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# Via E-mail

Technical Director – File Reference No. 1025-300 Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116 Via email to: director@fasb.org



LETTER OF COMMENT NO. 98

Re:

File Reference No. 1025-300 – Comments on 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)"

#### **Executive Summary**

We respectfully request that the FASB consider the impact on the business and financial results of companies whose equity securities are issued and redeemed at book value ("book value companies") before adopting its 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)" (the "Proposed Standard"). Adoption of the Proposed Standard would cause considerable volatility in the share price of book value companies and place them at a competitive disadvantage in the marketplace.

Unified empathizes with the concerns voiced to the FASB by the SEC, PBGC and elements of the investment community regarding underfunded benefit obligations. Unified supports and agrees with the FASB's response to these concerns by clearly articulating the funding level of postretirement obligations on the face of the sponsoring company's financial statements. However, the offsetting entry to shareholders' equity will place a particular hardship on book value companies. As noted under Issue 3(b) of the Proposed Standard, the FASB indicates that "nonpublic entities (and possibly some public entities) may have contractual arrangements based on financial statement amounts, such as book value," and is "interested in gathering information for use in determining the time required to implement" the Proposed Standard for such entities. We respectfully submit that:

 As drafted, the Proposed Standard will place book value companies, including cooperatives, at a competitive disadvantage by potentially reducing Member share

value. As a result, prospective and existing Members may choose to purchase goods and services from alternate suppliers.

- A consequence of the Proposed Standard is that companies whose share values are market-based ("publicly traded") are treated differently than those based on book value. Publicly traded companies' valuations are primarily driven by their income statement and cash flows, which are not substantially impacted by this Proposed Standard. The traded value of the shares of book value companies, however, will be immediately impacted by the full amount of the adjustment upon implementation.
- The Proposed Standard will introduce significant volatility into book value companies' share value due to its requirement to record the offsetting adjustment to the benefit obligation as a component of shareholders' equity. Slight changes in the discount rate, or a temporary dip or spike in the return on investments held by benefit trusts, can have a significant impact on shareholders' equity. Much of this volatility will therefore be due to factors outside of the sponsoring company's base operations.
- The possibility of changing at some future date from using the projected benefit obligation ("PBO") to some other means of measuring the pension liability would introduce an additional level of volatility in the year such change is effective.
- Retrospective application, as required in the Proposed Standard, presents a unique
  and very troublesome issue to book value companies and their shareholders.
  Shares would be revalued as of their original issue date to a book value that
  differs from their historical issuance price. This would create numerous questions
  among existing shareholders.
- The Proposed Standard may force companies to eliminate or curtail pension and
  postretirement benefits. Cooperatives and book value companies often offer
  enhanced pension and postretirement benefits in lieu of stock options. Such
  changes in benefit structure would have a negative effect on employees.
- It is not appropriate to record an additional liability for unfunded postretirement benefits that are unilaterally cancelable by the companies sponsoring such benefits.
- At their discretion, cooperatives may distribute a significant portion of their earnings to their shareholders in the form of patronage dividends. Accordingly, the retained earnings of cooperatives are typically much lower than publicly traded companies of similar size. Vendors and other trading partners who look at the balance sheet of a cooperative whose shareholders' equity has been adjusted to reflect an underfunded benefit plan may conclude that the cooperative is not as

financially sound as a comparable publicly traded company. This may result in less favorable pricing or terms for the cooperative as compared to the publicly traded company.

## **Background**

Unified Western Grocers, Inc. ("Unified" or "the Company") is a retailer-owned, grocery wholesale cooperative serving supermarket operators located primarily in the western United States and the South Pacific. For purposes of the Proposed Standard, Unified is a public entity (an "SEC reporting company") required to file reports with the Securities and Exchange Commission (the "SEC") under Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (the "Exchange Act"), but whose debt and equity securities are not traded on a stock exchange or in the over-the-counter market. Unified was organized in 1922 and operates as a cooperative for tax purposes. Unified's customers include its owners ("Members") and non-owners ("non-members"). Unified's Members are primarily independent grocers that range in size from single store operators to regional supermarket chains. To be able to receive the benefits of membership in the cooperative, each Member is required to hold a specified number of Class A and B Shares of the Company's common stock.

Each Class A and B Share held by a Member has an issuance value equal to the book value per share of the Company's outstanding shares at the close of the last fiscal year end prior to the issuance of such Shares.

All purchases and sales of stock are based on book value and not driven by outside market forces.

