

United States General Accounting Office Washington, DC 20548

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Mr. Lawrence Smith Director of Technical Application and Implementation Activities Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

Re: File Reference No. 1025-200

Dear Mr. Smith:

The General Accounting Office (GAO) appreciates the opportunity to comment on the Exposure Draft of the Proposed Statement of Financial Accounting Standards, Employers' Disclosures about Pensions and Other Postretirement Benefits – an amendment of FASB Statements No. 87, 88, and 106 and a replacement of FASB Statement No. 132 (the ED). The GAO serves the United States Congress as an independent, nonpartisan federal agency and is committed to enhancing financial statement transparency and accountability in both the public and private sectors. GAO supports the Board's initiative to consider a more principles-based approach to accounting in the United States. We offer these comments as a means to further enhance disclosures within the current accounting framework.

General Comments

Overall, the GAO supports the initiative to enhance disclosures for pension and other postretirement benefits. We believe that, among other things, improved transparency with respect to plan funding and funded status, investment strategies, and market risk can lead to improved funding, which in turn may reduce the risks to the federal government's pension insurance programs and promote the retirement security of workers and retirees. However, we believe that the proposed changes in disclosure requirements could be strengthened to address certain additional issues with respect to the current accounting for retirement obligations, thereby further promoting transparency. A number of our comments on the ED encourage providing users with additional information to assess the effects of the delayed recognition methods permitted by Statement 87 on earnings quality and future cash flows. Our comments also address the need to provide financial statement users with adequate information on plan liquidity and clear links between the accounting for postretirement benefits and the effects on the statement of financial position and the statement of operations.

Disclosures of Plan Assets, Defined Benefit Pension Plan Accumulated Benefit Obligation, Cash Flow Information, and Assumptions

Plan Assets

The ED requires disclosure of certain information for significant categories of plan assets. Disclosures for each asset category would include the percentage of the fair value of total plan assets, the target asset allocation percentage, the expected long-term rate of return, and the range and weighted average of the contractual maturities of all debt securities. We agree with the Board that additional information would help financial statement users assess plan investment risks and evaluate management's selection of an expected long-term rate of return on assets. However, we believe that the disclosure of holdings by broad asset categories and their respective expected long-term rates of return does not, in itself, provide users with enough information to complete this assessment. Different levels of investment risk can exist in the pension funds of companies reporting similar asset allocations and expected returns. Appropriate consideration should be given, however, to whether and to what extent general-purpose financial statements should be the avenue through which additional information is provided.

If the Board determines that financial statement footnotes are cost beneficial means of providing information that can be readily understood and used, we encourage the Board to require more detailed disclosures about plan investment policies and strategies to better explain how the expected long-term rate of return will be achieved and at what risk. This could include matters such as (1) investment objectives (capital preservation, appreciation, etc.), (2) policies for holding and disposing of investments, (3) the extent to which expected interest and principal payments align with benefit payments, (4) target market capitalization for equities and target ratings for bonds, (5) asset diversification by industry, geography, and liquidity, and (6) other matters that could have an impact on the pension fund's investment risk profile, such as holdings of derivatives.

If the Board determines that it would not be cost beneficial to provide this much information in financial statement footnotes, we suggest that the Board consider requiring companies to disclose the names of all defined benefit plans they sponsor and where additional information on investment policies, strategies, and holdings for each of these plans can be found, either from the company or government agencies. However, we recognize that presently audited plan financial statements and regulatory reports are often not completed and available when the sponsor's audited financial statements are issued and may disclose the plan's investment holdings, but not its investment policies and strategies.

We also support the ED's retention of disclosures required by FASB Statements No. 87, 106, and 132 regarding the amounts and types of securities of the employer and related parties included in plan assets, the approximate amount of future annual benefits of plan participants covered by insurance contracts issued by the employer or related parties, and any significant transactions between the employer or related parties and the plan. We encourage the Board to require disclosure of information on any sale restrictions or holdings requirements for these assets.

Defined Benefit Pension Plan Accumulated Benefit Obligation

The ED requires disclosure of an aggregate accumulated benefit obligation for all defined benefit pension plans sponsored by a company. FASB Statement No. 132 requires disclosure of aggregate benefit obligations and aggregate fair value of plan assets only for those plans with benefit obligations in excess of plan assets. We believe that requiring the disclosure of an accumulated benefit obligation measurement for all defined benefit pension plans – rather than just for plans where a minimum pension liability is recorded – may provide users with a low-cost method to monitor the aggregate funded status of all the company's plans. The inability of a company to maintain aggregate plan assets above the present value of the accumulated benefits would reinforce the need for further assessment of a company's financial condition and its plans' funded status.

