

Letter of Comment No: 5
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Financial Accounting Standards Board
401 Merritt 7
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RE: Comments on Tentative Decisions Reached on March 3, 2004 and March 31, 2004 Regarding the Interpretation of Statement 87 for "Cash Balance" Pension Plans

Gentlemen:

As both a user and preparer of financial statements, we support FASB's efforts to strengthen the value and relevance of financial information reported to those who rely on it.

However, we are concerned about the tentative decisions reached by the Board on March 3, 2004 and March 31, 2004 regarding the accounting for cash balance pension plans. The decisions call for a fundamentally different accounting approach for a subset of defined benefit plans than the approach for all other defined benefit plans.

Currently, the obligations for all pension plans are determined on a discounted cash flow basis. The discount rate is based on the yield on a portfolio of high quality fixed income investments that would provide for the anticipated cash flows. The anticipated cash flows assume an ongoing plan. This is consistent with general accounting principles which call for accounting for pension obligations on a going concern basis.

Under current accounting rules, an assumption about the variable interest rate is made in order to project cash flows for a cash balance plan with a variable interest rate. This assumption is inherently no different than other assumptions made regarding turnover and retirement, future inflation, and future compensation increases. Under the tentative decision, the liability for a variable interest rate cash balance plan would be set equal to the value of the accounts at the measurement date. For this to be the

obligation of the plan, all employees must terminate and receive their cash balance accounts as a lump sum on the measurement date.

Our concerns are as follows:

- **Lack of Comparability.** The proposed decision reduces comparability between companies that have certain types of cash balance plans and all other companies that sponsor defined benefit plans. The assumptions required to estimate future interest credits in a variable credit plan are no more complex than the assumptions needed to estimate future pay in traditional defined benefit plans and do not justify separate accounting treatment. The Board has, on several occasions, endorsed the concept that *all* cash balance plans are defined benefit plans; we agree with that conclusion and see no rationale for different accounting for some defined benefit plans.
By not reflecting future interest credits in the measurement of benefit obligations for cash balance plans as the current accounting standard does, the tentative decisions distort the comparability of cash balance plans with traditional defined benefit pension plans. Interest credits index or update past benefit accruals under cash balance plans in a manner similar to the way future salary increases index past benefit accruals in a traditional defined benefit plan. Just as the benefit obligation for traditional defined benefit plans reflects future salary increases on past benefit accruals, the benefit obligation for cash balance plans needs to reflect future interest credits on past benefit accruals in order for the benefit obligations to be comparable.
- **Inconsistent Application:** The notional account is simply a formula used to arrive at a benefit. Most cash balance plans have additional aspects to the benefit that could result in a variance between the benefit and the notional account. These include minimum benefits under traditional formulas, special annuity options, favorable annuity conversion rates, and subsidized early retirement. In addition, these plans have substantial obligations for former employees and current employees that are based on traditional pensions. It is inconsistent under a single accounting standard and philosophy to divide individual and plan benefits into the portion subject to the immediate termination approach and the portion subject to the discounted cash flow approach.

- **Disruptive transition effects.** Under the proposed transition provisions, many employers could be faced with a significant one-time charge to earnings and/or a significant reduction in shareholder equity, merely because of the change in accounting standards. Of particular concern is the potential mismatch between the transition adjustment (which is based on the difference between the notional account balances and the *projected* benefit obligation) and the effect on shareholder equity (which is based on the difference between the notional account balances and the *accumulated* benefit obligation). If these two adjustments move in the opposite direction, a plan sponsor could have a simultaneous credit to income and charge to shareholder equity – an illogical result.
- **Potential for Multiple Accounting Transitions.** We understand the Board, in conjunction with the International Accounting Standards Board, is considering a comprehensive review of pension accounting. It would be more appropriate to make any changes for accounting for cash balance plans in conjunction with that global convergence projection. This would ensure that cash balance sponsors not recognize a series of accounting method changes in a relatively short period of time and that the accounting for all pension plans change in a consistent fashion.

We urge the board to reconsider these tentative decisions before issuing an exposure draft of the proposed FASB Interpretation.

Sincerely,



Fredric J. Friedberg