MINUTES

To:	Board Members
From:	Interpretation of Statement 87 Team (Hurst, ext. 262)
Subject:	Minutes of the May 12, 2004 Board Meeting
Date:	May 18, 2004
cc:	Leisenring, Bielstein, Petrone, L. Smith, Polley, Mahoney, Cassel, Durbin, Hurst, Sutay, Thompson, Gabriele, Lapolla, Intranet

Topic: Scope, Effective Date and Transition, and Implementation Issues

Basis for Discussion: Memorandum dated May 7, 2004 and the Board meeting audience handout (attached)

Length of Discussion: 9:00 a.m. to 10:00 a.m.

Attendance:

Board members present:	Batavick, Crooch, Herz, Schieneman, Schipper, Seidman, Trott
Board members absent:	None
Staff in charge of topic:	O'Callaghan
Other staff at Board table:	Cassel, Durbin, Hurst, L. Smith
Outside participants:	None

Summary of Decisions Reached:

The Board met to discuss issues related to scope, effective date and transition, and implementation issues.

The Board decided to expand the scope of the project to amend FASB Statement No. 35, *Accounting and Reporting by Defined Benefit Pension Plans*, to apply the Board's March 3, 2004 decision—that the obligation for cash balance pension plans with a market or market-related (variable) interest crediting rate should be measured by reference to the notional account balance—to the measurement of accumulated plan benefits under Statement 35. The Board also asked the staff to research the implications of further expanding the scope of the project to amend the guidance on the selection of discount rates in Statement 35 to make that guidance consistent with the discount rate guidance in FASB Statement No. 87, *Employers' Accounting for Pensions*. The Board deferred discussion of the transition and effective date of the amendment to Statement 35 until a decision is reached regarding the discount rate issue.

With respect to the implementation issues that the Board was asked to consider, the Board decided the following:

- Service cost should be determined by the pay/principal credits allocated to employees' notional account balances; similarly, interest cost should be determined by the interest credits allocated to employees' notional account balances.
- The interest cost component of net periodic pension cost should be based on the actual interest credited to plan participants' notional account balances for the period.
- For plans that contain a cash balance formula with a variable interest crediting rate, the assumed discount rate that should be disclosed is the discount rate used to measure the portion of the projected benefit obligation (PBO) that is not attributable to the variable cash balance formula. The PBO amount measured at that rate also should be disclosed.
- For mixed formula plans in which a cash balance pension plan formula has been integrated into traditional defined benefit pension plans (or vice versa) and an employee is entitled to the greater benefit of the two formulas, the PBO should be based on the formula that results in the

greater of the two benefits to the participant at the plan's measurement date.

The Board discussed the transition guidance for a particular fact pattern in which an entity has an unfunded accumulated benefit obligation (ABO) before the application of the Interpretation, and, upon application of the Interpretation, the unfunded ABO increases but the PBO decreases. In such instances, the Board decided that the following transition guidance should be applied:

- The increase in the unfunded ABO should be recognized in the income statement in a manner similar to the cumulative effect of a change in accounting principle.
- The decrease in the PBO would reduce unrecognized losses and prior service cost (the items giving rise to the unfunded ABO).

Objective of Meeting:

The objective of the meeting was to (a) consider expanding the scope of the project to include an amendment to Statement 35 for cash balance plans with a variable interest crediting rate (and the effective date and transition guidance for any such amendment), (b) consider whether to provide guidance on several implementation questions arising from the Board's decisions to date, and (c) reconsider the transition guidance for a particular scenario in which the unfunded ABO increases but the PBO decreases following application of the Interpretation.

Matters Discussed and Decisions Reached:

Scope Question

Mr. O'Callaghan asked the Board whether to expand the scope of the project to address the inconsistencies between the guidance in Statement 35 and Statement 87. He said that the staff recommended the Board amend Statement 35 so that the reporting in pension *plan* financial statements for cash balance pension plans with a variable interest crediting rate is consistent with the Board's decision in the context of Statement 87 for those plans.

Mr. Trott agreed with the staff's recommendation and suggested that the guidance for measurement of pension obligations for all types of pension plans should be consistent between Statement 35 and Statement 87.

Some Board members expressed concern that such scope expansion is not appropriate in this project and would place too great a burden on staff resources. Mr. Schieneman said that he was in favor of such expansion only if the amendments would result in simplification of the measurement of pension plan obligations for the two different reporting purposes. Mr. Batavick said that because he did not agree with the Board's previous decision to require use of the "hybrid approach" (see the March 3, 2004 Board Meeting minutes) to measure a cash balance pension plan obligation, he does not believe that such guidance should be carried over to Statement 35. Other Board members believed, however, that the staff should, at a minimum, estimate the time and resources necessary to amend Statement 35 so that it is consistent with Statement 87 and to report back to the Board with that information so the Board can reconsider whether the scope should be expanded in accordance with Mr. Trott's proposal.

Mr. Cassel clarified that "Mr. Trott's proposal" relates to the inconsistency between the guidance in Statement 35 and Statement 87 as to the selection of the discount rate used to measure the actuarial present value of accumulated plan benefits. Other measurement differences between the two standards would not be subject to reconsideration at present.

The Board voted in favor of expanding the scope of the project so that its decisions in this project also would apply to cash balance pension plans under Statement 35. [Four Board members agreed; three did not: GJB, GSS, LFS.) The Board also voted to request that the staff research the feasibility of widening the scope to amend Statement 35 with respect to all pension plans to be consistent with the guidance in the Statement 87 and the proposed Interpretation. [Five Board members agreed; two did not: GJB, RHH.]

The Board deferred discussion of the transition and effective date provisions of the proposed amendment to Statement 35 until a decision is reached regarding the scope of that amendment.

