



PCPS

PRIVATE COMPANIES PRACTICE SECTION

June 6, 2006

Mr. Lawrence Smith, CPA
Technical Director—File Reference No. 1025-300
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116



LETTER OF COMMENT NO. 224

Re: March 31, 2006 FASB Exposure Draft (ED) of a Proposed Statement of Financial Accounting Standards (SFAS), *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R)*

Dear Mr. Smith:

One of the objectives that the Council of the American Institute of Certified Public Accountants (AICPA) established for the PCPS Executive Committee is to act as an advocate for all local and regional firms and represent those firms' interests on professional issues, primarily through the Technical Issues Committee (TIC). This communication is in accordance with that objective. These comments, however, do not necessarily reflect the positions of the AICPA.

TIC has reviewed the ED and is providing the following comments for your consideration.

GENERAL COMMENTS

Phase I Issues

TIC believes the proposed ED represents a significant improvement in financial reporting over current standards and applauds the Board for its efforts.

However, TIC strongly believes the effective date of the final standard should be deferred for two years for nonpublic entities. A delayed effective date is necessary to recognize the distinct risks and conditions faced by nonpublic entities that have defined benefit plans and one or more contractual or regulatory restrictions that provide for minimum net worth requirements or other thresholds based on certain financial statement metrics. Users of nonpublic entities' financial statements typically address these thresholds and metrics annually based on generally accepted accounting principles as currently enacted. An extended effective date for TIC's constituency would prevent economic hardship for a number of entities without adverse consequences for users of nonpublic entities' financial





statements.

Phase II Issues

TIC understands the Board's desire to defer consideration of measurement issues to Phase II of this project and looks forward to commenting at a later date on alternatives to the current method of calculating the benefit obligation and the selection of discount rates.

Specific comments on these and other issues are presented below.

SPECIFIC COMMENTS ON ISSUES PRESENTED

Costs of Implementing the Proposed Statement's Requirement to Recognize a Plan's Overfunded or Underfunded Status in the Employer's Statement of Financial Position

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.)

TIC agrees that the financial statement preparation and auditing costs of implementing this ED would not be significant. However, TIC is concerned that, absent a longer implementation period, there could be significant incidental costs to nonpublic companies, including costs relating to bank loan covenant waiver fees, costs associated with delayed financial statement issuance (and associated loss of business opportunities for those users seeking current financial statements), and increased professional fees associated with making changes to defined benefit plans and buy-sell agreements in a tightly compressed timeframe.

The Employer's Measurement Date

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.)

Although TIC does not object to the three-month rule above, TIC is concerned that actuaries will experience workload compression if the demand for plan valuations is significantly altered without the necessary resources to complete the work. For example, if actuaries are preparing actuarial valuations for their insurance company clients or public companies at the same time as nonpublic and not-for-profit defined benefit plan valuations, a backlog could develop that would delay the timely issuance of actuarial reports for smaller plans. If such timing issues occur, issuance of employers' financial statements could be delayed. TIC recommends that the Board have additional discussions with the actuarial community to determine the potential for this outcome before re-deliberating the measurement date issue.

Effective Dates and Transition

Recognition of the Overfunded or Underfunded Status

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.)

The Board has correctly identified a serious transition issue for nonpublic entities that have a defined benefit pension or postretirement plan along with certain contractual or regulatory requirements. Although the information necessary to comply with the new standard would be readily available, the change from disclosure to recognition creates special problems for our constituency. TIC appreciates the Board's request for comments on the length of the





transition period and is pleased to offer its views.

Based on TIC's collective experience, debt covenants in standard loan agreements would have the most pervasive impact on for-profit private entities with defined benefit plans. We disagree strongly with the Board's assumption that such arrangements could be modified easily or that creditors would make appropriate adjustments to the covenants in anticipation of this standard becoming effective. Further, retrospective application of the standard will likely cause some companies to be put into an out-of-compliance position as of the beginning of the year, with uncertain consequences.