Cash Flow Information

The ED requires disclosure of a schedule of estimated future benefit payments included in the determination of the benefit obligation for each of the five succeeding fiscal years following the latest statement of financial position, and the total amount thereafter, as well as the employer's pension contributions expected to be paid during the next fiscal year. We believe that, if properly presented, this information would be beneficial to users attempting to assess short-term pension and other postretirement plan cash requirements.

These disclosures should indicate a clear distinction between benefit payments used to calculate obligations and future contributions required from the plan sponsor to fund those obligations. Furthermore, to improve understanding of the link between funding and annual service costs, we believe that the above disclosures should be accompanied by information on how ERISA-established funding requirements are calculated and disclosure of the assumptions underlying the future contributions. In particular, discount rates used and differences in assumptions between the calculations of pension obligations and expected contributions need to be highlighted. Discussions of any plans not subject to the funding requirements and the applicability of the full funding limitation may also be useful.

In addition, we suggest that the Board consider expanding the required pension contribution disclosures from only the subsequent year as now called for in the exposure draft to the next five years. These additional funding disclosures would add to users' ability to compute various liquidity ratios and compare more complete information about plan funding and status over the proposed five-year period.

Assumptions

The ED requires the use of a tabular format for disclosure of key benefit obligation and net benefit cost assumptions such as discount rates, rates of compensation increase, and expected long-term rates of return. The information would be required on a weighted-average basis for companies reporting on multiple benefit plans. While we agree that the consistent presentation and added clarity of the related measurement period for the assumptions is helpful for financial statement users, we believe the Board should consider the opportunity to improve the transparency of management's selection of these assumptions and the reasons for differences in the assumptions used to calculate benefit obligations and net cost. For example, we suggest that the footnotes show historical trend data on actual rates of return and generally accepted market benchmarks for each asset category for comparison purposes, and the basis for management's selection of long-term rate of return assumptions.

Sensitivity Information about Changes in Certain Assumptions

The ED maintains requirements from FASB Statement No. 132 to disclose the effects of a one-percentage-point increase and a one-percentage-point decrease in the assumed health care cost trend rates on total service and interest cost components of net periodic postretirement health care benefit cost and on the accumulated postretirement benefit obligation for health care benefits. The ED also considered, but did not recommend, the requirement of additional sensitivity information on changes in discount rates, expected long-term rates of return on assets, and rates of compensation increase while holding the other assumptions constant.

We believe that the need for comparability of information between companies and the assessment of uncertainties in the measurement of benefit obligations cannot be met by the disclosure of potentially misleading information. The interrelation of factors such as changes in compensation increases and discount rates may not be easily expressed in the footnotes and, even if they could be, their inclusion would not ensure comparability among different companies.

We also believe that, if given further information on the sources of annual actuarial gains and losses, users may not require additional sensitivity analyses. This statement assumes that investment analysts and other sophisticated users of financial information already possess economic models to assess the potential effects of changes in discount rates, asset returns, and compensation increases. We also believe that the proposed decision to retain sensitivity information on health care cost trend rates makes sense as these changes are generally more difficult to assess than other assumptions because of the presence of plan provisions, such as annual spending limitations and other cost-sharing provisions.

Reconciliations of Beginning and Ending Balances of Plan Assets and Benefit Obligations

The ED eliminates the FASB Statement No. 132 requirement to provide reconciliations of beginning and ending balances of benefit obligations and the fair value of plan assets in favor of requiring disclosure of ending balances and retaining key elements of the reconciliations that are not disclosed elsewhere. The elimination of these reconciliations reduces both the ease and the ability of financial statement users to assess the root causes of changes in the statement of financial position. While the presentation of key elements of the reconciliations would still be presented, the removal of the standard format does not promote the consistent presentation and content of the disclosures. Furthermore, it is unclear whether information on the effects of actuarial gains and losses, plan amendments, divestitures, and curtailments would be required. Recent accountability failures in the private sector highlight the importance of providing clear information to participants about their plan and any changes to it that affect plan benefits. These matters, such as existing floor-offset arrangements and plan conversions, can have a significant effect on the benefit obligations and funded status of a plan.

