



---

# National Grocers Association

---

May 31, 2006



LETTER OF COMMENT NO. 183

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

RE: Exposure Draft of 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)

File Reference Number: 1025-300

Dear Sir or Madam:

The National Grocers Association (N.G.A.) appreciates this opportunity to comment on the Proposed Statement issued by the Financial Accounting Standards Board (FASB or the "Board") to amend FASB Statements No. 87, 88, 106 and 132(R)(the "Proposed Statement").

N.G.A. is the national trade association that represents exclusively the interests of independent community-focused grocery retailers and wholesalers. An independent, community-focused retailer is a privately owned or controlled food retail company operating in a variety of formats. Most independent operators are serviced by wholesale distributors, while others may be partially or fully self-distributing. A few are publicly traded, but with controlling shares held by the family and others are employee owned. Independents are the true entrepreneurs of the grocery industry and are dedicated to their customers, associates, and communities. N.G.A. members include retail and wholesale grocers. The wholesale grocers include both voluntary wholesalers and retailer-owned cooperatives. Our retailer-owned cooperative members generally issue and redeem equity securities at book value ("book value companies"). N.G.A. retail and wholesale members accounted for \$200 billion of U.S. grocery sales last year.

N.G.A. believes in FASB's goal of providing transparency as to the funded status of defined benefit pension plans or other postretirement benefit plans. However, we wish for the Board to strongly consider some modifications to the Exposure Draft which contemplate the following: (1) the use of projected benefit obligation (PBO) rather than

accumulated benefit obligation (ABO) is not the proper measure of the market value of a company's pension liabilities and (2) the disparate impact of the debit side of the entry (in the case of underfunded plans) to book value companies such as retailer-owned grocery cooperatives. **Based on a preliminary analysis, it appears that equity levels for our retailer-owned cooperative members could be reduced between 10% and 25% if the Proposed Statement were implemented.**

Due to the sweeping nature of the Proposed Statement, we would encourage FASB to delay the effective date to give adequate time for affected organizations to comply. We recommend that the Proposed Statement not be implemented until the various analyses scheduled for Phase II of the FASB project are completed. The conceptual analysis to determine the proper measurement of benefit obligation—which we believe is the ABO—should be complete before companies are required to adjust their balance sheets.

We have even greater concerns about the implications of Phase II—primarily relating to the treatment of multiemployer pension plan liabilities and postretirement health plans. Analyses that may impact the financial statements, such as determining the impact of multiemployer pension plans should be completed prior to implementation in order to avoid a potential situation where share value is negatively impacted in Phase I and then subsequently impacted again in Phase II. Since this is a two-phase, multi-year review, we suggest incorporating consideration of the Proposed Statement into the multi-year review to provide interested parties the time they need to determine and inform FASB of the impact of these changes on their businesses and pension and other postretirement benefit plans.

## **I. The Use of PBO is Not an Accurate Reflection of the Market Value of a Company's Pension Liabilities, FASB Should Use ABO Instead**

### ***A. ABO is the More Relevant Measure than the PBO***

Including future salary levels in pension liabilities does not provide shareholders with the most relevant information about the current value of their obligations. Balance sheet liabilities presumably represent shareholders' economic obligations as of the statement date. Unless an obligation to increase future pay levels exists, beyond the level of competitive rates, there appears to be no justification for including the value of future salary increases directly in the balance sheet. The plan, if not amended, will pay benefits indexed to pay but the plan sponsor makes no commitment to increase the pay itself. An employer that commits itself to providing competitive total compensation has not thereby committed itself to recognizing future pay increases by offering a defined-benefit plan. PBO accounting would force recognition of future salary increases for sponsors of defined-benefit plans but not otherwise, a distinction for which there is no justification.

From an economics perspective, it is not clear that the PBO is relevant for any aspect of measurement. Consider what happens with PBO pricing. The employer will have "paid" more than the employee will have "received" for a year of service. The employer may freeze or terminate the plan and take a curtailment gain. This moral

hazard, from the employee's point of view is only avoidable if there is an enforceable multi-period contract between the employer and the employee. Except in the government sector and in some collectively bargained plans (which usually are not salary-based), recent experience confirms that such multi-period contracts don't exist or are not enforceable for the vast majority of employees. Thus, there is typically no basis for employees to assume that they will be entitled to anything more than their accumulated benefit and, if they do so, they will have accepted lower current pay in return for a rescindable promise of their employer.

As PBO includes expected future pay increases, it results in a substantially larger liability than ABO. Using PBO to determine the funded status of benefit liabilities produces a liability that is greatly overstated. The impact of changes in actuarial assumptions will thus be magnified using a PBO liability.

