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Consultants and Actuaries

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8000 Towers Crescent Dr., Suite 1000  
Vienna, VA 22182  
Tel 703-917-0143 Fax 703-827-9266  
www.milliman.com

Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

via email to: director@fasb.org

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**Re: Proposed FASB Staff Position FAS 106-b, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003"**

This comment letter expresses the recommendations of Milliman USA's Employee Benefits Research Group. Others within the firm may have different views and we do not profess to speak on their behalf.

We commend the quick attention of the Financial Accounting Standards Board (FASB) in providing guidance to employers on accounting for the special subsidy under the newly enacted Medicare Part D prescription drug program. We submit the following comments with respect to the Proposed FASB Staff Position FAS 106-b (Proposed FSP FAS 106-b), "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003."

We support the FASB's reasoning and decisions in its overall approach to accounting for the subsidy. An employer's provision of drug benefits and its qualification for receipt of the subsidy are so interdependent that we agree that accounting for them in a dependent manner under Statement of Financial Accounting Standard (SFAS) 106 is the correct methodology.

We believe the following issues should be considered in the Board's consideration of a final FASB Staff Position:

***1) Decoupling of Amendment Cost and Gain from Medicare Part D Subsidy***

As described within the Proposed FSP FAS 106-b, the portion of the effect of the special subsidy attributable to past service is to be treated as an actuarial gain. However, under Proposed FSP FAS 106-b, if a plan amendment is adopted to make the plan actuarially equivalent for purposes of the special subsidy, then the gain is combined with the prior service cost associated with the plan amendment and recorded differently, depending upon whether the net is positive or negative: as a gain if the net is a decrease in the obligation, but as prior service cost if the net is an increase in the obligation. We recommend that the Board reconsider this approach and instead provide guidance that gains be treated separately from prior service costs under SFAS 106, even when both flow from a related transaction. Our reasoning follows:



- First, numerous other plan amendments -- in both pension (which are similarly accounted for under the comparable standards of SFAS 87) and retiree health programs -- give rise to gains and losses, as well as prior service costs. Only in the instance of a settlement or curtailment, where there is either a reduction or elimination of periods of service over which benefit costs are recognized or an irrevocable transfer of employer obligation, is there a comparable accounting practice of combining benefit-related gains or losses with prior service costs. No such circumstances exist with respect to the Medicare special subsidy.
- Second, the determination of whether a plan is being amended specifically with the intention of gaining actuarial equivalence will be difficult or might induce artificial actions, since employers may be making other amendments to the plan, particularly in response to the existence of the Medicare Part D program but not necessarily with respect to actuarial equivalence for purposes of the special subsidy. To have an unrelated amendment concurrently affect the usual accounting under SFAS 106 on the plan's status vis a vis actuarial equivalence would be inconsistent.
- Third, and most importantly, the proposed combining could create significant comparability problems between different plan sponsors, particularly in the years following implementation of the new standard. Because the final net periodic benefit cost itself combines the costs attributable to the recognition of the gain and prior service costs, the final FSP FAS 106-b should continue to treat those elements separately.

## **2) Methodology for Recognition of Gain**

Most employers do not accelerate recognition of gains or losses on a more rapid basis than currently allowed under SFAS 106. That is, the portion of net periodic benefit cost attributable to accumulated unrecognized net gains or losses is equal to the excess, if any, of the accumulated amount over 10% of the greater of the accumulated postretirement benefit obligation or the market-related value of plan assets, divided by the average remaining service period of active plan participants.

For usual gains or losses under a retiree health plan — indeed, for gains and losses that in the future may be directly related to increases or decreases in plan obligations arising from changes in the special subsidy — the usual SFAS 106 gain/loss recognition is an appropriate method for offsetting accumulated gains and losses from year to year, because gains that are measured in one year are not necessarily expected to be realized, but rather may be offset by future losses, and vice versa. In contrast, the gain under Proposed FSP FAS 106-b corresponding to the decrease in accumulated postretirement benefit obligation will in fact be received in future years, without any measurable offsetting future losses directly related to the same element of the program.

