting Standards Board
of the Financial Accounting Foundation

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FINANCIAL ACCOUNTING SERIES (ISSN 0885-9051) is published quarterly by the Financial Accounting Foundation. Periodicals postage paid at Norwalk, CT and at additional mailing offices. The full subscription rate is \$230 per year. POSTMASTER: Send address changes to Financial Accounting Standards Board, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116. | **No. 354**

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Summary

Why Is the FASB Issuing This Accounting Standards Update (Update)?

The objective of the amendments in this Update is to clarify how loans to participants should be classified and measured by defined contribution pension benefit plans.

Participant loans are currently classified as investments in accordance with the defined contribution pension plan guidance in paragraph 962-325-45-10. Subtopic 962-325 requires most investments held by a plan, including participant loans, to be presented at fair value. Topic 820, Fair Value Measurements and Disclosures, provides specific guidance on how fair value should be measured.

In practice, most participant loans are carried at their unpaid principal balance plus any accrued but unpaid interest, which was considered a good faith approximation of fair value. However, some stakeholders questioned whether that measurement conforms to Topic 820, which requires the use of observable and unobservable inputs such as market interest rates, borrower's credit risk, and historical default rates to estimate the fair value of participant loans. Other stakeholders questioned whether the use of those assumptions would result in information that is decision useful.

Who Is Affected by the Amendments in This Update?

Any defined contribution pension plan that allows participant loans is affected by the amendments in this Update.

What Are the Main Provisions?

The amendments in this Update require that participant loans be classified as notes receivable from participants, which are segregated from plan investments and measured at their unpaid principal balance plus any accrued but unpaid interest.

How Do the Main Provisions Differ from Current U.S. Generally Accepted Accounting Principles (GAAP) and Why Are They an Improvement?

Existing guidance requires participant loans to be classified as plan investments, which are generally measured at fair value as required by paragraph 962-325-35-1. The guidance requiring loans to participants to be classified as notes receivable from participants reduces the amount of time that plan administrators spend on estimating the fair value of participant loans using observable and unobservable inputs as defined under Topic 820. The classification of participant loans as notes receivable from participants acknowledges that participant loans are unique from other investments in that a participant taking out such a loan essentially borrows against its own individual vested benefit balance.

The Task Force concluded that it is more meaningful to measure participant loans at their unpaid principal balance plus any accrued but unpaid interest, rather than at fair value. Participant loans cannot be sold by the plan. Furthermore, if a participant were to default, the participant's account would be reduced by the unpaid balance of the loan, and there would be no effect on the plan's investment returns or any other participant's account balance.

When Will the Amendments Be Effective?

The amendments in this Update should be applied retrospectively to all prior periods presented, effective for fiscal years ending after December 15, 2010. Early adoption is permitted.

How Do the Provisions Compare with International Financial Reporting Standards (IFRS)?

Participant loans are not as commonly observed outside the United States and IAS 26, *Accounting and Reporting by Retirement Benefit Plans*, does not specifically provide accounting guidance for participant loans. However, IAS 26 acknowledges that there may be some situations in which fair value may not be the most meaningful measurement attribute for plan investments, such as when securities that have a fixed redemption value are acquired to match the obligations of the plan or specific parts of the plan. It also states that estimates of fair value may not be possible in certain situations. IAS 26 does not explicitly require a specific classification of the loans to participants as investments or receivables separately from investments. However, participant loans are generally carried at amortized cost by a plan applying IFRS.

Amendments to the *FASB Accounting Standards Codification*TM

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–13. In some cases, not only are the amended paragraphs shown but also the preceding and following paragraphs are shown to put the change in context. Terms from the Master Glossary are in **bold** type. Added text is underlined, and deleted text is ~~struck out~~.

Amendments to Subtopic 310-10

2. Amend paragraphs 310-10-50-5B and 310-10-50-7B, with a link to transition paragraph 962-310-65-1, as follows:

Receivables—Overall

Disclosure

General

> Nonaccrual and Past Due Financing Receivables

310-10-50-5A The guidance in paragraphs 310-10-50-6 through 50-8 does not apply to loans acquired with deteriorated credit quality (accounted for under Subtopic 310-30).

