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April 6, 2004

Director, TA&I—FSP
Financial Accounting Standards Board
401 Merritt 7
P. O. Box 5116
Norwalk, CT 06856-5116

Dear Sir:

Subject: Comments on Proposed FSP FAS 106-b

This email contains Hewitt Associates' comments on proposed FSP FAS 106-b. Hewitt Associates is a global management consulting firm assisting large and small employers in all aspects of employee benefit and compensation programs. Our actuaries and consultants have a great deal of experience in the subject area of Medicare and Statement 106.

We have organized our comments by the corresponding paragraph numbers of FSP FAS 106-b.

Paragraph 3: Broaden Scope

We believe the scope of the FSP is broader than that detailed in paragraph 3. In particular, paragraph 3 suggests that guidance in the FSP is limited to issues related to accounting for the federal subsidy, but the FSP clearly addresses other issues related to the Act. For example, paragraph 9 discusses the need to consider the impact of the Act on participation rates and macroeconomic events of the Act, and paragraph 21 discusses some of the accounting related to those issues. Thus, we believe it would be helpful to specifically state that the scope of the FSP includes not only accounting for the subsidy, but other accounting issues related to the direct and indirect impacts of the Act.

Similarly, we think it would be helpful to note that issues not directly addressed by the FSP should be accounted for by following existing guidance in Statement 106 (and other already existing guidance). We have found that there is a great deal of confusion about accounting for the Act because individuals are trying to infer that FSP's "silence" on other issues means that there is no guidance for those issues.

Paragraph 12: Allow Some Actuarially Equivalent Plans to Defer Recognition

We agree with the position in the FSP that measures of the APBO and the NPPBC on or after the date of enactment should reflect the effects of the Act. Obviously, this has the result that plan sponsors who determine that benefits under their plan are actuarially equivalent to Medicare Part D as of the enactment date need to apply the guidance of the FSP retrospectively.

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However, we have seen some plan designs where the effect of receiving the subsidy will only have a small effect on the APBO (and, thus, NPPBC). For example, this could be the situation for a plan where it is anticipated that the plan will qualify for the subsidy for only a year or two (e.g., because of an already existing provision that will impact eligibility for the subsidy at a future date). We believe that the final FSP should explicitly allow that if a plan is actuarially equivalent as of the date of enactment, but the impact on the APBO is not significant, recognition of the effect of the subsidy could be delayed until the next measurement date occurring after the release of the final FSP.

Paragraph 12: Provide Guidance on Impact on Statement 132(R) Disclosure of Future Benefit Payments

Paragraph 5(f) of FAS 132(R) requires disclosure of the benefits expected to be paid in the next ten fiscal years. Paragraph 5(f) indicates that the expected benefit should be based on the same assumptions used to measure the benefit obligations.

Under the FSP, the subsidy is considered the same as any other payment from Medicare and is reflected as such in the calculation of the benefit obligations. This viewpoint suggests that the disclosure of projected benefit payments should be net of the subsidy payments that the plan sponsor expects to receive.

On the other hand, benefit payments to plan participants will not be reduced since the subsidy payments do not affect plan benefits. This viewpoint suggests the projection of benefit payments should not reflect the subsidy payments that the plan sponsor expects to receive.

Since both viewpoints seem supportable, it would be preferable for the final FSP to indicate the proper disclosure to ensure comparability. We believe the former viewpoint is the correct one.

Paragraph 15: Specify Treatment for a Plan Initially Determined To Be Actuarially Equivalent, But Subsequently Determined Not To Be

The guidance in the proposed FSP addresses most of the situations that involve the subsidy. However, there is one situation that is not directly addressed by the FSP and we believe that it would be beneficial to give guidance on this situation.



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The situation is for a plan sponsor who makes a determination that their plan is actuarially equivalent as of the enactment date and applies the guidance in the FSP, but subsequently determines that their plan is NOT actuarially equivalent (e.g., because of the issuance of final regulations in 2005). We believe that this situation would follow the guidance in paragraph 15—this subsequent determination would be considered a significant event and would be accounted for prospectively as an actuarial loss. For purposes of completeness, we believe that it would be helpful to specially describe this situation and the related accounting in the final FSP.

Paragraph 18: Allow for Less Complex Tax Accounting

We agree that the approach discussed in paragraph 18 is the proper approach for determining the amount of the temporary tax difference. However, as noted in the FSP, this approach will likely be quite complex and require two Statement 106 valuations (i.e., one valuation reflecting the subsidy, one valuation not reflecting the subsidy).

