

May 31, 2006

Ms. Suzanne Q. Bielstein
Director of Major Projects and Technical Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116



LETTER OF COMMENT NO. 87

RE: File Reference No. 1250-300, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans -- an amendment of FASB Statements No. 87, 88, 106, and 132 (R)

Dear Ms. Bielstein:

PricewaterhouseCoopers LLP appreciates the opportunity to respond to the Financial Accounting Standards Board's ("FASB" or the "Board") exposure draft, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans -- an amendment of FASB Statements No. 87, 88, 106, and 132 (R)* (the "ED" or the "proposed standard"). We commend the Board for undertaking this project and support its efforts to improve the accounting and reporting for defined benefit postretirement benefit arrangements.

Recognition of the Funded Status of a Defined Benefit Postretirement Plan

We support the FASB's proposal of recognizing the funded status of a plan in a company's statement of financial position based on the difference between the fair value of plan assets and the plan obligation, with pension benefit obligations measured based upon the projected benefit obligation (PBO), and other postretirement benefits (OPEBs) measured and recognized based on the accumulated postretirement benefit obligation (APBO).

We believe that an employer's promise to provide pension and OPEBs to employees meets the definition of a liability in Statement of Financial Accounting Concepts No. 6, *Elements of Financial Statements*, and economically has value to both the employer and the employee. There is a mutual understanding between employers and employees that employees will provide services and, in exchange, the employer will provide a competitive compensation package consisting of a combination of salary and other benefits, including postretirement benefits. These benefits have an economic value to employees and a real cost to employers that need to be measured and recorded in employers' financial statements.

Measurement of the benefit obligation

Under the current measurement guidance that has been in place for many years, companies have been including amounts in statements of operations and statements of financial position based on the existing PBO and APBO measurement frameworks, and for some companies the PBO and APBO are

fully recognized. In order to achieve the objective of full recognition of the funded status of these benefit arrangements on corporate balance sheets, we believe that recognition based upon the PBO and APBO is a pragmatic solution to achieving that objective without a full reconsideration at this time of the measurement of the obligation. Furthermore, similar to the assumptions made in benefits accounting about salary progression, healthcare inflation, and continued employment, there are other areas of financial reporting where judgments and assumptions need to be made about future events and future cash flows. And there are numerous liabilities for which the ultimate payment amount depends on future events. For example, in measuring asset retirement obligations, preparers are required to consider the future cost of services to be employed in settling such obligations. Thus, we believe that recognizing pension and postretirement benefit obligations based upon the PBO and APBO is consistent with other aspects of the existing financial reporting model. We acknowledge that while measuring the obligation using the PBO is a pragmatic solution while waiting the resolution of Phase II of this project, we believe that the market place is better served by this financial reporting. We note that generally the financial analyst community currently uses the PBO and APBO measures when developing equity values and determining credit ratings.

We believe that recognizing these off-balance sheet amounts, which collectively are estimated at billions of dollars¹, represents a significant improvement in financial reporting and can be achieved in the very near term, and users of financial statements will be more informed and the capital markets better served by recognizing these significant off-balance sheet amounts on the balance sheet now. Additionally, financial statements will be more complete and transparent by fully recognizing these amounts rather than continuing to relegate them to the financial statement footnotes, which can be difficult to understand.

While we support, within the context of this phase of the project, recognizing the funded status based on the Board's definition in the proposed standard, we strongly encourage the Board, together with the International Accounting Standards Board (IASB) (the "Boards"), to immediately begin reconsideration of the measurement of pension and OPEB obligations. We understand that this issue is complex and it cannot be separately addressed. The vast array of existing benefit formulas must be considered – for example, plans with lump sum benefit features and variable interest crediting rates, and other plans that have evolved since FASB Statement No. 87, *Employers' Accounting for Pensions* (FAS 87), was issued. Determining the appropriate measurement model for employee benefit obligations will require considerable time and effort by the Boards and their respective staffs in order to thoroughly analyze the issue. Because of the significance of these liabilities to many employers' financial position, we encourage the FASB to devote the resources necessary to expedite this part of the project (i.e., Phase II) similar to the approach in Phase I.

Measurement date

The proposed standard requires that plan assets and benefit obligations be measured as of the date of an employer's statement of financial position. We support consistently measuring plan assets and obligations as of the balance sheet date because doing so improves financial statement comparability and usefulness. However, we have identified some practical concerns with this proposal, outlined in our response to Issue 2 in Attachment A, that we recommend the Board consider in concluding on the effective date of this proposal.