Unified issues and redeems Class A and Class B Shares based on book value per share. Generally speaking, the book value per share of Class A and B Shares is determined as total shareholders' equity, divided by the number of Class A and B Shares outstanding at fiscal year end.

Unified's capital stock can only be held by Members, cannot be transferred without the consent of the Company's Board of Directors (the "Company's Board") and is subject to redemption as specified in the Articles of Incorporation and Bylaws. All redemptions occur solely at the discretion of the Company's Board, which has the right to amend the Company's redemption policy at any time. Accordingly, *Unified's capital stock*, *like that of other cooperatives*, cannot be publicly traded and has limited liquidity.

### Discussion

## Impact on Share Value - Volatility

Phase 1 of the Proposed Standard seeks to improve financial statement transparency by placing the overfunded or underfunded pension and postretirement obligations on the statement of financial position. However, the offsetting charge to shareholders' equity is

particularly harmful to book value companies such as cooperatives. Were the Proposed Standard to be in effect as of Unified's prior fiscal year end of October 1, 2005, the impact of charging shareholders' equity for Unified's underfunded benefit obligations would have been to reduce book value per share by 12%. Although market value companies may never detect a change in their stock prices as a result of implementing the Proposed Standard, Unified and similar book value companies would be forced to immediately recognize this impact on their equity share values.

We are cognizant that volatility exists in the normal business cycle. We believe that accounting principles should generally require such volatility to be recognized in the period that it occurs. However, we believe the share value of book value companies should not be subjected to volatility that results from short-term market fluctuations relative to pension and other postretirement benefits. Most decisions that are made relative to pension and other postretirement benefit plans are made with a view toward long-term trends.

Using Unified's 2005 actuarial data, the Proposed Standard would have resulted in a net charge of \$15.4 million to shareholders' equity. The discount rate used in computing this charge was 5.50%. The discount rate used in 2005 represented a 0.75% decrease over the 6.25% discount rate used in 2004. If all other actuarial assumptions were held constant (and the value of our investments did not change), using a 6.25% discount rate in 2005 would have resulted in a \$6.0 million net charge to shareholders' equity; a \$9.4 million lower reduction to our shareholders' equity. Stated differently, a 0.75% change in the discount rate would have a 7.5% impact on our book value per share. While we have not yet commenced our actuarial valuation for 2006, early indications are that the discount rate will increase to a level that is near that used in our 2004 valuation. Under this scenario, Members who purchased shares in the Company during 2005 would have benefited from the lower share price resulting from a temporary decline in a rate that is unrelated to our long-term investment strategy or the base operations of the Company.

Due to the volatility inherent in adjusting benefit obligations through shareholders' equity, Unified's Members may be unfairly penalized or benefited by the timing of their entrance to or exit from the Company. In addition, the reduction in share value would negatively impact the value of our Members' shareholdings and potentially would create deficiencies in required minimum levels of ownership. An unintended consequence of the Proposed Standard may be that potential or existing Members may choose an alternative form of supply, thereby putting Unified and similarly positioned companies at a competitive disadvantage in the marketplace.

The Company believes that a more appropriate treatment of the offset to recording the benefit obligation would be to establish a deferred charge or credit on the balance sheet, similar to intangible assets recorded for prior service costs in current practice. Such a deferred charge or credit could be accounted for in the same manner as currently prescribed for intangible pension assets under SFAS No. 87. This treatment would allow changes in prior service costs and actuarial gains or losses to be recognized as components of net periodic pension cost and

provide a consistent, fair distribution of costs over the multiple generations of the Company's membership. Since the liability represents a future benefit obligation, a deferred charge or credit would serve the same purpose as a charge (or credit) to shareholders' equity. Expense would be recognized as a component of net periodic pension cost and ultimately be recognized in equity. This would mitigate the negative impact caused by the reduction in equity resulting from a charge to shareholders' equity for cooperatives and book value companies who may already be thinly capitalized.

A second alternative the FASB might consider is reporting accumulated other comprehensive income ("OCI") in a section between long-term liabilities and shareholders' equity. In so doing, long-term deferred charges or credits that will adjust future periods' statements of operations may be isolated and reported upon, without the potentially punitive impacts that will occur to book value companies if such components are included in shareholders' equity and thereby impact book value. Such an alternative would also serve to mitigate the impact of other pronouncements whose fair value or mark-to-market adjustments temporarily reside in OCI until final recognition occurs in the income statement.

