Interpretation of the Emerging Accounting Issues Working Group

INT 04-12: EITF 03-4: Determining the Classification and Benefit Attribution Method for a "Cash Balance" Pension Plan

ISSUE NULLIFIED BY SSAP NO. 102

INT 04-12 Dates Discussed

September 12, 2004; December 5, 2004

INT 04-12 References

SSAP No. 14—Postretirement Benefits Other Than Pensions (SSAP No. 14)
SSAP No. 89—Accounting for Pensions, A Replacement of SSAP No. 8 (SSAP No. 89)

INT 04-12 Issue

1. Per EITF 03-4, *Determining the Classification and Benefit Attribution Method for a "Cash Balance" Pension Plan* (EITF 03-04):

> 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.
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> 2. For purposes of this Issue, the Task Force considered a plan (referred to hereinafter as "the cash balance plan") with the following characteristics:
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> - 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.
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> 3. The issues are:
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> Issue 1—Whether cash balance plans should be considered defined benefit plans or defined contribution plans.
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> 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.

INT 04-12 Discussion

2. Per EITF 03-04, the consensus position is as follows:

> 4. The Task Force reached a consensus on Issue 1 that the cash balance plan should be considered a defined benefit plan. In light of the definitions of a defined contribution plan and a defined benefit plan, the working group 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.

- An employer's financial obligation to the plan is not satisfied by making prescribed principal and interest credit contributions-whether in cash or as a hypothetical contribution to participants' accounts-for the period; rather, the employer must fund, over time, amounts that can accumulate to the actuarial present value of the benefit due at the time of distribution to each participant pursuant to the plan's terms.

- A defined contribution plan 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 a cash balance plan, individual account balances are determined by reference to a hypothetical account rather than specific assets, and the benefit is dependent upon the employer's promised interest-crediting rate, not the actual return on plan assets. The definition of a defined benefit plan 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.

5. The Task Force reached a consensus on Issue 2 that the benefit promise in the cash balance arrangement is not pay-related. 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. 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.

3. The working group reached a consensus to adopt the consensus position of EITF 03-04 as a interpretation of SSAP No. 14 and SSAP No. 89 with modification to exclude non-vested employees, the non-vested portions of partially vested employees and to incorporate the transition provisions provided in paragraph 4, below.

4. For statutory accounting purposes, the consensus will be effective upon adoption. If an entity had been accounting for the cash balance pension plan addressed in this Interpretation 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 December 7, 2004 in accordance with *SSAP No. 3—Accounting Changes and Corrections of Errors*. If an entity had been accounting for a cash balance pension plan as a defined benefit plan, the effect of re-measuring the pension obligation using the guidance in this consensus should be calculated as of the plan's next measurement date after December 7, 2004.

INT 04-12 Status

5. No further discussion is planned.