

Letter of Comment No: //
File Reference: FSPFAS106B
Date Received: 04-12-04

April 12, 2004

Director, TA&I-FSP
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

VIA e-mail

Dear TA & I Director:

RE: File Reference No. FSP FAS 106-b

Chicago Consulting Actuaries LLC (CCA) is pleased to submit our comments on the proposed FASB Staff Position "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" (FSP FAS 106-b).

CCA performs actuarial valuations for the postretirement benefit programs of many publicly-traded and privately-held companies. We assist employers preparing relevant information for their financial statements. As actuaries, we also assist many companies in their due diligence analysis of employee benefit programs in merger and acquisition situations. While we are not accountants, we do have extensive knowledge of postretirement benefit programs and the corresponding FASB standards, and thus feel qualified to offer commentary on the proposed FSP.

We would like to address the initial accounting of the effect of the federal subsidy on benefits attributable to past service, as described in paragraph 13 of FSP FAS 106-b. The paragraph states that the effect of the subsidy on a plan's APBO should be accounted for as an actuarial experience gain. We feel that FASB guidance should be to treat the federal subsidy as negative prior service cost (i.e., prior service credit).

As described in paragraph 6 of the FSP and paragraph 40 of FASB Statement 106 (FAS 106), future changes in laws concerning medical costs covered by government programs can not be anticipated in measuring a plan's APBO. Accordingly, prior to the recent Medicare Act (the Act), the substantive plan for a company with a prescription drug benefit did not provide for any Medicare drug coverage, and there was no assumption in the development of APBO that Medicare would be changed to cover prescription drugs. With the Act, the substantive plan changed. Under FAS 106, any change in the substantive plan should be treated as a prior service cost or credit.

Furthermore, FAS 106 defines a “gain or loss” as a change “resulting from experience different from that assumed...or the consequence of a decision to temporarily deviate from the substantive plan.” The effect of the Act is not due to a temporary deviation from the substantive plan. Nor is the effect the result of a deviation of experience from an assumption, given any such assumption about the Act was explicitly prohibited.

Additionally, under paragraphs 16 and 17 of FSP FAS 106-b, the treatment of the effect of the federal subsidy changes from an actuarial experience gain to a prior service cost depending on how changes to a company’s prescription drug benefit are enacted. FAS 106 describes what should be accounted for as a prior service cost and what should be accounted for as an actuarial gain or loss. In those descriptions there is no discussion of comparable events being treated differently due to timing of the events.

Ideally accounting standards should yield consistent results for similar situations both between companies and within a company. As proposed, the treatment of this subsidy creates undesirable inconsistencies. For example, consider a company with a drug benefit just shy of the threshold to obtain the subsidy. Benefits are then increased just enough to earn the subsidy, and a large experience gain is added to the gain/loss base. Subsequently, the company decides to amend the plan back to its original levels. A large prior service cost base is now established, roughly equivalent to the gain that had previously been added. So even though the plan ends up in roughly the same economic position as it started, its accounting position is now much different.

Disparity can also occur between companies in similar circumstances. Consider two companies, both of which put in prescription drug benefits after the enactment of the Act. The first company immediately puts in a benefit just sufficient to capture the full subsidy. Under the proposed guidance, this company will set up a prior service cost base equal to the APBO after netting out the subsidy. The second company initially puts in a plan just shy of the threshold for the subsidy, and establishes a prior service cost accordingly. Subsequently, this plan is further amended to capture the subsidy, and a gain is established equal to the net of the subsidy and the small plan change required to capture it. The result is then two companies with the same benefits but very different accounting positions (as the first company has just a prior service cost base and the second has a larger prior service cost base and a large gain base).

In closing, we believe that FAS 106 as written requires that changes in law that effectively change the plan should be accounted for as any other plan amendment. Accordingly, the effect of the Medicare subsidy should be treated as a negative prior service cost.

RE: File Reference No. FSP FAS 106-b
April 12, 2004
Page 3.

Thank you for consideration of our comments. We would be happy to discuss our position with you further, if desired. You can contact me at 214-492-2225 or TMiano@ChicagoConsultingActuaries.com.

Sincerely,

Thomas Miano, FSA, MAAA
Principal