One further alternative the FASB might consider would be to report accumulated OCI in a separate caption following shareholders' equity, such that the components of OCI are isolated as discussed above, but allowing cooperative members' equity to be reported exclusive of OCI adjustments.

Being sensitive to the differing needs of investors in publicly traded companies versus the needs of investors in book value companies, the Board may also want to consider allowing companies whose stock is traded at book value to record the OCI charge using one of the methods described above.

## Impact on Value of Shares Traded in Years Prior to Implementation

Unified is also concerned with implementation issues raised by the Proposed Standard. We believe the issue of retrospective application presents a unique and troublesome challenge to book value companies and their shareholders. Retrospective application would require Unified and similar companies to recalculate book value per share as if the Proposed Standard had been in effect for all prior years disclosed. All share issuances and redemptions by Unified occur solely at the discretion of the Company's Board. The Company's issuance and redemption policies currently provide that Class A Shares and Class B Shares be issued or redeemed at the book value per share of the Company at the close of the last fiscal year end prior to issuance or redemption. Retrospective determination of prior years' book value would complicate the issuance and redemption process by causing the value of previously traded shares to come into question. Accordingly, Unified believes the proposed requirement of retrospective application should be amended to permit pro-forma footnote disclosure of the impact on prior years' financial statements.

#### Employee Recruitment & Retention - Competitive Challenge

A further competitive issue for book value companies is attracting and retaining a well-qualified and competent employee base. While this issue applies to all companies in today's business environment, it is particularly difficult for cooperatives and book value companies such as Unified who, because of their structure, are not able to offer equity based stock compensation. On the contrary, benefit packages that include pension and postretirement benefits are offered in lieu of equity based compensation. The impact of the Proposed Standard on book value companies may cause them to consider freezing, reducing or eliminating such benefits due to the negative effect of the OCI charge on share value, creating additional competitive disadvantages in the marketplace.

#### Vendor Perceptions

As mentioned earlier, cooperatives inherently tend to have lower equity than market value companies. This is typically integral to the design of the cooperative's capital structure, wherein the cooperative endeavors to facilitate the return of capital to owners, providing funds for the owners to expand their businesses. As the owners' businesses expand, their purchases through the cooperative will increase, enhancing the strength of the cooperative. Accordingly, a direct charge to shareholders' equity for underfunded benefit obligations could have a greater percentage impact on the equity of cooperatives, as a group, than the impact on companies in similar industries who do not operate under the cooperative structure. Vendors who are selling goods and services to cooperatives and non-book value companies could conclude they must offer less advantageous pricing and terms to cooperatives.

#### Other Technical Issues

Unified respectfully requests that the FASB address certain technical issues relative to the Proposed Standard that may have a greater impact on book value companies than on publicly traded companies. We are mindful that the Board has researched and thought about these issues in great detail; however, we would like to point out how the conclusions reached in the Proposed Standard would have a greater impact on book value companies than on publicly traded companies. Specifically, Unified has concerns with respect to the following:

• FASB's proposed use of the PBO instead of the accumulated benefit obligation ("ABO") to measure the balance sheet pension liability is not consistent with other accounting principles that outline a methodology for recording future obligations. A pension plan's PBO is an actuarially determined amount based on the sponsoring company's best estimate of future compensation increases. Therefore, the PBO may have little relation to the actual amount necessary to settle plan liabilities as of any specific date. Changes in assumptions regarding future compensation increases would have an immediate and possibly significant impact on the share value of book value companies.

• Under current accounting, balance sheet adjustments are made relative to the ABO. Recognition of the ABO would be a reasonable extension of pension accounting under FAS 87. Currently, the excess, if any, of the value of the ABO over the fair value of assets is recognized in the balance sheet in certain cases. We believe it would be an appropriate extension of current practice to require the difference between ABO and fair value of assets to be recorded as the benefit obligation. Under the Proposed Standard, basing the balance sheet on the PBO appears to be a fundamental shift in pension accounting theory that changes accounting measurement of benefit obligations before the FASB has addressed measurement issues.

We disagree with the arguments presented in paragraph B17 of the Proposed Standard, specifically that excluding future compensation from the liability (by using the ABO) and including it in the calculation of net periodic pension cost are conflicting positions and therefore not appropriate. It is very likely that plan sponsors would likely not have a problem with net periodic pension cost being determined based on accrued compensation to date.

Additionally, we disagree that using the ABO would have any impact on the development of the discount rate, particularly given the fact that the methodology proposed in paragraph 44 would be applied to the obligation for benefits earned to date. The fair market value of that obligation, as determined in the marketplace between plan sponsors and insurers, is a function of the actual rates in the marketplace, not the hypothetical rate discussed in certain paragraphs of FAS 87 referenced by the discussion in paragraph B17 of the Proposed Standard.