Disclosures Considered but Not Proposed

The ED lists a number of disclosures that were considered but rejected by the Board and we have discussed some of these disclosures throughout this document. We believe that several additional disclosures specifically considered by the Board but not proposed would, in fact, benefit financial statement users without imposing excessive reporting costs on employers.

We agree with the Board's statements that other methods to evaluate the financial consequences of plan termination, most notably the calculation of a termination obligation, would entail additional costs to the employer and are not consistent with the financial statement concept of a going concern. However, we believe that disclosing the benefit obligation and funded status determined on a standard plan termination basis may be appropriate when required by law or regulation. Moreover, we believe that disclosing the guaranteed benefits liability may be appropriate in some circumstances, such as when the auditor concludes that there is substantial doubt about a company's ability to continue as a going concern. Such a presentation would enable users to better understand what could potentially be a more relevant measurement of one of the company's liabilities.

We suggest that the Board consider requiring disclosure of the amount and classification of net periodic pension and postretirement benefit cost or income recognized in the statement of operations. The Board previously acknowledged in its Basis for Conclusions to FASB Statement No. 87 that "a reconciliation of amounts included in the employer's statement of financial position to the funded status is essential to understanding the relationship between the accounting and the funded status of the plan." We believe that similar reasoning should be used to clearly show where net periodic cost is reported in each of the employer's statements. While we agree that the pension and postretirement benefit costs can be insignificant to the operating results of some companies, we believe this additional disclosure would allow users to assess any benefit-related impact on industry ratios and trend analysis.

We also suggest increased disclosures of company participation in multiemployer plans. Currently, financial statement users are generally unable to obtain information on company participation in multiemployer plans. The absence of this information results in a partial view into total future cash requirements and liquidity. We believe that, except for the funded status of the plan, all of the information considered for disclosure by the Board should be readily available and could be included in each participating company's financial statements without significant added cost. Disclosing the names of each multiemployer plan that a company participates in would enable users to obtain further information on the plans' funded status from regulatory agencies when that data becomes available.

Furthermore, we suggest that the Board consider requiring for each participant group the disclosure of the number of plan participants, average ages, the amount of benefit obligation, and the weighted-average duration of benefit obligation. This information is readily available and would assist users of financial statements in understanding management's choice of discount rates.

Additional Disclosures

There are some additional disclosures that we believe the Board should require that are not included in the ED or existing requirements.

We encourage the Board to investigate the benefits and costs of requiring companies to provide further information on unrecognized actuarial gains and losses. We believe the matters listed below, if disclosed, would help users to better understand the effects the delayed recognition methods have on the measurement of net periodic pension cost. These include (1) separation of unrecognized gains and losses by asset and liability components, (2) reconciliation of the beginning and ending balances of these respective components, (3) disclosure of the point at which unrecognized gains and losses would be recognized, and (4) disclosure of the period over which unrecognized gains and losses are recognized as a component of net periodic pension cost.

We also suggest that the Board evaluate the costs and benefits associated with segregating assets, obligations, and costs of qualified and nonqualified plans. We believe that this segregation of current disclosures would be one way to provide more meaningful information on executive benefit plans.

Effective Date and Transition

The ED states that the proposed changes in employers' disclosures about pension and other postretirement benefits would be effective for fiscal years ending after December 15, 2003. The ED also requires the restatement of prior years' disclosures to conform to the new disclosure rules. Due to the perceived availability of the proposed disclosure information through annual actuarial computations and other existing plan information, the proposed effective date would not seem to impose a significant burden on financial statement preparers.

Concluding Remarks

In summary, we realize that the ED and our comments on the ED propose to increase the amount of disclosures already required for pension and other postretirement plans. However, the underlying delayed recognition accounting for postretirement benefits drives the need for even more extensive information for users to make proper assessments of earnings quality and forecasts of future cash flows. This need must be fully addressed if the final standard is to achieve transparency and accountability in financial reporting. In addition, we encourage the Board to initiate a broader project to consider recognition and measurement of investment returns and actuarial gains and losses for defined benefit plans. We appreciate your consideration of our comments and would be pleased to further discuss these issues at your convenience.

Sincerely yours,

Jeffrey C. Steinhoff Managing Director

Financial Management and Assurance Team