

VIA email to director@fasb.org

May 30, 2006

Technical Director – File Reference No. 1025-300 Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, Connecticut 06856-5116



LETTER OF COMMENT NO. \$5

Re:

Comments on Proposed Statement of Financial Accounting Standards on Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans

Dear Mr. Herz:

Aon Consulting (Aon) appreciates the opportunity to comment on the Financial Accounting Standards Board's (Board) Proposed Statement of Financial Accounting Standards, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R) (ED).

Aon is the third largest benefits consulting firm in the U.S. and has helped many employers (both public and nonpublic) analyze the ED. Insight gained from these analyses, combined with a desire to help the Board formulate an appropriate standard, forms the basis of these comments.

Our comments are divided into two categories. First, we offer comments on four of the issues identified in the ED as areas in which the Board would like comments. Second, we offer comments on additional matters, which we believe are of extreme importance and should be brought to the Board's attention. We would be pleased to provide additional clarification or answer any questions related to these comments.

Thank you for considering these comments.

Issues for Which Comments Were Specifically Requested in the ED

Issue #1: Implementation Cost

Except for employers who are being forced to change their measurement date, we agree with the Board's conclusion that implementation of the ED will not usually require information that is not already available (other than information related to income tax effects).

We do not agree with the Board's conclusion that the costs of implementing the ED are not significant. Employers will bear both internal, soft costs, and external costs from actuaries, consultants, and accountants to help them with the implementation. These costs are primarily due to the requirement that the statement be applied retrospectively. This requires that employers re-determine past expense amounts, liability entries, and tax effects. Each re-determination will take analysis and must be done individually, by plan. For each plan, calculations must be performed, checked, reviewed, explained, and documented. Costs will vary, but will not be deemed insignificant by most employers.

Employers who have to renegotiate loan covenants, review rate recovery issues with public utility commissions, or have other arrangements that are affected by the change will incur additional analysis and negotiating costs.

Employers who are forced to change their measurement date will have greater additional costs than other employers. They will have to obtain asset and liability information that may not currently be available. They will incur two additional types of costs:

- 1. Transition Costs: As part of a prudent review and financial statement preparation process, employers who change their measurement date will want to quantify the effect of the change. This will require dual calculations in the year of change (one set of calculations at the old measurement date and one set at the new). The cost of the dual calculation will be significant for many employers. In addition, there will be the cost of asking the plan trustees, actuaries, and accountants to implement new procedures to accommodate the new measurement date.
- 2. Ongoing Costs: On an ongoing basis, performing calculations at the new measurement date will exceed the prior cost. Reasons will vary by employer, but will usually include:
 - a. Most employers who are forced to change measurement dates will want to forecast results prior to year-end. Some may want several forecasts. The cost of the forecasts performed within three months of the fiscal year end will be an additional cost. Generally, employers who chose non-fiscal year end measurement dates did so, in part, because they felt it was important to know year end results before year end. Thus, they are likely to want multiple forecasts.
 - b. There will be significant time pressure to produce final year end numbers for those employers who are switching measurement dates. Added time pressure will increase cost by requiring greater involvement of more, higher-level people than was required when there was less time pressure.

Issue #2: Measurement Date

Cost and timing are the two primary implementation issues associated with moving an employer's measurement date to the fiscal year end. Cost is discussed as part of Issue #1. Timing, however, is the primary concern for many employers who previously chose non-fiscal year end measurement dates. Timing pressures may cause these employers to take shortcuts that jeopardize the quality of the information presented. Thus, the proposed

requirement to have the measurement date be the statement date could degrade the accuracy of the information, rather than improve it, which is counter to the Board's goals.

