



LETTER OF COMMENT NO. 196

May 31, 2006

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

Re: File Reference No.1025-300
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)*

Dear Technical Director:

The Accounting Principles Council of the National Association of College and University Business Offices (NACUBO) thanks the Board for this opportunity to provide comments on the Exposure Draft (ED) referenced above. The council consists of experienced volunteers from member institutions who, collectively, possess a thorough knowledge of higher education accounting and reporting issues and practices.

Among our member institutions, defined contribution pensions are more common than defined benefit plans. However, many independent colleges and universities do have defined benefit plans and provide other postretirement benefits like health insurance and will thus be impacted by the changes proposed in the Exposure Draft (ED). In addition, based on data from fiscal years ending in 2000, we estimate that over half of our members from independent institutions (not-for-profit colleges and universities) consider themselves "public" entities and currently provide the lengthier disclosures required under SFAS No. 132R.

Since NACUBO member institutions are tax-exempt entities, we provide no comments with respect to the impact on deferred income taxes (Issue 3a). We have organized our other comments by the issues listed in the preface to the ED. Other comments and concerns are discussed following the specific issues upon which the Board has requested responses.

Issue 1 – Cost of Implementation

We agree that the cost related to the recognition of the unfunded postretirement obligation should be relatively minor given that almost all necessary information is available from prior years' footnote disclosures. Our concurrence is based on the presumption that improvements in the examples provided will be made in the final version of the standard (as we will discuss later). We are also presuming that voluntarily reported historical data would not need to be restated retroactively.

Issue 2 – Employer's Measurement Date and

Issue 4 – Measurement Date

Because most of our member institutions already have postretirement asset and liability measurement dates at the end of the fiscal year NACUBO supports changing the date to coincide with the employer's statement of financial position. However, NACUBO recommends a one year delay for the change in measurement date requirement. Such a delay will allow sufficient time for institutions that must change their measurement date.

Issue 3(b) – Effective Dates

The proposal's planned effective date will mean that most colleges and universities will be implementing the ED for fiscal years ending during the summer of 2007. This means that our members would be applying the proposed provisions before major corporations with years ending on December 31, 2007. We suggest the effective date for not-for-profit entities should be no sooner than the fiscal year **beginning** after December 15, 2006 – fiscal year 2008 for the vast majority of higher education institutions. We assume the pressure for quick adoption of the ED is coming from the SEC, however, for SEC "non-issuers" (not-for-profit entities and other nonpublic entities) an additional year to implement the changes would be appreciated for the following reasons:

1. The impact on college and universities will be substantial and could affect debt covenants and other agreements. We have looked at a small set of representative member institutions (both large and small). The average increase in liabilities was 13% and the average decrease in unrestricted net assets was 9%. This results in a worsening of the debt to net asset ratio by an average of 24%.
2. Most colleges and universities with public debt have debt covenants. However, we have no industry-wide data available to convey the percentage of cases in which the ED will cause covenant violations. A delay in the implementation date would help institutions inform their

creditors and other parties regarding the impact of the change. If changes are needed, it would give more time to renegotiate provisions.

3. The board also requested information regarding arrangements other than debt covenants. For colleges and universities, this would primarily be sponsored research grants and contracts. The change in accounting for postretirement obligations will not affect most Federal contracts since Federal reimbursement is generally based on the cash outflows to fund pension plan assets or to make payments on behalf of beneficiaries. However, some institutions have negotiated for reimbursement based on reported accrual-based expenses. These institutions will require renegotiation of their contracts to avoid loss of the transition obligations that will not be recognized in expense under the ED. In some cases, the transition obligations being “erased” are substantial in size and losing reimbursement would represent a severe decline in funding.

In summary, delaying the effective date for recognizing funded status has the benefit of letting institutions make all necessary changes resulting from the ED in the same time period. A requirement to implement the ED in one year but make the change in actuarial measurement date in a second year unnecessarily complicates and lengthens financial statement disclosures.

Issue 5 – Provisions for Not-for-Profit Organizations

The Board has gone to considerable effort to evaluate the impact on not-for-profit entities. We appreciate the efforts made to accommodate colleges and universities (including the example for University B released after the original exposure draft). NACUBO supports the Board’s decision to continue to use the current measurement model substantially unchanged. However, we strongly recommend that the amortization of transition costs be permitted to run their natural course (see next paragraph). With this exception, we concur with the rationale provided in ED paragraph B57.

We acknowledge that the unamortized balance related to pension plans is generally small. However, there are often substantial transition amounts related to other postretirement benefits. Eliminating transition costs is one of the more burdensome aspects of implementation for the ED. For not-for-profit entities, the statement of activities as well as the statement of functional expense (if presented) must be restated. Once the change is instituted, the accounting is fairly straight-forward. We suggest that the board consider simplifying the changes required under the ED by leaving transition gain/loss as one of the unrecognized amounts included in accumulated other comprehensive income (or its equivalent for not-for-profit entities), with the ability to amortize the transition gain/loss into operations over time.

The ED in essence recognizes any unrecognized transition amounts on the balance sheet and therefore the transition costs will never appear on the statement of

activities as expense. Letting transition cost continue their present course toward extinction would benefit institutions that have negotiated contracts on the basis of expenses. Treating the transition amount similar to prior service cost would avoid this problem.