¹ Credit Suisse Equity Research (May 5, 2006) estimates that there is approximately \$382 billion (pretax) of unrecorded pension and OPEB obligations for the S&P 500 companies.

Retrospective application

As communicated to the Board in our comment letter on FAS 154, *Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and FASB Statement No. 3* (FAS 154), we generally support retrospective application for changes in accounting principle as proposed in this ED. However, in that comment letter we strongly encouraged the Board to be mindful of this requirement when deliberating new accounting standards and be certain that retrospective application is feasible and would pass a robust cost benefit test. We do not believe that retrospective application of the proposed standard passes the cost/benefit test and recommend that the standard be applied prospectively. We believe that the Board may have underestimated the magnitude of the efforts necessary to apply the standard retrospectively, which would cause companies to incur significant time, effort, and costs, both internal and external, and would provide limited benefits. As well, the accounting for income tax effects in prior periods can be complex and prior period income statements may be impacted by the accounting for plan curtailments, settlements, and amendments in those periods. Finally, we do not believe that retrospective application in what is largely a matter of presentation of financial condition (rather than a new measure of performance of operations), provides benefit to the users of the financial statements sufficient to outweigh the cost to preparers.

We recommend that the proposed standard be applied prospectively for fiscal years beginning after December 15, 2006. We believe our recommended effective date is a reasonable alternative based upon when the final standard is expected to be issued (September 2006 at the earliest) and the need for companies to renegotiate financial covenants.

Our concerns regarding retrospective application and the proposed effective date are described in more detail in our responses to Issues 1 and 3(b), respectively, in Attachment A.

Attachment A to this letter includes our responses to the five specific issues in the "Notice for Recipients of This Exposure Draft" on which the Board has requested feedback. Attachment B includes our other comments on the ED.

If you have any questions about our comments, please contact Ray Beier (973-236-7440) or Gerard O'Callaghan (973-236-7817).

Sincerely,

PricewaterhouseCoopers LLP

Attachment A

FASB Exposure Draft: Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans -- an amendment of FASB Statements No. 87, 88, 106, and 132 (R)

PricewaterhouseCoopers LLP's Responses to Specific Issues Described in the "Notice for Recipients of This Exposure Draft"

Issue 1: The Board concluded that the costs of implementing the proposed requirement to recognize the overfunded or underfunded status of a defined benefit postretirement plan in the employer's statement of financial position would not be significant. That is because the amounts that would be recognized are presently required to be disclosed in notes to financial statements, and, therefore, new information or new computations, other than those related to income tax effects, would not be required.

Do you agree that implementation of this proposed Statement would not require information (other than that related to income tax effects) that is not already available, and, therefore, the costs of implementation would not be significant? Why or why not? (See paragraphs B20–B34 for the basis for the Board's conclusions.)

We agree that the information required to implement the proposed standard, other than the related income tax effects, should be available. However, as described below, we believe that companies could incur significant costs, both internal and external, related to retrospective application of the standard.

In general, we support retrospective application for changes in accounting principle because it improves the period-to-period comparability, usefulness, and transparency of financial information. However, as we have previously expressed to the Board in our response letter to the proposal for FAS 154, we strongly encourage the Board, when deliberating new accounting standards, to be certain that retrospective application is feasible and would pass a robust cost/benefit test.

In this instance, we believe the costs outweigh the benefits of retrospective application. We believe that retrospective application would cause companies to incur significant time, effort, and costs, both internal and external, and would provide limited benefits. We discuss below some of the drivers of the cost of retrospective application below. Alternatively, we recommend that the standard be applied prospectively for fiscal years beginning after December 15, 2006². Our recommended change to the effective date of the proposed standard is further discussed under Issue 3(b).

Costs of Retrospective Application

1. *Accounting for the income tax effects in prior periods could be more complex than anticipated.* Recognizing the funded status of pension and OPEB plans in prior periods could introduce additional complexities to the reporting of income taxes. In order to apply the proposed standard retrospectively, a company would need to identify the income tax consequences by plan and by jurisdiction. In each jurisdiction, the company would then determine the temporary differences and, applying the applicable tax rate during the relevant periods, determine the deferred tax balances. Additionally, any incremental deferred tax assets resulting from application of the proposed statement must then be assessed for realizability by jurisdiction. This analysis could be complex

² The effect of recognizing the funded status of the plan would be reported as an adjustment to the opening balances of accumulated other comprehensive income and/or retained earnings as appropriate.

and time consuming, especially if a company must perform these steps to account for the income tax effects of multiple plans in various foreign and state tax jurisdictions. Retrospective application of the proposed standard could result in changes to the previously reported tax provision if a valuation allowance is required in a period subsequent to the initial recognition of an incremental deferred tax asset.