Furthermore, the PBO cannot be settled while the ABO can. No insurance company will accept an obligation to pay benefits based on future pay levels to be set arbitrarily by the annuity purchaser. How can there be a market value of a liability when the marketplace will not value it? The lack of marketability of the excess PBO over ABO is a strong indication of the lack of economic substance to the PBO.

### ***B. Use of PBO May Drive Employers Away from Defined Benefit Plans***

Defined benefit retirement plan sponsors are providing highly-valued financial security programs for their employees. Constant change and uncertainty around the accounting for these plans do factor into the highly-publicized trend of employers deciding to move away from these programs.

Immediately requiring the PBO in Phase I is likely to result in artificially increased liabilities for many plan sponsors, which will discourage the continuation of defined benefit pension plans. FASB should strive to ensure disclosure while minimizing the incentive to freeze, reduce or eliminate defined benefit pension plans. This proposal has far reaching public policy implications that should be thoroughly vetted in the public policy arena before being implemented. A slower and more deliberative process for implementation on the part of FASB would permit more interested parties to provide input in the debate, such as organizations representing seniors, retirees and workers.

## **II. FASB Must Carefully Contemplate the Unique Challenges Presented to Cooperatives by the Proposed Statement**

### ***A. Background***

We encourage FASB—as it has done in other instances—to recognize the unique structure of cooperatives when implementing standards. The retailer-owners of grocery cooperatives are often family-owned, independent business that already face an unlevel playing field when competing with investor-owned companies. For example, federal tax policy severely penalizes family-owned businesses—the death tax can claim nearly half of the value of their assets which sadly forces many family-owned businesses to liquidate

an ongoing enterprise at its weakest moment while their larger competitors face no such penalty. Independent grocers face a difficult competitive environment in a climate where antitrust laws are not enforced and must increasingly compete with supercenters—who often have an advantage in obtaining tax abatements and other benefits from state and local governments.

N.G.A. has as members most of the nation's retailer-owned grocery cooperatives. The cooperative structure allows independent businesses to combine their buying and advertising power which helps to level the playing field for independent businesses and benefits consumers with lower prices and a diversified marketplace from which to shop.

Retailer-owned grocery cooperatives tend to obtain all of their equity from their member-owners. Equity holders in most enterprises make an equity investment of money with the expectation of securing income or profit from the entrepreneurial or managerial efforts of others. Cooperatives, on the other hand, are organized for the purpose of adding value to the individual efforts of the equity holder such as aggregating their buying and advertising power.

Retailer-owned grocery cooperatives are unique in that they are businesses, yet they operate on a not-for-profit basis but still must apply generally accepted accounting principles that are applicable to all enterprises in general. In recent years, the evolution of accounting standards towards an emphasis on investor owned companies has resulted in the potential for increased and disproportionate impacts to book value companies such as retailer-owned grocery cooperatives. Indeed, it is not unfathomable to think that retailer-owned grocery cooperatives may eventually be faced with the possibility that they could be receiving going concern opinions from their auditors, not because business prospects had changed or deteriorated in any way, but because of the application of noncash accounting standards which reduced or eliminated equity levels or resulted in technical defaults under existing loan or contractual covenants.

The offsetting entry to shareholders' equity required by the Proposed Statement will place a particular hardship on book value companies. A number of our member retailer-owned grocery cooperatives have defined-benefit pension plans, many of which are unfunded or only partially funded. Based on a preliminary analysis, if the Proposed Statement were implemented it appears that their equity levels could be reduced between 10% and 25%.

## ***B. Challenges Cooperatives Face Under the Proposed Statement***

### ***1. Erosion in Credit Quality for Book Value Entities***

If the Exposure Draft is implemented as proposed, it may have a significant impact on the operations of cooperatives by affecting their relationships with vendors. 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 examine 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 publicly traded company. Retailer-owned grocery cooperatives would be compelled to attempt to convince vendors that reduction in equity levels as a result of the debit to other comprehensive income (OCI) did not represent immediate erosion in the credit quality of the cooperative.

While lenders may understand generally accepted accounting principles, it is unlikely that many vendors will fully comprehend the reasons behind the deterioration in financial statements, placing such entities at a distinct competitive disadvantage with investor owned entities. Retailer-owned grocery cooperatives may be faced with less favorable credit terms or elimination of credit entirely not because any element of the cooperative's business had changed, but because of the application of accounting standards which reduced equity levels yet did not mandate the use of cash from current operations. *This may result in less favorable pricing or terms for the cooperative as compared to the publicly traded company.*

## ***2. Economic Volatility Disproportionately Impacts Book Value Companies***

Retail-owned grocery cooperatives using book valuations will be affected disproportionately by the Proposed Statement. FASB's migration from historical basis financial statements to fair value financial statements, and resulting offsets to equity, will cause disparate harm to book value companies and result in inter-generational inequities among shareholders in cooperatives. N.G.A. comprehends that volatility exists in the normal business cycle and that accounting principles should generally require such volatility to be recognized in the period that it occurs. However, subjecting the share value of book value companies to the volatility resulting from short-term market fluctuations relative to pension and other postretirement benefits will have disparate impacts on cooperatives. N.G.A. does not believe that cooperatives should be subject to these fluctuations as such. Most decisions that are made relative to pension and other postretirement benefit plans are made with a view toward long-term trends. This may push potential and existing members of cooperatives to non-coop suppliers as they see their equity decline. This poses a significant challenge to the cooperative channel of doing business.

