



Pension Analyst

Compliance Bulletin

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FASB revises its position on reporting of participant loans

The Financial Accounting Standards Board (FASB) recently revised its position on the reporting of loans to participants from defined contribution plans. According to FASB's new position, the financial statements of defined contribution plans should classify participant loans as notes receivable, measured as the outstanding principal amount plus accrued but unpaid interest. This change affects any defined contribution plan that offers participant loans.

Background

Existing accounting guidance requires participant loans to be classified as plan investments. Accounting standards require most plan investments, including participant loans, to be reported at fair value. In practice, participant loans are generally reported at their unpaid principal balance plus any accrued but unpaid interest, which is considered a good faith approximation of fair value. Recently, concerns have been raised about such fair value approximations since a true fair market valuation requires the consideration of such factors as market interest rates, borrower's credit risk and historical default rates.

Loan notes as receivables

While FASB's reclassification of participant loans as notes receivable requires participant loans to be segregated from plan investments, they will continue to be valued at their unpaid principal balance plus any accrued but unpaid interest. FASB noted that the classification of participant loans as receivables recognizes that participant loans are different from other plan investments because a participant taking a loan essentially borrows against his or her own individual vested account balance. FASB concluded that it is more appropriate to measure participant loans at their unpaid principal balance plus any accrued but unpaid interest, rather than an estimated fair value.

FASB also noted that participant loans cannot be sold by the plan, unlike other plan investments. If a participant defaults on a loan, the participant's account balance is reduced by the unpaid balance of the loan. However, other plan investment decisions are not affected by the creditworthiness or market value of the defaulted loan.

The Department of Labor (DOL) continues to require the unpaid balances of participant loans plus accrued but unpaid interest to be reported as investments on the supplemental schedule of assets held to be included in audited financial statements and annual Form 5500 reporting. It is unclear if the DOL will issue guidance on the reporting of participant loans in response to the FASB position.

Effective date

The classification of loans as notes receivable is applied retrospectively to all prior periods. The amendment to the Accounting Standards Codification resulting from this classification change is effective for fiscal years ending after December 15, 2010, with early adoption permitted.

Although participant loans will generally be valued the same for FASB and DOL reporting purposes, plan sponsors will need to present participant loans differently on their financial statements as either notes receivables or as investments depending on the purpose of the statement.

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Next Steps

The revised FASB position impacts plan level financial reporting to include accrued but unpaid loan interest on the value of outstanding loans. However, the change does not impact the processing of participant loans. At Prudential Retirement, we are currently reviewing our processes to ensure that the financial statements will comply with reporting requirements.



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