While we acknowledge that paragraph 16 of the proposed standard provides an impracticability exception in situations in which the realizability of any incremental deferred tax assets must be assessed as of a prior balance sheet date, this is not the only situation in which retrospective application may introduce practical difficulties. Specifically, changes to other comprehensive income in prior periods may require a change in the allocation of the income tax provision among continuing operations, discontinued operations, extraordinary items, and other comprehensive income pursuant to the complex intraperiod allocation rules in FASB Statement No. 109, *Accounting for Income Taxes* (FAS 109). For example, the amortization of prior service costs/credits and actuarial gains/losses recorded in other comprehensive income in prior periods does not affect total income tax expense or benefit for the period; however, other comprehensive income (one of the items to which income tax expense or benefit is allocated) would be changed by the amount of the amortization. Because other comprehensive income has been changed, but the total income tax expense or benefit has not changed, the amount of income tax expense or benefit recognized for other items (e.g., discontinued operations) could be affected.

That phenomenon could be further complicated in a situation in which a) a company is in a full valuation allowance position at both the beginning and the end of a particular period, and b) reports a pre-tax loss from continuing operations, and c) the net result of the application of the proposed standard is additional income in other comprehensive income (i.e., the exception in paragraph 140 of FAS 109 applies). In this situation, a company could be required to record an income tax benefit in continuing operations due to additional income that might be reported in other comprehensive income (either due to reclassification adjustments for the amortization of prior service costs and actuarial losses or the initial recognition of negative plan amendments or actuarial gains). The change in the income tax benefit in continuing operations would affect net income/loss and earnings per share in the prior period.

2. *Retrospective application may affect the accounting for plan curtailments, settlement, and amendments in prior periods.* Retrospective application may also affect the accounting for plan settlements, curtailments, and amendments in prior periods. Retrospective application of the proposed standard will result in the elimination of unrecognized transition assets and obligations through an adjustment to the opening balance of retained earnings in the earliest period presented. As well, it will result in the exclusion of prior period amortization of the transition asset or obligation from the financial statements. Under FASB Statement No. 88, *Employers' Accounting for Settlement and Curtailments of Defined Benefit Pension Plans and for Termination Benefits* (FAS 88), unrecognized transition assets or obligations affect the determination of the net gain or loss from plan settlements and curtailments. Thus, as a result of retrospective application of the proposed standard, a previously determined curtailment or settlement gain or loss may change and cause a change to net income for that period. In addition, the period in which curtailments were recognized could change if a curtailment previously determined to have resulted in a loss would result in a gain.

Under FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions* (FAS 106), plan amendments that reduce the related benefit obligation are recorded first as a reduction of any existing unrecognized prior service cost, and then as a reduction of any remaining unrecognized transition obligation. The excess, if any, (i.e., the net negative prior service cost) is amortized on the same basis as positive prior service cost. Thus, if the unrecognized transition obligation is eliminated in prior periods, the amount of net negative prior service cost to be amortized would also be affected.

As Appendix I to this letter, we have included examples demonstrating the effect of retrospective application on the accounting for plan curtailments, settlements, and amendments.

If the Board retains the requirement for retrospective application, we recommend that the Board reconsider its proposal to adjust any remaining transition obligation or asset to the opening balance of retained earnings. We understand the conceptual distinction the Board has drawn between transition assets/obligations and prior service costs/credits. However, in the interest of simplifying the transition provisions of the standard, we suggest that the adjustment be reported in other comprehensive income. Our recommendation would have the additional benefit of resolving our concerns regarding the effect of the proposal on the calculation of plan curtailments, settlements, and amendments, and would result in cost recognition in future periods that is consistent with the current requirements.