310-10-50-5B The guidance in paragraphs 310-10-50-6 through 50-7A shall be provided by **class of financing receivable** except for the following financing receivables:

- a. Receivables measured at fair value with changes in fair value reported in earnings
- b. Receivables measured at lower of cost or fair value
- c. Trade accounts receivable, except for credit card receivables, that have both of the following characteristics:
 1. They have a contractual maturity of one year or ~~less~~less.
 2. They arose from the sale of goods or services.
- d. Participant loans in defined contribution pension plans.

310-10-50-6 An entity's summary of significant accounting policies for financing receivables shall include all of the following:

- a. The policy for placing financing receivables, if applicable, on nonaccrual status (or discontinuing accrual of interest)
- b. The policy for recording payments received on nonaccrual financing receivables, if applicable
- c. The policy for resuming accrual of interest
- d. Subparagraph superseded by Accounting Standards Update No. 2010-20
- e. The policy for determining past due or delinquency status.

310-10-50-7 An entity shall provide both of the following disclosures related to nonaccrual and past due financing receivables as of each balance sheet date:

- a. The recorded investment in financing receivables on nonaccrual status
- b. The recorded investment in financing receivables past due 90 days or more and still accruing.

310-10-50-7A An entity shall provide an analysis of the age of the recorded investment in financing receivables at the end of the reporting period that are past due, as determined by the entity's policy.

310-10-50-7B The guidance in paragraph 310-10-50-7A does not apply to the following financing receivables:

- a. Receivables measured at fair value with changes in fair value reported in earnings
- b. Receivables measured at lower of cost or fair value
- c. Except for credit card receivables, trade accounts receivable that have both of the following characteristics:
 1. They have a contractual maturity of one year or ~~less~~less.
 2. They arose from the sale of goods or services.
- d. Participant loans in defined contribution pension plans.

Amendments to Subtopic 962-310

3. Add paragraph 962-310-35-2 and its related heading, with a link to transition paragraph 962-310-65-1, as follows:

Plan Accounting—Defined Contribution Pension Plans— Receivables

Subsequent Measurement

> Participant Loans

962-310-35-2 Participant loans shall be measured at their unpaid principal balance plus any accrued but unpaid interest.

4. Add paragraph 962-310-45-2 and its related heading, with a link to transition paragraph 962-310-65-1, as follows:

Other Presentation Matters

> Participant Loans

962-310-45-2 For reporting purposes, participant loans shall be classified as notes receivable from participants.

5. Add paragraph 962-310-50-1 and its related heading, with a link to transition paragraph 962-310-65-1, as follows:

Disclosure

> Participant Loans

962-310-50-1 The fair value disclosures prescribed in paragraphs 825-10-50-10 through 50-16 are not required for participant loans.

6. Add paragraph 962-310-65-1 and its related heading as follows:

> Transition Related to Accounting Standards Update No. 2010-25, *Plan Accounting—Defined Contribution Pension Plans (Topic 962): Reporting Loans to Participants by Defined Contribution Pension Plans*

962-310-65-1 The following represents the transition and effective date information related to Accounting Standards Update No. 2010-25, *Plan Accounting—Defined Contribution Pension Plans (Topic 962): Reporting Loans to Participants by Defined Contribution Pension Plans*:

- a. The pending content that links to this paragraph shall be effective for fiscal years ending after December 15, 2010.
- b. An entity shall apply retrospectively the pending content that links to this paragraph.

- c. Early application of the pending content that links to this paragraph is permitted.
- d. The disclosures in paragraphs 250-10-50-1 through 50-3 shall be provided in the period an entity adopts the pending content that links to this paragraph.

Amendments to Subtopic 962-325

7. Amend paragraph 962-325-35-2, with a link to transition paragraph 962-310-65-1, as follows:

Plan Accounting—Defined Contribution Pension Plans—Investments—Other

Subsequent Measurement

> Reporting at Fair Value

962-325-35-1 Plan investments should generally be presented at their **fair value** at the reporting date (see paragraph 965-325-35-3 for special provisions concerning the valuation of insurance contracts and paragraph 962-325-35-5 for special provisions concerning the valuation of fully benefit-responsive investment contracts).