Under Proposed FSP FAS 106-b, for any year in which the net unrecognized gain or loss is under the 10% corridor currently used by an employer, no recognition of the original decrease in accumulated postretirement benefit would be recorded, even though for any year after 2005 the



employer will have received the special subsidy. Indeed, since many employers were carrying unrecognized net losses prior to the enactment of the Medicare Part D program, the gain from the decrease in the accumulated postretirement benefit obligation would generally only offset that unrecognized net loss, making the lack of recognition more likely with respect to the special subsidy, other than the effect of each year on the service cost.

We recommend that the FASB provide a rule to permit the gain attributable to the Medicare Part D subsidy be granted special treatment under the gain/loss rules, separate from other gains or losses. In addition, as in the original implementation of SFAS 106 with regard to the transition asset or obligation, the gain should be spread over the future service period of current active employees who would be eligible to receive benefits under the plan, without the usual 10% corridor. We recommend this approach be taken for the gain whether or not it is segregated from the prior service cost, as discussed in the first point, above.

### ***3) Segregation of Elements for Deferred Tax Asset Calculations***

We recommend that the FASB provide further detail in the Proposed FSP FAS 106-b's body and illustrative examples about the tax treatment relating to the special subsidy. As noted by the Proposed FSP FAS 106-b, the subsidy is exempt from federal income tax, yet does not offset amounts determined for purposes of deductibility of employer contributions made under the plan. To properly reflect these tax implications in the deferred tax assets shown in an employer's financial statement, balances directly arising from accounting for the special subsidy must be carried separately from other balances carried under the plan, both upon implementation and throughout future years. Whether or not the final FSP FAS 106-b requires separate disclosure of these different classes of balances, the accounting guidance and examples should provide more details on the underlying methodology.

At the very least, the final FSP FAS 106-b should point out that separate accounting must be done in all future years for each of the following items associated with the subsidy payments: the initial gain separately from any associated prior service cost; future gains and losses (including changes in assumptions, such as the discount rate) attributable directly to the calculation of this portion of the negative accumulated postretirement benefit obligation; future prior service costs that reflect expected changes in the receipt of the subsidy; the negative net periodic benefit cost; and the iteratively developed accrued/prepaid benefit cost (adjusted for actual receipt of the subsidy payments and changes in the net periodic pension cost associated with all of these variables listed here). This group of numbers must be separated by actuaries performing the calculations and may be overlooked if the final FSP FAS 106-b does not point out the need for such details to properly perform the deferred tax asset calculations under SFAS 109.

### ***4) Clarification of Effective Date for Certain Non-Calendar Fiscal Year Employers***

Proposed FSP FAS 106-b would supersede FSP FAS 106-1. Proposed FSP FAS 106-b provides guidance for the transition to FSP FAS 106-b for those employers that had elected deferral under FSP FAS 106-1, as well as for those that had not elected deferral under FSP FAS 106-1, in both



instances generally applying the new rules effective for interim or annual periods beginning after June 15, 2004. Under the general effective date rule given in paragraph 21, the new rule would apply for any other company at the next measurement date for plan assets and obligations. Presumably, then, FSP FAS 106-1 would be in effect until that next measurement date. For example, consider an employer with a fiscal year ending on May 31 that uses a March 31 measurement date for its retiree health benefit plan. Because that measurement date in 2004 will have preceded the final issuance of FSP FAS 106-b, such an employer would retain the choices (including, in particular, the deferral of treatment) described under FSP FAS 106-1, even if the final FSP FAS 106-b is published before the end of the company's fiscal year on May 31, 2004. Under the remainder of Proposed FSP FAS 106-b's effective date provisions, the new rules would thus apply for the first interim period beginning after June 15, 2004 (i.e., in this case the quarter beginning on September 1, 2004). If this is the Board's intended application, we suggest clarification, particularly with respect to the instance that FSP FAS 106-1 would not be considered superseded until the date as of which FSP FAS 106-b is effective for a particular employer.

We thank you for considering our comments.

Respectfully submitted,

Mark G. Beilke, ASA, MAAA, EA  
Director of Employee Benefits Research  
Milliman USA, Inc.