3. *SEC registrants will be required to amend a significant amount of prior year information in their annual reports.* SEC registrants must provide five years of selected financial data in their annual reports in order to comply with Regulation S-K, Item 301, Selected Financial Data. In addition, some registrants voluntarily present more than five years of financial information, and in those cases SEC rules require that information to be presented on a consistent basis if accounting principles have been applied retrospectively. Accordingly, registrants will be required to amend multiple years of financial data. In addition to amounts in the primary financial statements and summary tables, corresponding amounts in footnote disclosures—such as segment information, income taxes, and earnings per share—and in management's discussion and analysis will also need to be adjusted. These adjustments will likely require significant effort by the company.
4. *Complications may arise if prior periods were audited by a predecessor auditor.* Retrospective application of the proposed standard could result in burdensome re-audit requirements for companies in certain scenarios. This is because auditors must be independent during the period in which the audit is conducted and during the period covered by the financial statements. In many cases, predecessor auditors may no longer be independent of former audit clients because, for example, they are now rendering non-audit services to the company. In that case, they would be unable to issue a dual-dated report covering the retrospective change because the non-audit services make them not independent during the period in which they would be performing audit procedures for the prior period(s). Accordingly, affected companies would be forced to have the prior years completely re-audited. We recognize that these issues are not specific to this proposed standard and could arise in any instance that retrospective application is required. However, we believe that for any new accounting standard the Board should consider these potential complications when assessing whether the benefits of retrospective application outweigh the costs.

In addition to the concerns enumerated above, other consequences of retrospective application may exist that may not become apparent until companies begin to implement the proposed standard. Based on the proposed effective date, many companies will have little time to respond to issues encountered when applying the standard to prior periods. Consequently, the difficulties associated with retrospective application will be amplified.

We believe that the examples provided in the proposed standard that illustrate retrospective application of the proposed standard are straightforward and do not reflect many of the complexities that companies will encounter. For example, none of the illustrations include the impact of plan curtailments, settlements, amendments, or amortization of gains and losses. In addition, the examples present only one or two years of financial information. Even in these straightforward situations, the examples demonstrate that retrospective application of the proposed standard will be complex.

In summary, the benefits of retrospective application are the improvement in the comparability of financial information provided to users of financial statements. However, in this instance, because the

amounts to be recorded on the balance sheet are largely set out in the footnotes in prior years, the benefits of retrospective application are limited. Thus, given the limited benefits and the practical difficulties associated with retrospective application, we have concluded that the costs of retrospective application outweigh the benefits to the users of the financial statements in this situation. We believe that prospective application of the proposed standard is consistent with the Board's objective of reducing complexity, and does not compromise the overall understandability, transparency, and usefulness of financial reporting.

Issue 2: Unless a plan is sponsored by a subsidiary that is consolidated using a fiscal period that differs from the parent's, this proposed Statement would require that plan assets and benefit obligations be measured as of the date of the employer's statement of financial position. This proposed Statement would eliminate the provisions in Statements 87 and 106 that permit measurement as of a date that is not more than three months earlier than the date of the employer's statement of financial position.

Are there any specific implementation issues associated with this requirement that differ significantly from the issues that apply to other assets and liabilities that are recognized as of the date of the statement of financial position? (See paragraphs B36–B40 for the basis for the Board's conclusions.)

We believe that using a measurement date that coincides with a company's balance sheet date to measure plan assets and obligations is preferable. Consistently measuring assets and liabilities as of the balance sheet date improves financial statement comparability and usefulness. The characteristics of these obligations and assets are not sufficiently unique to justify a measurement date other than the balance sheet date. Companies currently measure extensive portfolios of investment securities and numerous and complex derivative financial instruments at the balance sheet date. Published data³, as well as our own limited surveys of our larger clients, suggest that a majority of larger entities currently use the balance sheet date as their measurement date. We also understand that there are techniques available to rollforward data from earlier periods that may alleviate some of the difficulties associated with complying with the proposed change in measurement date.

We are aware of concerns that have been raised regarding the practical difficulties of complying with the change in measurement date. Some of the factors that could influence the practicability of complying with the change in measurement date include:

- Difficulties in receiving timely valuations for certain plan assets which do not have readily available market values, for example, real estate, limited partnerships, and private equity securities, both in the U.S. and in foreign jurisdictions,
- Difficulties in obtaining timely actuarial valuations, primarily for foreign plans,
- Increasingly tight reporting deadlines, including the decrease in the annual report filing deadline to 60 days for large accelerated filers (effective for fiscal years ending on or after December 15, 2006), and
- Strain on the overall pool of qualified practitioners available in the actuarial profession due to the compression of the timeframe in which valuations will need to be performed.

We are sensitive to these concerns and recommend that the Board carefully analyze all practical concerns raised in response to this proposal, in particular the accelerated SEC reporting deadlines, when concluding on the required effective date for complying with this aspect of the proposed standard.

³ Credit Suisse Equity Research (May 5, 2006) reported that 66 percent of S&P 500 companies use their fiscal year end as the measurement date for their defined benefit pension plans.

Issue 3(a): The Board's goal is to issue a final Statement by September 2006. The proposed requirement to recognize the over- or underfunded statuses of defined benefit postretirement plans would be effective for fiscal years ending after December 15, 2006. Retrospective application would be required unless it is deemed impracticable for the reason discussed below.