Preparing pension and other postretirement benefit information requires complex calculations that involve the significant and coordinated efforts of the employer, trustees, actuaries, and accountants. The length of time needed to coordinate and complete these calculations varies significantly by employer and many employers need to use a measurement date prior to the fiscal year end to allow adequate time for this process. Some of the unique aspects of pension and other postretirement benefit obligation calculations that require more time than other calculations include:

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- 1. Discount Rate: Liabilities cannot be determined until the discount rate is finalized. Complex yield curves are increasingly being used to determine appropriate discount rates. These yield curves are usually not available until approximately ten business days following the measurement date. Once the yield curves are derived, a plan-specific discount rate must be developed. Developing, reviewing and finalizing this discount rate can easily take another 14 days.
- 2. Actuarial Calculations: Only after the plan-specific discount rate is finalized can the actuarial calculations begin. These calculations are likely to take at least 7 14 days. For larger organizations, the calculations can easily take 20 30 days. It is not practical to run calculations at multiple discount rates ahead of time so they can be ready as soon as a final discount rate is known. There are too many potential discount rates and the cost of running multiple options is too great.
- 3. Multiple Parties: Preparing year end calculations requires the coordinated efforts of the employer, trustees, actuaries, and accountants. Each has a significant role, and each role takes time. Many of the steps must be completed linearly, and the entire process can easily take 30 days or more.
- 4. Asset Information: Asset information for non-marketable securities can take thirty, sometimes forty-five, days to value. Some non-traditional investments may take even longer. Statement information cannot be prepared until all asset information is received.

As an example of the time constraint problem, Aon works with a Fortune 100 company that has only 60-days after its financial statement date to issue its 10-K. They have nontraditional assets that take 60-90 days to value. Thus, they simply cannot provide accurate information on the 10-K unless they are permitted to use a measurement date that precedes the financial statement date.

Sarbanes Oxley emphasizes the importance of plan sponsors understanding and supporting the information provided on their financial statements. To do this effectively, plan sponsors need ample time to review and analyze the information. Requiring the measurement date to be the fiscal year end will pressure employers to take shortcuts or omit proper reviews in order to meet deadlines.

Pension and other postretirement benefit obligations are long-term in nature. A mere three-month shift in the measurement of those obligations would have very little effect on the accuracy of the measurement. If the Board believes it is important for all companies with the same fiscal year end to use the same measurement date, we suggest mandating a measurement date that is three months prior to the fiscal year end.

Issue #3a: Retrospective Application

We believe retrospective application should generally not be required. This is due to its associated costs as described in the second paragraph of the comments in this letter under Issue #1, Implementation Cost.

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Issue #4: Effective Date of Measurement Date Change

The ED's proposed effective dates generally do not leave sufficient time for employers to plan or to revise their processes to accommodate the new requirements. The proposed effective date for the measurement date change for a public entity should be delayed by one-year. This would allow public entities appropriate time to modify their procedures and prepare for the change. Since a final statement is not expected until September, the currently proposed effective date would allow only approximately three months for planning and process changes. This short time period is not sufficient given the number of providers (employer, trustee, actuary, and accountant) who will be affected.

Additional Matters

Additional Matter #1: Effective Date

The effective date of the non-measurement date portion of the ED should be delayed by one-year, from the fiscal year ending after December 15, 2006 to the fiscal year ending after December 15, 2007. Since a final statement is not expected until September, the currently proposed effective date would allow only approximately three months for employers to determine the effects of the changes and to take appropriate mitigating actions. Employers will need more time to adequately review the effect of the changes on their loan covenants, rate recovery agreements, and other aspects of their business.

Additional Matter #2: Pension Liabilities should be Measured by the ABO, Rather Than the PBO

For reporting a pension plan's funded status on an employer's statement of financial position, the Accumulated Benefit Obligation (ABO) is a more appropriate measure of plan liabilities than the Projected Benefit Obligation (PBO). Reasons include:

1. **Definition of Liability:** A pension plan's PBO does not meet the definition of a liability. FASB Concepts Statement No. 6, Elements of Financial Statements defines liabilities as "probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to

other entities in the future as a result of past transactions or events". A pension plan's PBO does not meet this definition because