962-325-35-2 Some plan investments may not have market quotations and, therefore, will need to be valued in good faith. Examples include all of the following:

- a. Real estate
- b. Mortgages or other loans (~~including~~excluding loans to participants ~~of a 401(k) plan~~)
- c. Limited partnerships
- d. Restricted securities
- e. Unregistered securities
- f. Securities for which the market is thin
- g. Nontransferable investment contracts.

8. Amend paragraph 962-325-45-5, with a link to transition paragraph 962-310-65-1, as follows:

Other Presentation Matters

> Non-Participant-Directed Investments

962-325-45-5 The presentation of non-participant-directed investments in the statement of net assets available for benefits or in the notes shall be detailed by general type, such as the following:

- a. Registered investment companies (for example, mutual funds)
- b. Government securities
- c. Common-collective trusts
- d. Pooled separate accounts
- e. Short-term securities
- f. Corporate bonds
- g. Common stocks
- h. Mortgages
- i. Subparagraph superseded by Accounting Standards Update 2010-25. Loans to participants
- j. Real estate.

9. Supersede paragraph 962-325-45-10 and its related heading, with a link to transition paragraph 962-310-65-1, as follows:

> Participant Loans

962-325-45-10 Paragraph superseded by Accounting Standards Update 2010-25. For reporting purposes, participant loans shall be classified as investments.

10. Amend paragraph 962-325-55-16, with a link to transition paragraph 962-310-65-1, as follows:

Implementation Guidance and Illustrations

> Illustrations

> > Example 1: Illustrative Financial Statements and Disclosures of a Defined Contribution Plan with Participant-Directed and Non-Participant-Directed Investment Programs

962-325-55-16 This Example illustrates certain applications of the provisions of this Subtopic to the annual financial statements of a defined contribution plan with participant-directed and non-participant-directed investments. The following are illustrative financial statements and disclosures.

	December 31,	
	20X1	20X0
Assets:		
Investments (See Note C)	\$ 9,177,000	\$ 7,995,000
Investments (See Note C)	<u>\$ 9,107,000</u>	<u>\$ 7,980,000</u>
Receivables:		
Employer contribution	14,000	10,000
Participant contributions	52,000	50,000
<u>Notes receivable from participants</u>	<u>70,000</u>	<u>15,000</u>
<u>Total receivables</u>	<u>66,000</u>	<u>60,000</u>
<u>Total receivables</u>	<u>136,000</u>	<u>75,000</u>
Total assets	<u>9,243,000</u>	<u>8,055,000</u>
Liabilities:		
Accounts payable	10,000	20,000
Accrued expenses	15,000	-
Total liabilities	<u>25,000</u>	<u>20,000</u>
Net assets available for benefits	<u>\$ 9,218,000</u>	<u>\$ 8,035,000</u>

See accompanying notes to the financial statements.

[For ease of use, the remainder of this paragraph, which is unaffected by the amendments in this Update, has been omitted.]

11. Amend paragraph 310-10-00-1, by adding the following items to the table, as follows:

310-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph Number	Action	Accounting Standards Update	Date
310-10-50-5B	Amended	2010-25	09/28/2010
310-10-50-7B	Amended	2010-25	09/28/2010

12. Add paragraph 962-310-00-1 as follows:

962-310-00-1 The following table identifies the changes made to this Subtopic.

Paragraph Number	Action	Accounting Standards Update	Date
962-310-35-2	Added	2010-25	09/28/2010
962-310-45-2	Added	2010-25	09/28/2010
962-310-50-1	Added	2010-25	09/28/2010
962-310-65-1	Added	2010-25	09/28/2010

13. Amend paragraph 962-325-00-1 as follows:

962-325-00-1 ~~No updates have been made to this subtopic.~~ The following table identifies the changes made to this Subtopic.