An entity would be exempt from retrospective application only if the entity determines that it is impracticable to assess the realizability of deferred tax assets that would be recognized in prior periods as a result of applying the proposed Statement.

Should the Board provide an impracticability exemption related to the assessment of the realizability of deferred tax assets? Why or why not? Are there other reasons that retrospective application might be impracticable that the Board should be aware of? (See paragraphs B61–B64 for the basis for the Board's conclusions.)

Please refer to our response to Issue 1 for discussion of our views on retrospective application. We recommend that the new standard be applied prospectively with all new requirements effective for fiscal years beginning after December 15, 2006.

If the Board retains the requirement for retrospective application, we agree that an impracticability exemption should be provided related to the assessment of the realizability of deferred tax assets. In general, we do not believe that the capital markets would be served by requiring companies and their auditors to contemplate the judgments they may have made, as of earlier points in time, concerning incremental deferred tax assets which they were not required to assess on a real-time basis. However, we have concerns that the wording in paragraph 16 of the proposed standard, which refers to "incremental deferred tax assets," may be misunderstood. For example, prior to adoption of the proposed standard, a company may have recognized a deferred tax liability related to a prepaid pension asset. Upon adoption of the proposed standard, the company may recognize a reduction in that deferred tax liability as a result of recording a decrease in its net pension asset. Reduction of the deferred tax liability would reduce the expected future taxable income that would have been realized from the reversal of the taxable temporary difference and could also affect the company's assessment of the realizability of other pre-existing deferred tax assets. Thus, the company may conclude that a valuation allowance is required for the pre-existing deferred tax assets. These pre-existing deferred tax assets are not "incremental deferred tax assets" (as stated in paragraph 16); however, we believe that the impracticability exemption should also apply to the inability to assess the realizability of such deferred tax assets.

We have not identified any other circumstances that would cause retrospective application to be impracticable. However, there may be uncertainty as to the classification of certain income tax effects of applying the proposed standard to prior periods as direct or indirect effects of adoption. For example, we believe that a new or increased valuation allowance related to pre-existing deferred tax assets as a result of applying the standard (refer to the scenario described above) would be a direct effect of adoption. We base our conclusion primarily on the definition of an indirect effect in FAS 154, which refers to a change to current or future cash flows resulting from a change in accounting principle. Additionally, the income tax effects of applying the proposed standard are a result of mechanically applying the requirements of FAS 109. If certain income tax effects were to be considered indirect effects of adoption, FAS 154 would require that the adjustments be recorded in the period of adoption. For most companies, the adjustment would be recorded in continuing operations (as opposed to other comprehensive income). We recommend that the Board clarify that the income tax effects of applying the standard—i.e., effects from the application of FAS 109 to the newly measured temporary differences and components of comprehensive income—are direct effects of adoption.

Issue 3(b): Some nonpublic entities (and possibly some public entities) may have contractual arrangements other than debt covenants that reference metrics based on financial statement amounts, such as book value, return-on-equity, and debt-to-equity. The calculations of those metrics are affected by most new accounting standards, including this proposed Statement.

The Board is interested in gathering information for use in determining the time required to implement this proposed Statement by entities that have such arrangements other than debt covenants. That information includes (a) the types of contractual arrangements that would be affected and what changes to those arrangements, if any, would need to be considered, (b) how the economic status of postretirement plans that is presently included in note disclosures is currently considered in those arrangements, and (c) how the effects of the current requirement in Statement 87 to recognize a minimum pension liability previously were addressed for those contractual arrangements. (See paragraph B65 for the basis for the Board's conclusions.)

Our knowledge of contractual arrangements that reference metrics based on financial statement amounts is limited to anecdotal information and discussions with our clients. However, our concerns regarding the current timetable for adopting the standard apply equally to companies that do not have these contractual arrangements.

Under the proposed standard, the requirement to recognize the funded status of pension and OPEB plans would be effective for fiscal years ending after December 15, 2006. A second effective date is proposed for the change in measurement date. We recommend that the new standard be applied prospectively with all new requirements effective for fiscal years beginning after December 15, 2006. Based on the Board's planned timeline, a final standard is not expected to be issued until September 2006 at the earliest. We believe that the amount of time between the issuance of a final standard and the proposed effective date (December 2006) is too short, in absolute terms, given the other pressures placed on the preparer community, including the accelerated SEC reporting deadlines. While we acknowledge that much of the information required to recognize the funded status is available, we believe the timetable is too short in relative terms for this particular standard given some of the complexities associated with applying it: determining the income tax effects (by plan and by jurisdiction); assessing the impact on debt covenants and other contractual arrangements, and negotiating amendments, if needed.