Most covenants applicable to 2006 have already been established based on existing generally accepted accounting principles. These covenants are reviewed annually at most, and lending institutions are not likely to adjust covenants based on a FASB exposure draft. The interest rates for adjustable rate loans may often fluctuate up or down by a factor that varies, in part, with changes in the borrower's tangible net worth. Creditors have not been modifying, nor would they modify, tangible net worth calculations based on the pension disclosures in the borrower's footnotes. Therefore, a short transition period could cause many borrowers to incur double penalties—(1) higher interest rates as of their next interest rate adjustment interval following the effective date of the standard and (2) technical default of debt covenants as of year-end.

Entities incur other tangible and intangible costs when contractual or regulatory provisions are violated, including:

- Delays in issuing their financial statements
- Increased scrutiny by credit committees
- Direct fees to lenders for obtaining default waivers
- Possible adverse risk rating adjustments
- Additional audit/external accounting fees

Organizations having contractual agreements involving minimum net worth requirements and formula-based buy/sell agreements would also be adversely affected by the timing of this proposal. Two out of 14 TIC members (14%) present at our last TIC meeting had clients with defined benefit plans that also had book value buy/sell agreements. The company's solution (i.e., freezing the plan benefits) would take over a year to accomplish and would have to occur in the first half of the plan year. Accordingly, it would not be possible for this company to freeze the plan before the proposed effective date.

The other solution would be to amend the contractual arrangement. Parties to buy-sell agreements have negotiated book value multiples in these agreements based on currently enacted generally accepted accounting principles. Again, if independent counterparties are





involved, this process will likely be time-consuming and expensive and will involve attorneys and potentially litigation or other dispute resolution processes. Similarly, renegotiating these agreements will take time that the ED does not provide.

Organizations requiring surety bonds and franchisees may also fail to meet the minimum equity requirements imposed by some states (such as Alabama) for state regulation of various types of licenses. Many states won't allow a franchisee to sell if it has negative equity. Since states could not be expected to change their rules, entities affected would have to freeze their defined benefit plans. As discussed in the foregoing, these entities would likely not be able to freeze the plan prior to the effective date stated in the ED.

Therefore, TIC recommends a two-year deferral beyond the stated effective date of "fiscal years ending after December 15, 2006." A two-year period is needed to allow enough time for:

- Practitioners to advise their clients on the impact the standard will have and to guide them to an appropriate course of action.
- Clients to work with attorneys, lenders, regulators and others to renegotiate contractual agreements and potentially freeze benefits for existing defined benefit plans.

Based on the arguments presented in the ED's Basis for Conclusions, especially paragraph B12, the call for balance sheet recognition of the funded status of defined benefit plans originates primarily with regulators and users of public company financial statements. TIC does not see a similar urgency on the part of financial statement users in the private company environment and would urge the Board consider this fact as it re-deliberates the transition period for this ED.

Measurement Date

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.)



TIC appreciates the additional time provided to ensure a smooth transition to year-end measurement date reporting.

OTHER COMMENTS

Asset Impairment Issue

TIC questions whether the asset recognized for an overfunded plan is subject to impairment testing. The asset is a hybrid amount that is comprised of the fair value of the plan assets minus the benefit obligation, which is not based on fair value principles. The ED is silent on the issue. TIC believes the final standard should provide guidance for asset impairment considerations. Impairment issues are inevitable and could present practice problems since the existing impairment models are not relevant to this type of asset. TIC would recommend a valuation allowance model that would reduce the asset recognized when all or a portion of it is not likely to be realized using a “more likely than not” threshold.

Clarifications and Editorial Issues

TIC recommends that the “Objective” of the ED be revised to clarify that the proposed amendments are not applicable to multiemployer pension and postretirement benefit plans. TIC expects questions about these plans to be very common since many construction contractors have multiemployer plans. TIC noted that this information may be inferred from Appendices C and D, which list the paragraphs in FASB Statements 87, 88 and 106 that are amended by the ED. However, TIC believes this information should be placed in a more prominent location in the final standard so that the scope of the amendments may be readily understood.

TIC appreciates the opportunity to present these comments on behalf of PCPS member firms. We would be pleased to discuss our comments with you at your convenience.

Sincerely,

Edward J. Knauf, Chair
PCPS Technical Issues Committee

cc: PCPS Executive and Technical Issues Committees