Paragraph Number	Action	Accounting Standards Update	Date
962-325-35-2	Amended	2010-25	09/28/2010
962-325-45-5	Amended	2010-25	09/28/2010
962-325-45-10	Superseded	2010-25	09/28/2010
962-325-55-16	Amended	2010-25	09/28/2010

The amendments in this Update were adopted by the unanimous vote of the five members of the Financial Accounting Standards Board:

Robert H. Herz, *Chairman*
Thomas J. Linsmeier
Leslie F. Seidman
Marc A. Siegel
Lawrence W. Smith

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Task Force's considerations in reaching the consensus in this Update. It includes the Board's basis for ratifying the Task Force consensus when needed to supplement the Task Force's considerations. It also includes reasons for accepting certain approaches and rejecting others. Individual Task Force and Board members gave greater weight to some factors than to others.

Background Information and Conclusions

BC2. Participants in a defined contribution plan can direct the investment of their plan account balance into an investment in a loan to themselves if the plan allows for participant loans. Although participant loans are by their nature receivables, for reporting purposes, participant loans are considered a plan investment. Before the issuance of FASB Statement No. 157, *Fair Value Measurements* (codified as Topic 820), fair value of a plan investment was defined as the amount that the plan could reasonably expect to receive in a current sale of assets and was required to be measured by quoted market prices when available. In practice, most participant loans were carried at their amortized cost, which was considered a good-faith approximation of the fair value using that definition. According to Topic 820, fair value of a plan investment is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Under Topic 820, plans can no longer assume that the outstanding principal balance of a loan approximates its fair value and, so, the valuation principles of Topic 820 should be applied. Stakeholders have questioned whether reporting participant loans at fair value as determined under Topic 820 would result in information that is decision useful.

BC3. The Task Force concluded that participant loans are unique plan assets that should be classified as notes receivable from participants. The Task Force concluded that classification of participant loans as receivables acknowledges that participant loans are essentially a participant borrowing against their own individual account. Furthermore, Task Force members noted that this classification best reflects the legal nature of the asset, which is a loan from the plan to the participant.

BC4. The Task Force concluded that it would be more meaningful to report participant loans at their unpaid principal balance plus any accrued but unpaid interest than at fair value. Any individual credit risk is mitigated by the fact that the loans are secured by the participant's vested balance. In addition, if the participant is currently an employee, loan repayments are generally withheld by the employer from that employee's payroll check, thereby minimizing the risk that the loan will default. If a participant were to default, the participant's account would be reduced by the unpaid balance of the loan and the participant would be subject to a penalty and additional taxes. An individual default would have no effect on the other plan participants' investment balances. The Task Force also noted that a participant loan is not necessarily issued at fair value at the inception of the loan because an individual's credit risk is not considered in determining the loan terms, which are preestablished for all participants in the plan document.

BC5. Some Task Force members indicated that participant loans are more accurately reflected as distributions. Those Task Force members noted that the borrower is not legally obligated to pay back the loan to the plan. However, other Task Force members noted that nonrepayment of loans is generally remote because of the severe penalties imposed upon default.

BC6. The Task Force also discussed that the Department of Labor requires participant loans to be included as an investment on the supplemental schedule of assets held (measured as the unpaid principal balance plus any accrued but unpaid interest) to be included with the audited financial statements. The Task Force noted that although for purposes of the supplemental schedule participant loans will still be reported as investments, the current value included on the supplemental schedule for the participant loans will now be consistent with the measurement requirements in GAAP.

Effective Date and Transition

BC7. The amendments in this update are effective for fiscal years ending after December 15, 2010.

BC8. The Task Force decided that the provisions of this Update should be applied retrospectively upon adoption. The Task Force concluded that retrospective application is possible and cost effective because plan sponsors have the necessary historical information to reclassify participant loans from investments to notes receivable from participants separately from investments. Furthermore, the Task Force noted that the application of the amendments in this Update would generally not result in a change to how participant loans are being measured in practice.

BC9. The Task Force decided to permit early adoption of this Update to allow for the application of this guidance to be reflected in an entity's 2009 financial statements included in Form 5500 if those financial statements have yet to be filed.

Benefits and Costs

BC10. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Task Force's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC11. The Task Force does not anticipate that entities will incur significant costs as a result of the amendments in this Update. The Task Force expects that the measurement of participant loans is currently used in practice and that information to apply the guidance in this Update on a retrospective basis would be readily available.

Amendments to the XBRL Taxonomy

There are no proposed amendments to the XBRL taxonomy as a result of the amendments in this Update.