Additionally, the Board's Proposed FASB Interpretation, *Accounting for Uncertain Tax Positions*, is expected to be effective for fiscal years beginning after December 15, 2006, which many believe will require a significant amount of preparer effort to apply and may require a second renegotiation of debt covenants and other contractual arrangements. Changing the effective date of the proposed [pension] standard to fiscal years beginning after December 15, 2006 would provide preparers with additional time to complete both of these complex implementations and require only one assessment of the combined effect on debt covenants and other contractual arrangements.

Based on these considerations, we believe that our recommendation represents a reasonable compromise. It balances the capital markets' need for improved financial reporting with the burden placed on the preparer community.

Issue 4: This proposed Statement would require a public entity that currently measures plan assets and benefit obligations as of a date other than the date of its statement of financial position to implement the change in measurement date as of the beginning of the fiscal year beginning after December 15, 2006. If that entity enters into a transaction that results in a settlement or experiences an event that causes a curtailment in the last quarter of the fiscal year ending after December 15, 2006, the gain or loss would be recognized in earnings in that

quarter. Net periodic benefit cost in the year in which the measurement date is changed would be based on measurements as of the beginning of that year.

Are there any specific impediments to implementation that would make the proposed effective date impracticable for a public entity? How would a delay in implementation to fiscal years ending after December 15, 2007, alleviate those impediments? (See paragraphs B66–B69 for the basis for the Board’s conclusions.)

Please refer to our responses to Issues 2 and 3(b) for our views, respectively, on the proposed change in measurement date and the proposed effective date. In our response to Issue 3(b), we recommend that the new standard be applied prospectively with all new requirements effective for fiscal years beginning after December 15, 2006.

Issue 5: This proposed Statement would apply to not-for-profit organizations and other entities that do not report other comprehensive income in accordance with the provisions of FASB Statement No. 130, *Reporting Comprehensive Income*, Paragraphs 7– 13 of this proposed Statement provide guidance for reporting the actuarial gains and losses and the prior service costs and credits by those organizations and entities.

Do you agree that those standards provide appropriate guidance for such entities? If not, what additional guidance should be provided? (See paragraphs B53–B58 for the basis for the Board’s conclusions.)

We support the Board’s decision to apply the guidance developed for for-profit business entities to not-for-profit organizations (NFPs). We believe that there are no substantive differences in the area of defined benefit postretirement plans that would justify different reporting. However, we do not believe the proposed standard will be operational for NFPs unless implementation guidance accompanies it. The other comprehensive income (OCI)-like model developed for reporting actuarial gains and losses and prior service costs within a statement of activities is not intuitive and will be difficult to grasp without illustrations. Therefore, because the FASB took the time and effort to develop illustrative examples and posted them for public comment we recommend that the guidance and illustrative examples contained in the ED’s supplement, *Implementation Guidance for Not-For-Profit Organizations and Other Entities that Do Not Report Other Comprehensive Income* (the “Supplement”), be included in Appendix A of the final standard.

We understand that, consistent with the anticipated impact on stockholder’s equity of for-profit entities, the implementation of this standard has the potential to significantly impact the equity section of many NFPs’ statements of financial position. Specifically, there will be situations in which adoption of this standard will entirely eliminate an NFP’s unrestricted equity and, in some cases, cause the entity to report negative equity (i.e., unrestricted net deficit). While that potential also exists among for-profit entities, those entities have “built-in” financial statement transparency in that the stockholder’s equity section of the statement of financial position displays accumulated other comprehensive income apart from retained earnings and other components of equity. Therefore, users of for-profit financial statements would not be misled into thinking that a business’s retained earnings had been eliminated.

Because NFPs do not have similar reporting requirements regarding the presentation of accumulated other comprehensive income, that inherent transparency does not exist in their statements of financial position. Therefore, in years subsequent to initial adoption of this proposed standard, an NFP’s statement of financial position may carry forward an unrestricted net deficit with no financial statement transparency that the deficit is due to implementation of this proposed standard. FAS 117, *Financial Statements of Not-for-Profit Organizations* (FAS 117), states that the information provided in a not-for-profit organization’s statement of financial position “should help donors, members, creditors, and others to assess the organization’s ability to continue to provide services as well as its financial flexibility,

ability to meet obligations, and needs for external financing." Absent a transparent portrayal of the impact of the adoption of this proposed standard on unrestricted net assets, the financial position of a not-for-profit organization that has been significantly impacted by this proposed standard will not be clearly communicated to and understood by the users of its financial statements.