- a. The PBO is not a "present obligation". If time stopped on the date of the statement of financial position, the employer's obligation would be for the ABO, rather than the PBO.
- b. The PBO does not result entirely from "past transactions or events". By definition, it results from past service and past and *future* salary. Since future salary is not a past transaction or event, the PBO fails this part of the definition of a liability. In contrast, the ABO results from past service and past salary. Therefore, the ABO is a more appropriate measure of a plan's liability than the PBO.
- 2. Legal Obligation: Employers generally have no legal obligation to provide pension benefits greater than those that are based on an employee's past service and past salary. Thus, an employer's legal obligation is generally for the plan's ABO, rather than its PBO. In order for an employer's obligation to rise to the PBO, the employer would have to (i) continue its plan into the future, (ii) continue to employ its current employees (through the exit ages assumed by the plan's turnover and retirement assumptions), and (iii) grant future salary increases to those employees at the assumed rate. While all three events might happen, employers generally have no legal obligation for any of them. As evidenced by the large number of employers that have terminated or frozen their pension plans, employers have no obligation to continue their current pension plans. Also, as evidenced by the large number of corporate layoffs, employers generally have no obligation to continue the employment of their current employees. Finally, employers generally have no legal obligation to grant future salary increases.
- 3. Consistency with Discount Rate Requirements: FAS 87 discount rates are determined on a plan settlement basis. Only a plan's ABO can be settled. There is no market for the PBO, and the PBO does not actually exist to be settled. As long as the discount rate is a settlement rate, the ABO will be the more appropriate measure of the plan's liabilities to use for statement of financial position purposes. Using the PBO would be inherently inconsistent with the setting of the discount rate and inappropriate. If, however, the PBO is used, the discount rate should be a combination of (i) a long-term, assumed settlement rate, and (ii) an assumed rate of return on plan assets for the time prior to settlement.

Additional Matter #3: Other Postretirement Plan Liabilities Should Include Only Those Liabilities for Which There is a Legal Obligation

For other postretirement plans, the measurement of plan liabilities for statement of financial position purposes should reflect only those liabilities for which the employer has a legal obligation. Since postretirement benefits other than pensions generally do not vest and employers generally have no statutory legal obligation to provide these benefits, the definition of a liability is generally not met, and no liability should be recorded.

Notwithstanding the absence of a statutory obligation, case law suggests that, in certain situations, benefits vest when employees become fully eligible for them. Thus, we suggest the Board require that liabilities for Statement of Financial Position purposes be based only on liabilities for fully eligible participants unless circumstances indicate that the employer has a legal obligation for a different category of employees. This would add an element of conservatism to the calculation and would also bring the determination more in line with the Board's definition of a liability.

Additional Matter #4: Phase 1 Versus Phase 2

We believe that no statement should be issued at the current time. This will (i) help ensure a logical, appropriate approach to accounting for pension and other postretirement benefit plans, (ii) prevent employers from taking inappropriate, short-sighted actions as a result of the ED, and (iii) leave the Board with maximum flexibility as it moves to phase 2 of this project. Phase 1 of this project should instead be consolidated with phase 2, and a comprehensive, logical approach to accounting for pension and other postretirement benefit plans should be released after the completion of phase 2.

The most significant element of the ED is the proposed requirement that employers record the funded position of their pension and other postretirement benefit plans on their statements of financial position. This change is so significant that many employers will consider plan changes as a result. Some plans are likely to be frozen and others significantly curtailed. These changes will be driven directly by the requirement that the plan's unfunded PBO be *inappropriately* recorded on the statement of financial position. If the Board concludes after phase 2 that a different measure of funded status is more appropriate, employers will have made important, irreversible changes that adversely affect thousands of employees, based on temporary rules that are later determined to be inappropriate.

Another reason to avoid issuing a statement at this time is that if the ED is implemented without change, it will put unnecessary pressure on the Board to confirm its phase 1 conclusions when it considers additional changes in phase 2. This is true regardless of the appropriateness of the phase 1 conclusions. Only by confirming its phase 1 position will the Board be able to avoid the appearance of admitting that a mistake was made in phase 1 - a mistake that caused employers to freeze or curtail their plans and caused employees to permanently lose their pension benefits. To avoid a situation where the Board has to either (i) confirm an inappropriate policy, or (ii) admit making a mistake that caused irreparable harm, no statement should be issued at this time.

Consolidating phase 1 with phase 2 will also provide the Board with sufficient time to develop and propose a more logical, appropriate, and comprehensive solution to this complex situation.

Thank you for considering these comments. Please contact me at 336 728 2378 if you have any questions or would like to discuss.

Sincerely,

Tonya B. Manning, F.S.A. Chief Actuary – US Retirement Aon Consulting

Tonya_Manning@aon.com