Additional Clarification and Amendments Needed in SFAS No. 117

SFAS No. 117 should be amended to clearly define what it means to have an intermediate measure of operations that is “the functional equivalent of income from continuing operations.” We believe the guidance that NACUBO will be issuing with respect to what should be included in any “nonoperating” section of the statement of activities is fairly consistent with the Board’s intent. For example, unrealized gains and losses reported outside of the operating section are similar to the gain/loss from available for sale securities that are reported in comprehensive income. Certain gains and losses from interest rate swaps used to hedge university debt would be somewhat equivalent to the accounting for cash flow hedges permitted under SFAS No. 133. While “similar” these examples are certainly not identical. We are concerned that a carelessly written definition would have unintended consequences. For instance, having a functionally equivalent performance measure might force not-for-profit entities to follow a dual set of standards. In such cases would we have to analyze our investment portfolios between trading, held-to-maturity and available for sale securities so that only the gain/loss on available for sale securities is presented outside the operating section? The example for Hospital A implies that this would be the case. Higher Education would prefer to have other operating measures that are useful yet not necessarily the functional equivalent of income from continuing operations in a strict sense.

We realize that such clarification would require considerable revision of SFAS No. 117 – particularly paragraph 23. We would prefer to retain flexibility for reporting intermediate measures within the statement of activities that would generally place the new items related to postretirement benefit obligations on separate lines below the intermediate measure. We also suggest that appropriate language be added to SFAS No. 117 (paragraphs 26-28) to indicate that not-for-profit entities shall report certain items separately from functional expense categories including the items specified in the ED. Modifying the examples in paragraph 159 to include prior service cost and actuarial loss would also be helpful.

We also recommend adding language to paragraph 8 (or 9) in the ED to clarify that not-for-profit entities may also voluntarily report an intermediate measure of operations that is not the functional equivalent of income from continuing operations of a for-profit entity and that, generally, the prior service cost and actuarial loss provisions of the ED would not be included in such an intermediate measure of operations.

Clearly the Board does not intend to change current expense reporting. Reporting the “comprehensive income” items within total expenses (even if separate line items) seems to do just that. We suggest that the language in ED paragraph 9 be clarified so that it is clear that these new items are not to be included in “total expense.” In other words,

the line for “total expenses” in the statement of activities should not include prior service cost amortization and actuarial losses. For entities without an intermediate operating measure, a second summary line could be labeled “total expenses and effect of changes in unrecognized postretirement benefit costs.”

Pension Disclosures

Upon reading the revised definition of *public entity* in paragraph 14 of the ED, we concluded that many colleges and universities will be classified as public entities due to publicly-traded debt issues. For such institutions we believe that the full set of disclosures is warranted and useful to financial statement users. Alternatively, NACUBO agrees that a lower level of disclosure is appropriate for colleges and universities considered nonpublic.

However, we would like to point out that the notations in the amendments to SFAS No. 132(Revised 2003) will doubtless cause confusion. The examples provided -- ED paragraph E1 (p) which amends SFAS No. 132R, paragraph C3 (begins page 81 of the ED) -- have notations that “Nonpublic entities, including not-for-profit organizations, are not required to provide information in the above tables...” Because our interpretation of the ED leads us to believe the Board intends certain not-for-profit organizations to include these disclosures, since they would be classified as *public entities* per paragraph 14 of the ED; this notation is surely going to cause confusion. We suggest removing the “including not-for-profit organizations” that was added. Alternatively, change the wording to “including many (or most) not-for-profit organizations.”

Defining current liability

We recommend that the Board remove the requirement to classify postretirement benefits as current and noncurrent. The language added to Paragraph 36 of SFAS No. 87 (ED paragraph C2 (I)) effectively provides no logic for measurement and could lead to a variety of practices. To permit a discretionary amount is an invitation for financial statement manipulation. Management might choose to make no contribution in the coming year merely to improve the current ratio! The planned contribution (including discretionary amounts) is information already disclosed under the provisions of SFAS No. 132 (Revised 2003).

NACUBO recommends that the measurement of the current portion of postretirement obligations is something the Board should explicitly consider in the next phase of its project. In the meantime, entities could continue to classify postretirement benefits as noncurrent. With the improved disclosures in FASB Statement No. 132R, the anticipated cash flows are clearly stated and available to the users of both public and nonpublic entities’ financial statements.

Problems with Examples

The detailed not-for-profit examples the Board released subsequent to the ED should be included in the final standard and/or in SFAS No. 117 as amended. We found the for-profit example (on which the not-for-profit examples are based) to be extremely hard to follow. In addition, tracking the Company A adjustments to the not-for-profit examples is not particularly obvious.

Improving the examples

It would help to show how the balance sheet adjustments discussed for Example A are applied to the not-for-profit statement of financial position. Part of the confusion results from the fact that only the most recent balance sheet is adjusted for Company A, making the changes in net assets unclear in the University B example.

The Company A example would be more understandable if it included all the components of postretirement benefit costs and the complete schedules for changes in projected benefit obligations and plan assets. Such inclusions would help the reader understand that the constant \$10,000 change in actuarial loss is NOT the result of amortization (and a backward amortization at that) but the difference between expected and actual return on plan assets. We suggest that the unrecognized loss be made larger so that amortization of the excess is included in expense. The example should also include an "other actuarial gain/loss" that often affects the benefit obligation due to changes in interest rates and other assumptions. NACUBO is in the process of creating an Excel template that can be used by our members to estimate the impact of the ED on their statements of financial position and activities. If requested, we would be happy to provide it to the Board.

In closing, we again wish to express our appreciation for the opportunity to comment. We look forward to answering any questions the Board or the staff may have about our response. Please direct your questions to Sue Menditto at 202-861-2542 or sue.menditto@nacubo.org.

Sincerely,

Sue Menditto
NACUBO
Director, Accounting Policy