Implementation Issues

Mr. O'Callaghan referred to the unsolicited comment letters that have been received related to the Board's decisions made to date and certain implementation questions raised in those letters. He asked the Board to consider providing guidance on the following issues.

1. How are the service cost and interest cost components of pension cost determined?

All Board members agreed with the staff's recommendation that service cost should be determined by the pay/principal credits allocated to employees' notional account balances during the period; similarly, interest cost should be determined by the interest credits allocated to employees' notional account balances.

2. If interest cost is determined by interest credits, should the interest credits be based upon actual interest credits or assumed interest credits?

The Board voted to require that the interest cost component of net periodic pension cost should be based on the actual interest credit to plan participants' notional account balances during the period. [Six Board members agreed; one did not: GJB.]

3. For plans that contain a cash balance formula with a variable interest crediting rate, what assumed discount rate should be disclosed?

The staff recommended that the assumed discount rate that should be disclosed is the rate related to the nonvariable and/or noncash balance component of the PBO and that the related PBO amount also should be disclosed.

The Board voted in favor of the staff's recommendation. [Six Board members agreed; one did not: GJB.]

4. What is the proper accounting treatment for mixed formula plans in which the employee is entitled to the greater of the two benefit formulas?

All Board members agreed with the staff's recommendation that for mixed formula plans in which a cash balance pension plan formula has been integrated into traditional defined benefit pension plans (or vice versa) and an employee is entitled to the greater of the two benefit formulas, the pension obligation should be based on the formula that provides the greater of the two benefits to a participant at the plan's measurement date.

Transition

Mr. O'Callaghan referred to an unsolicited comment letter in which the transition guidance proposed at the March 31, 2004 meeting was questioned for the scenario in which an entity that has an unfunded ABO before the application of the Interpretation, and upon application of the Interpretation, the unfunded ABO increases and the PBO decreases. All Board members agreed with the staff's recommendation that the following transition guidance should be applied in that scenario:

- The increase in the unfunded ABO should be recognized in the income statement in a manner similar to the cumulative effect of a change in accounting principle. That treatment would be consistent with the Board's decision for the treatment of an increase in the PBO.
- The decrease in the PBO would reduce unrecognized actuarial losses and prior service cost.

Ms. Schipper noted that as the above treatment is somewhat counterintuitive, a numerical example, resembling the one provided in the Board memorandum issued in preparation for this meeting, should be provided in the Interpretation. Mr. O'Callaghan indicated that the staff planned to include a numerical example in the Interpretation.

Other

Mr. O'Callaghan asked the Board whether it supported issuing an Exposure Draft (ED) of the Interpretation based on the decisions made to date. The Board reaffirmed its decision to issue an ED and encouraged the staff to continue drafting the document notwithstanding the unresolved scope question with respect to the amendment of Statement 35. [Four Board members agreed; three did not: GJB, GMC, LFS.]

Ms. Seidman said that before proceeding with issuance of an ED, she would like to meet representatives from the actuarial profession in order to understand their views on the issues addressed in this project.

Follow-up Items:

The staff will explore the feasibility of expanding the scope of the project to amend Statement 35 to include all defined benefit pension plans and will return to the Board once it has a better understanding of the time and resources necessary to do so.

The staff will explore the possibility of arranging small group meetings with the Board members and representatives of the actuarial profession to ensure that the Board is appropriately informed regarding the characteristics of cash balance plans and the implications of the Board's decisions in this project on the accounting for those plans.

General Announcements:

None.

Board Meeting Handout

May 12, 2004

Interpretation of Statement 87 for "Cash Balance" Pension Plans

Purpose of Today's Meeting

At today's meeting the Board will discuss the following issues:

a. Consider expanding the scope of the project to include FASB Statement No. 35, *Accounting and Reporting by Defined Benefit Pension Plans*.

b. Consider several implementation questions; and

c. Reconsider the transition guidance for back-loaded cash balance plans.

Expand the scope of the project
The staff will ask the Board to consider expanding the scope of the project to include a plan's accounting, which would necessitate an amendment to Statement 35.

If the Board agrees to expand the scope of the project the staff will recommend that the decision[1] reached in measuring the pension obligation for cash balance plans with a variable interest crediting rate plan be expanded to measure the accumulated plan benefits for those types of plans.

The staff will ask the Board to consider an effective date for plan years beginning after December 15, 2004. Plan sponsors would perform a measurement of accumulated plan benefits pursuant to the amended measurement guidance as of its previous benefit information date. The difference between the accumulated plan benefit amount measured upon initial application of this Interpretation and that previously measured would be presented consistent with the guidance in paragraphs 25 and 26 of Statement 35.

Implementation Questions
The staff will ask the Board to consider and make decisions on the following questions:

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[1] The accrued benefit costs and pension obligations for variable interest or investment crediting rate plans shall be measured by reference to the aggregate of vested and expected-to-vest plan participants' notional account balances rather than a projection based on those notional account balances and assumed future interest or investment credits both discounted at a rate based on the yield of a portfolio of high quality fixed income investments.

1. How should the service cost and interest cost components of pension cost be determined?

2. If interest cost is determined by interest credits, should the interest credits be based upon actual interest credits or assumed interest credits?

3. What is the appropriate assumed discount rate to be disclosed?

4. For pension plans that provide employees with the greater of a cash balance benefit formula and a traditional defined benefit formula, how should the pension obligation be determined?

Transition

The Board will reconsider the transition guidance previously decided[2] upon to address scenarios in which the projected benefit obligation decreases or increases, and the minimum pension liability increases.

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[2] At the March 31, 2004 Board meeting the Board decided that the difference in measurement of the projected benefit obligation resulting from the adoption of the interpretation shall be fully recognized in the income statement similar to a cumulative effect of a change in accounting principle.