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committee on corporate reporting

April 12, 2004

Mr. Lawrence W. Smith
Director of Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: FASB Staff Position No. FAS 106-b, Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003

Dear Mr. Smith,

The Committee on Corporate Reporting ("CCR") of Financial Executives International ("FEI") appreciates the opportunity to share its views on the Proposed FASB Staff Position ("FSP") No. FAS 106-b, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" (the "Proposed FSP"). FEI is a leading international organization of 15,000 members, including Chief Financial Officers, Controllers, Treasurers, Tax Executives and other senior financial executives. CCR is a technical committee of FEI, which reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations. This document represents the views of CCR and not necessarily the views of FEI.

As you know, the passage of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Act") will have an impact on employers that sponsor postretirement health care plans that provide prescription drug coverage. Most notably, the Act offers a federal subsidy to sponsors that provide a prescription drug benefit that is at least the "actuarial equivalent" (to be defined by the federal government) to the new Medicare Part D coverage established by the Act. This subsidy may significantly reduce a sponsor's postretirement obligation. As a result, we appreciate the FASB's effort to promptly release guidance on the accounting for the effects of the Act through the Proposed FSP.

We agree with the conclusion that the accounting for the effects of the federal subsidy on an employer's postretirement benefit plan should be based on the guidance in FASB Statement No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" ("FAS 106"). However, CCR has concerns and/or observations on the specific approach for

recognizing the subsidy under FAS 106 provided in the Proposed FSP which we would like the FASB to consider before finalizing such guidance.

Our concerns, outlined in greater detail below, relate to a) the remeasurement of postretirement benefit cost, b) the differing treatment for the net effect of the Act and plan amendments, c) the accounting for the tax effects of the direct subsidy and d) the proposed transition guidance.

Remeasurement of Postretirement Benefit Cost

Many CCR member companies are still in the process of developing a strategy to coordinate their postretirement benefit plans with the Act. Some companies surveyed believe their benefit plans currently provide prescription drug coverage that would qualify for the federal subsidy. On the other hand, some companies believe their benefit plans may or may not qualify for the federal subsidy and are awaiting further guidance from the federal government before committing to next steps (i.e., plan amendments or application to Medicare for the subsidy). The Proposed FSP provides guidance for these two instances (refer to discussion below on transition concerns). However, there are other companies that provide different benefits to different groups of plan participants (for example, individuals that retired in certain years that were affected by different plan amendments). For these companies, it is entirely possible that one group of plan participants may receive benefits that are determined to be actuarially equivalent and, therefore, qualify for the federal subsidy, while another group may receive benefits that may or may not qualify for the federal subsidy, while another group may receive benefits that may or may not qualify for the

It is not clear whether a company should aggregate or disaggregate groups of plan participants and apply the guidance in paragraphs 21-28 of the Proposed FSP. Because the costs to remeasure plan assets and obligations are significant, we do not believe a company that disaggregates its plan participants should be required to remeasure its postretirement benefit cost each time actuarial equivalence is determined. Rather, we suggest that the remeasurement of postretirement benefit cost only be performed once the actuarial equivalence can be determined for all participants or where remeasurement of remaining benefit plans would not result in a material change of reported results.

Plan Amendments

As noted in paragraph 16 of the Proposed FSP, "if prescription drug benefits currently available under an existing plan are not actuarially equivalent as of the date of enactment of the Act, but the plan is subsequently amended" to be actuarially equivalent, the proposed accounting treatment would combine the effects of the plan amendment and the direct subsidy. If the combined effect on the accumulated postretirement benefit obligation ("APBO") is a gain, it is deemed an actuarial experience gain, but if it is a loss, it is deemed a prior service cost. Although both actuarial experience gains and prior service costs are not immediately recognized in earnings, the amortization or accretion of such amounts differs based on the guidance in FAS 106.

The Proposed FSP did not provide a basis for the argument to net the effects of a plan amendment and the federal subsidy. CCR members agree that the effects of the federal subsidy should be accounted for as an actuarial experience gain. This treatment is consistent with paragraph 40 of FAS 106 and the FASB's question and answer guide, "A Guide to Implementation of Statement 106 on Employers' Accounting for Postretirement Benefits Other Than Pensions". Projecting the federal subsidy as well as the potential effects that Act will have on participation rates and per capita claims costs will require difficult actuarial projections that will change over time. Therefore, the initial effect of the subsidy and resulting changes are appropriately characterized as actuarial experience.

However, we believe that a plan amendment that results in a postretirement plan that will qualify for the federal subsidy is a separate and distinct event and therefore should be accounted for as a prior service cost, as contemplated in FAS 106. Further, we do not agree that the effects of a plan amendment should be combined with the effects of the federal subsidy. In practice, companies revise existing plans in response to many external factors and we are not aware of other instances in accounting literature that require the "netting" of the effects. Further, as discussed below, the accounting for income taxes proposed will require separate tracking of the estimated effect of the federal subsidy, a difficult task that would be further complicated by this proposed guidance. As a result, we suggest that the guidance for plan amendments in paragraphs 16 and 17 of the Proposed FSP be removed.

Income Tax Accounting

While we generally agree with the concept outlined in the proposed accounting for the tax effect for the direct subsidy proposed in paragraph 18 of the FSP, in many cases this will cause a significant change in current recording practices and will be an operational challenge for many companies.

As noted in paragraph 18, an employer will receive a tax deduction when it pays retiree prescription drug benefits, however, the employer will not be taxed on any subsidy it receives under the Act. The Proposed FSP acknowledges that the employer would establish a deferred tax asset based on the assumed future tax deduction without regard to the subsidy. The measure of any temporary difference accounted for under FAS 109, "Accounting for Income Taxes", would have to be determined as if the subsidy did not exist. This treatment raises practical issues regarding tracking and allocating the tax effect of the impact of the subsidy.

Companies typically measure the deferred tax asset for its postretirement benefit plan based on the book basis of the balance sheet liability. As a result of the Proposed FSP, such a liability will now include a permanent difference for which no deferred tax asset will be recorded. In order to properly account for the proposed treatment, companies will be required to identify the portion of accrued postretirement benefit cost that reflects the subsidy for purposes of calculating the basis of the balance sheet liability for which a deferred tax asset is measured. We anticipate that this task will be extremely complicated, and will require two separate calculations of the APBO for all future years during which there is a subsidy. The complexity of this provision increases further as the assumed subsidy changes over time (e.g., actual subsidies versus assumed). Due to the anticipated

complexity, we encourage the FASB to provide illustrative examples of the application of the income tax provisions of the Proposed FSP.

Transition

We do not agree with the proposed transition guidance provided in paragraph 24 of the Proposed FSP. Specifically, we do not agree that pre-adoption interim periods of a fiscal year should be restated. We believe that such restatements could be misinterpreted by financial statement users. Due to this potential dilution of public confidence in financial statements, we believe the effects of the Proposed FSP should be limited to either prospective treatment from the date of implementation or including the cumulative effect, based on retroactive computation, in the period of implementation.

If you have any questions regarding this letter or would like further information about the complexity and administrative requirements that this Proposed FSP would require, please feel free to call Frank Brod at (989) 636-1541 or Ron Olejniczak at (860) 273-7231.

Sincerely,

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