BEA Moves to Accrual Accounting for Defined Benefit Pension Plans

- Employers provide employees with retirement benefits largely through two mechanisms: Defined contribution plans like 401(k)s or defined benefit pension plans. Under defined benefit plans, employees accrue benefits based on factors such as the employee's length of service and salary history.
- Employers provide these promised benefits to employees through a pension fund. Employers, and in some cases employees, make cash contributions to the fund. In addition, the fund holds financial assets, earns income and capital gains on those assets, and pays out benefits to retirees and beneficiaries.
- As part of its 14th comprehensive revision of the national income and product accounts that will be released beginning on July 31, BEA will switch from a cash accounting method to an accrual accounting method to measure the transactions of defined benefit pension plans.

Why is BEA making this change?

- Accrual accounting better reflects the retirement benefits an employee earns while working and improves BEA's measures of compensation by more closely aligning the accrual of retirement benefits with the employee's work. Accrual accounting also is consistent with business accounting standards.
- With the current cash accounting approach, sporadic cash contributions made by employers to the pension funds result in volatility in BEA's measure of compensation that does not accurately reflect the relatively smooth manner in which benefits are earned by the employee.
- In some cases, the pension plans may be underfunded, meaning that the plans do not have sufficient financial assets to cover pension promises. Employers are generally liable for payment of those promised benefits. If an employer does not make a cash contribution directly to the plan, the employer is effectively borrowing from the pension plan. BEA will recognize an imputed interest expense associated with underfunding.

How will this change affect BEA's accounts?

- Compensation will reflect the value of the pension promises made by the employer, rather than the employer's cash contributions to the pension fund. The switch to accrual accounting will dampen some of the volatility seen in the compensation measures.
- Business and government interest expenses will include imputed interest associated with pension plans' unfunded liabilities, which will also be reflected in personal interest income.
- Personal and government saving will be impacted by the changes to compensation and interest payments. In general, because most plans are underfunded, these changes will boost personal saving and lower government saving.
- Corporate profits will reflect the accrual-based estimates of compensation and the interest costs associated with unfunded liabilities.

For more information, go to **www.bea.gov/gdp-revisions**.

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