Interest rate and stock market movements will significantly impact book value. Furthermore, cooperative members may be unfairly penalized or benefited by the timing of their entrance or exit from cooperatives because on a particular day, the value of the equity is the book value—the shares are not traded or moved by market forces. Conversely many other factors determine equity values for market value companies. The Exposure Draft will make it difficult to maintain consistent, fair distribution of costs over different generations of membership. Changes in actuarial assumptions (previously deferred as “unrecognized actuarial gains and losses”) and plan amendments (previously deferred as “unrecognized prior service cost”) will immediately impact shareholders' equity. Shareholders' equity will no longer benefit by having gains and losses from changes in actuarial assumptions and plan amendments spread over future years. This makes it extremely difficult for the management and board of directors of cooperatives and book value companies to accomplish their fiduciary responsibility of providing an

equal “marketplace” for their members by maintaining a consistent cost structure and spreading the expenses of the cooperative as fairly as possible over the membership base.

In book value companies the valuation is the shareholder equity itself. In publicly-traded companies, valuations are primarily driven by their income statement and cash flows, which are not substantially impacted by the Exposure Draft. The traded value of the shares of book value companies, however, will be immediately impacted by the full amount of the adjustment on implementation.

### ***3. Exposure Draft May Lead to a Reduction in Defined Benefit Plan Offerings***

Another aspect of the Proposed Statement that impacts cooperatives in a disparate manner is the fact that it may force companies to eliminate pension and postretirement benefits. Many cooperatives offer such benefits in lieu of stock options in order to attract employees. It is also important to consider the implications of the Proposed Statement in accelerating the trend away from defined benefit pensions and other postretirement plans. It may encourage many cooperatives to curtail or abandon benefits thereby punishing thousands of employees of cooperatives for no other reason than an accounting rule change.

#### ***C. Alternative Solutions to the Proposed Statement***

One suggestion that N.G.A. proposes as a possible solution to the problem of disproportionate impact upon book value companies such as retailer-owned grocery cooperatives could be an alternative treatment of the debit side of the entry which would recognize the underfunded pension or postretirement benefit plan. We would propose that instead of a debit to OCI, FASB could allow cooperatives to record the debit on the asset side of the statement of financial position as a deferred charge. Since the liability represents a future liability, the deferred charge could serve the same function as the entry to OCI: that is, costs could be recycled out of the deferred charge as they were recognized in net periodic benefit cost and ultimately be recognized in the equity section of the statement of financial position. This would mitigate the collateral damage that could be caused by a serious reduction in equity that would result from a debit to OCI for entities such as retailer-owned grocery cooperatives.

A second alternative FASB should consider is reporting accumulated 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 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 to OCI adjustments.

***D. The Challenge of Retrospective Application***

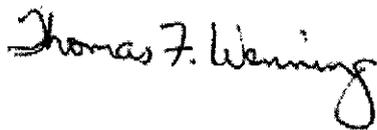
The retrospective application of the Proposed Statement is very troubling for book value companies and their shareholders. Retrospective application would change share values for prior years as if the Proposed Statement had been in effect for all prior years disclosed. This would complicate the issuance and redemption process by causing the value of previously traded shares to come into question. Recording of pension and postretirement obligations were not an issue in the past as deferral and amortization of actuarial gains and losses (and exclusion from OCI) on benefit plans minimized the impact on shareholders. FASB should reconsider implementing this aspect of the Proposed Statement.

**III. Conclusion**

N.G.A. believes in the goal of transparency in financial reporting for the interests of those entities that supply debt and equity capital that may not have access to the same information which is otherwise available to management. PBO is not an accurate reflection of the market value of a company's pension liabilities and will not serve to enhance transparency in reporting. As FASB has done so in the past, it should carefully consider the implications of Accounting Standards to cooperative enterprises to ensure that they are not unfairly penalized merely because of their structure. To ensure equitable treatment of cooperative businesses, N.G.A. encourages FASB to amend the Proposed Statement to incorporate the alternatives presented in this document.

We appreciate the opportunity to comment on this important matter.

Sincerely,



Thomas F. Wenning  
Senior Vice President and General Counsel



Erik R. Lieberman  
Director of Governmental Affairs