Rather than requiring two valuations, we believe a simplified approach would be appropriate for some plans. Under this simplified approach, the “special” Statement 106 valuation (i.e., the one that does not reflect the subsidy) would be calculated by adding (a) the actual Statement 106 expense and (b) the dollar amount of the subsidy payments anticipated for that fiscal year. For some plans, we believe that this sum would serve as a good proxy for the “actual” amount. Thus, we suggest that the final FSP allow for the use of this proxy approach for plan designs where it would result in an expense amount similar to the actual amount.

Paragraph 20: Clarify Disclosure of Gain Amortization

Paragraph 20(b) indicates that an employer is required to disclose the effect of the subsidy on current period NPPBC. The paragraph states that this effect includes any amortization of the actuarial gain either “explicitly or implicitly” as a component on NPPBC. We believe the intent is that the employer needs to disclose the actual effect on NPPBC and, if different, the effect on NPPBC if part of the gain is not being currently amortized because of the use of the 10% gain/loss corridor—though this is not clear from the current language. Thus, it would be helpful to clarify the intent in the final FSP.

Paragraph 21: Clarify Language

The last sentence of paragraph 21 indicates that if the only effects of the Act are changes in estimated health care rates or estimated health care costs and those effects are not “significant”, then those effects do not need to be reflected until the next regularly scheduled measurement date.



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It is not clear to us if this is referring to the next scheduled measurement date (a) after the date of enactment or (b) after the issuance of the final FSP. Since the effects are not significant, we believe that the latter date is appropriate and is what is intended. This needs to be clarified in the final FSP.

Also, we believe that if the combined impact of ALL of the effects of the Act are not significant (and not just those related to health care rates and estimated health care costs), then the plan sponsor should have the option to not reflect the impact until the next regularly scheduled measurement date occurring after the issuance of the final FSP. This is an extension of the comments we made about paragraph 12.

Paragraph 23: Effective Date Is Too Soon

We agree with the FSP guidance that provides a delayed effective date for reporting purposes to allow plan sponsors time to both evaluate the impact of the Medicare Act on their plan and to make any necessary calculations. However, we believe that the delayed effective date is not delayed enough. Practically, the proposed effective date will mean that companies with calendar fiscal years will need to get this work completed in early July so that they can discuss anticipated third quarter results with analysts. This will give plan sponsors only about two months after the issuance of the FSP to analyze their plans, meet with their consultants and accountants, perform calculations, etc. In addition, it is anticipated that the CMS will be issuing proposed regulations in June about the subsidy and other aspects of the Act, and this guidance will certainly result in a need for the plan sponsor to review (and revise) prior decisions.

Thus, we believe the June 15 date in paragraph 23 should be replaced with a later date such as September 15. This will create a more realistic timeframe for plan sponsors to not only perform this work, but to also make a better determination about the impact of the Act on their plans.

Paragraph 28: Specify Actuarial Gain Treatment

It seems clear that the impact of a subsequent determination of actuarial equivalence absent a plan amendment should be treated as an actuarial gain under the principles of the FSP. However, this is not stated in paragraph 28. Thus, to avoid any potential for misinterpretation, we suggest that paragraph 28 specifically state that the impact should be treated as a gain in this situation.



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Paragraph 28: Allow Retroactive Accounting Treatment

For plan sponsors who cannot make a determination of actuarial equivalence by the effective date of the FSP, the FSP requires that a subsequent determination of actuarial equivalence be treated as a new significant event that requires remeasurement at that date. The Board and Staff concluded that prospective accounting treatment in this situation would not effect comparability with companies that were able to make a determination prior to the effective date of the FSP (as documented on page 7 from the minutes of the February 25 Board Meeting).

However, for any individual company, the expense impact for fiscal 2004 could be significantly different dependent on whether or not the company can make a determination of actuarial equivalence by "June 15". Since many companies will seek to recognize a full year's worth of expense reduction, the FSP encourages these companies to make an aggressive interpretation of actuarial equivalence. Some of these aggressive interpretations are certainly going to be incorrect and could lead to significant adjustments subsequently.

To avoid this situation, we strongly suggest that the effective date of June 15 be changed to a later date (such as September 15)—as suggested in our comments for paragraph 23.

Another alternative would be to allow companies a choice between retroactive and prospective application when they make a subsequent determination of actuarial equivalence. We acknowledge that providing companies with a "choice" is possibly a less desirable alternative—but we submit that this is exactly the option that plan sponsors have under the proposed guidance.

Please contact me via email or telephone if you have any questions about these comments. Thank you.

Sincerely,

Hewitt Associates LLC

Curtis M. Cartolano

CMC:pac