In any case, the FASB's discussion highlights the fact that the deliberation of PBO versus ABO scheduled for Phase 2 should be resolved prior to implementing the proposed balance sheet adjustment in Phase 1. Defined benefit plan sponsors currently must recognize unfunded ABO on their balance sheets. If the FASB determines that the ABO is the proper measure of pension liability in Phase 2, temporarily requiring firms to increase the recognized liability from ABO to PBO in Phase 1 and then reversing that decision at a later point in time would add an additional element of uncertainty and volatility to the financial statements, particularly for book value companies.

• An inherent flaw in current accounting is the concept of discounting a benefit liability at a rate developed based on a hypothetical portfolio of high quality debt instruments that will be settled by invested assets that will grow at an equity market rate. FASB should allow for a discount rate that more closely matches the expected return on the plan's assets. In our instance, the rate used to discount the liability was 5.50% at June 30, 2005, while our actual rate of

return on plan assets over the past ten years averaged 9.8%. Using the rates on securities that would be purchased if a plan were to be terminated or settled is inconsistent with the going concern concept. Unless we have made a decision to terminate or settle our plan, it would be more reasonable to use the historical long-term rate of return on the asset classes that are used to fund those obligations.

- An inconsistency may exist between the differing treatments for postretirement medical plans and defined benefit pension plans. Postretirement medical plans are usually unilaterally cancelable, but would be recorded in the financial statements as if the plan is going to continue indefinitely. Contrast that with defined benefit pension plans that usually have an indefinite life span (and can only be cancelled if all accumulated benefits are liquidated), but would be recorded in the financial statements as if the plan were expected to be liquidated.
- It is not appropriate to record an additional liability for unfunded postretirement benefits that are unilaterally cancelable by companies. We recommend exploring alternative measures of liability for other postretirement benefits to reflect the reality that such benefits are not guaranteed by the sponsor to the same extent as pension benefits, if at all.

# Conclusions

In consideration of the issues discussed in the foregoing, Unified respectfully requests the FASB to amend its Proposed Standard to address the following:

We concur in the interest of transparency that pension obligations should be adjusted to fully recognize the funded liability for which companies are contractually obligated. However, we recommend that the FASB revise the Proposed Standard such that the offsetting charge or credit for adjusting the overfunded or underfunded benefit obligation be accounted for as a deferred charge or credit in the same manner as currently prescribed for intangible pension assets under SFAS No. 87, whereby changes in prior service costs and actuarial gains or losses are recognized as components of net periodic pension cost. Alternatively, accumulated OCI items could be grouped in a separate section of the balance sheet between liabilities and equity or grouped under a separate caption immediately following shareholders' equity on the balance sheet.

Second, revise the Proposed Standard to change the measurement base for adjusting the overfunded or underfunded benefit obligation to the ABO. Alternatively, at a minimum, delay implementation of the Proposed Standard until the FASB can deliberate the proper use of PBO versus ABO presently scheduled for Phase 2, thereby avoiding the volatility caused by potentially changing the measurement after companies have implemented the Proposed Standard based on PBO.

Third, revise the Proposed Standard to exclude requiring adjustment of the liability for postretirement benefits if the obligation is unilaterally cancelable at the discretion of the provider.

Fourth, retrospective application should be amended to permit pro-forma footnote disclosure of the impact on prior years' financial statements.

Finally, we recommend the Proposed Standard not be implemented until the various analyses scheduled for Phase 2 of the FASB project are completed. Analyses that may impact the financial statements, such as determining the impact of multi-employer plans, should be completed prior to implementation in order to avoid a potential situation where share value is negatively impacted in Phase 1 and then subsequently impacted again in Phase 2. This would allow cooperatives and book value companies to avoid unnecessary disruption to their members and shareholders, who often participate in our form of business to benefit from a stable cost structure and distribution of expenses. Furthermore, financial statement users would not be disadvantaged by combining Phase 1 and Phase 2 prior to implementation, since all of the information necessary to understand the impact of underfunded or overfunded benefit obligations is presently included in the financial statement footnotes.

If you have any questions concerning any aspect of the foregoing, please do not hesitate to contact me directly at (323) 264-5200 (ext. 4281).

Very truly yours,

Richard J. Martin,

Executive Vice President,

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Finance & Administration,

and Chief Financial Officer