In that regard, it is not clear whether the flexibility afforded to NFPs by FAS 117 (paragraphs 16 and 100) with respect to reporting designations of unrestricted net assets would allow a NFP to separately present deferred actuarial gains/losses and prior service costs within the unrestricted net assets caption, particularly if the NFP has other items such as cash flow hedges or unrealized gains and losses on investments embedded within its unrestricted net assets (as would be the case with NFPs that follow a variation of the FAS 117 model in which they report items of other comprehensive income in a manner similar to business enterprises). We recommend that the FASB clarify in its redeliberations of this proposed standard whether segregating the defined benefits-related impact from other unrestricted net assets in the statement of financial position is acceptable under FAS 117. We further recommend that the final standard provide guidance on this issue. In our view, NFPs should be permitted (but not required) to utilize such a presentation.

Specific comments related to not-for-profit issues

Paragraph 8

We recommend that the parenthetical phrase "(or performance indicator)" be placed after the phrase "functional equivalent of income from continuing operations of a for-profit employer," in order to clarify that the terms "performance indicator" and "intermediate measure of operations" are not synonymous. While the performance indicator is an intermediate measure of operations, it does not follow that all intermediate measures of operations are performance indicators. As described in AICPA Statement of Position 02-2, *Accounting for Derivatives by Not-for-Profit Health Care Organizations and Clarification of the Definition of Performance Indicator* (SoP 02-2), the term "performance indicator" refers to a not-for-profit measure of earnings that is comparable to income from continuing operations in a for-profit organization. Because that term originates from AICPA literature and not FASB literature, we believe that it would be helpful to refer users to SoP 02-2 for explanatory information on the concept of "performance indicator" and its relationship to income from continuing operations of a for-profit enterprise.

In the second sentence, we recommend deleting the phrase "by their functional classification," because we believe it is confusing. In our experience, organizations that report a performance indicator report expenses on the face of the statement of activities by means of natural classifications, rather than functional classifications.

Finally, we suggest moving the last two sentences in this paragraph to a position immediately after the first sentence in the paragraph and enclosing them in parentheses, to enhance clarity and readability of the paragraph.

Paragraph 9

We disagree with the Board's decision to not prescribe how a not-for-profit organization that presents an intermediate measure of operations would classify actuarial gains and losses, prior service costs, and reclassifications related to those amounts. While we acknowledge that FAS 117 provides significant flexibility with respect to the definition of an intermediate measure of operations, we do not believe that that flexibility should allow reporting information in a manner that is potentially misleading. An intermediate measure of operations represents a measure of performance for a period and, insofar as feasible, should exclude items extraneous to that period (for example, items that belong primarily to other periods).

The "reclassification" concept embodied in this proposed standard inherently involves the recognition and deferral of costs in the current period that will be reported as expenses in future periods. If a not-for-profit organization defines its intermediate measure of operations to include prior service costs and actuarial gains and losses (in addition to net periodic pension costs), that organization in essence would be double-counting costs associated with defined benefit plans within income from operations (once in the period when those costs are initially recognized and deferred, and again in the period when they are included in net periodic pension cost). We do not believe that the flexibility to self-define what is included in a measure of operations should extend to permitting inclusion of items that, by definition, cannot be considered part of current operations. Therefore, we recommend that the guidance prescribe that if an intermediate measure of operations is presented, that measure should exclude any deferred actuarial gains and losses and prior service costs (i.e., in a manner similar to guidance provided in paragraph 45 of FAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, and paragraph 18 of FAS 146, *Accounting for Costs Associated with Exit or Disposal Activities*).

Attachment B

FASB Exposure Draft: Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106, and 132 (R)

Other Comments

1. We recommend that the Board provide clarifying guidance on the requirement to report separately the current and noncurrent portions of the net pension asset or liability. Specifically, we believe that companies should generally report a net pension liability as noncurrent. Because an underfunded pension plan is presented net of the plan assets, the net pension liability includes both current funding requirements and the plan assets available to offset those requirements. If plan assets are sufficient to offset the current funding requirements, we believe that it would be inappropriate to classify a portion of the net pension liability as current.
2. In paragraphs C4 and C5 of Appendix C and paragraphs D4 and D5 of Appendix D, the Board states that the illustrations in FAS 87 and FAS 106 will not be updated to reflect the provisions of the proposed standard, owing to the extensive changes that would be required. We recommend that the Board reconsider this decision. These illustrations are still useful to, and used regularly by, financial statement preparers and auditors.
3. We recommend that the Board provide clarifying guidance on the definition of a "public" and "nonpublic" entity. The definition of "public entity" provided in paragraph 14 of the proposed standard includes entities that have issued debt securities traded in public markets, while paragraph 21 of the proposed standard implies that all not-for-profit organizations (NFPs) are nonpublic entities. This ambiguity creates significant implementation problems for NFPs that issue tax-exempt debt securities that are traded in the public markets. For example, some NFPs will be uncertain as to which effective date applies to them as well as which disclosure requirements they need to comply with in FAS 132(R), *Employers' Disclosures about Pensions and Other Postretirement Benefits*. We recommend that the definitions of public and nonpublic entity in the proposed standard be revised to reflect the Board's decisions in its proposed FSP FAS 126-a, "Definition of a Public Entity in Conduit Borrowing Arrangements."
4. Footnote 6 in Appendix C states that amortization of a net *unrecognized* loss results in an increase in net periodic pension cost. We believe that it should read as follows: "amortization of a net ~~unrecognized~~ loss results in an increase in net periodic pension cost." Under the provisions of the proposed standard, net gains and losses would be recognized in other comprehensive income and, therefore, would no longer be unrecognized.
5. Paragraph 103C in Appendix D duplicates paragraph 103B and should be deleted.

Appendix I

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Supplemental Information on the Potential Effects of Retrospective Application

The following examples demonstrate the potential effect of retrospective application on the accounting for plan curtailments, settlements, and amendments in prior periods.

Example 1: Plan Curtailment

Company A has a defined benefit postretirement medical plan.

At 12/31/x1, one year after adopting FAS 106, the transition obligation which was originally \$1,000 is now \$900, and will be amortized on a straight-line basis over the remaining nine years. At 12/31/x1, the net loss in the plan is \$200. A curtailment occurs at 12/31/x1 resulting in a \$300 reduction in the APBO and the accelerated recognition of \$400 of the transition obligation. In accordance with FAS 88, Company A offsets the \$300 reduction in APBO by the net losses of \$200 and nets the difference of \$100 against the \$400 in accelerated recognition of the transition obligation. Therefore, Company A records a curtailment loss of \$300 at 12/31/x1.

However, under the proposed standard, Company A will not have a transition obligation at 12/31/x1 to factor into the curtailment accounting and as a result will report a \$100 curtailment gain instead of a \$300 curtailment loss. The recognition of this gain would occur when the employees terminate. For purposes of illustration, assume that the employees do not terminate until 20x2. Not only would the reported effect of the curtailment be dramatically different, the timing of recognition would change as well. In addition, Company A would need to reverse the amortization of the remaining transition obligation recognized in subsequent financial statements.

Example 2: Plan Settlement

Company A sponsors a defined benefit pension plan.

At 12/31/x1, one year after adopting FAS 87, the transition asset, which was originally \$1,000 is now \$900 and will be amortized on a straight-line basis over the remaining nine years. At 12/31/x1 the net loss in the plan is \$300. A settlement occurs at 12/31/x1 representing 33 percent of the PBO. In accordance with FAS 88, Company A recognizes 33 percent of the net loss ($\$300 * 33\% = \100), and 33 percent of the transition asset ($\$900 * 33\% = \300), resulting in a net settlement gain of \$200. Therefore, Company A records a settlement gain of \$200 at 12/31/x1.

However, under the proposed standard, Company A would not have a transition asset at 12/31/x1 to factor in the settlement accounting, and as a result would have a \$100 settlement loss instead of a \$200 settlement gain. In addition, Company A would need to reverse the amortization of the remaining transition asset in subsequent financial statements.

Example 3: Plan Amendment

Company A has a defined benefit postretirement medical plan.

At 12/31/x1, one year after adopting FAS 106, the transition obligation, which was originally \$1,000, is now \$900 and will be amortized on a straight-line basis over the remaining nine years. A negative plan

amendment is adopted at 12/31/x1 resulting in a \$300 reduction in APBO. Therefore, Company A reduces its transition obligation to \$600, which it then amortizes straight-line over the nine remaining years, resulting in a \$67/year expense for the amortization of the transition obligation for the next nine years.

However, under the proposed standard, Company A will need to revise its periodic benefit cost to reflect the elimination of the annual \$67 amortization charge related to the transition obligation, as well as include a annual \$30 amortization benefit related to the negative plan amendment amortized over ten years. The negative amortization may need to be offset against subsequent positive amendments further changing reported earnings.