

October 27, 2003

Letter of Comment No: 8 File Reference: 1025-200 Date Received: 10 | 27 | 03

Mr. Lawrence W. Smith
Director, Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116
(via e-mail to director@fasb.org)

Re: Comments on Proposed Statement of Accounting Standards – Employers' Disclosures about Pensions and Other Postretirement Benefits (1025-200)

Dear Mr. Smith:

Mellon's Human Resources and Investor Solutions¹ is a leading global human resources and employee benefits consulting firm that assists its clients in complying with FAS 132.

We are pleased to offer these comments on your proposed standard entitled *Employers' Disclosures* about Pensions and Other Postretirement Benefits. We support the goal of providing better and timelier information to the users of financial statements. However, we would like to make the following comments on certain issues related to the proposed disclosures.

Issue 1 - Plan Assets

Disclosure of the target allocation percentages of assets. A target allocation of assets by asset class may be difficult to reduce to a simple numeric presentation. For example, in plans with little or no assets, the short-term allocation policy often differs from the long-term expectation. As assets grow, both current asset allocations and target allocations are likely to change. We believe that it would be more helpful to have a narrative description of the plan's investment allocation strategy, a proposal that was tentatively rejected by the Board in Issue 9.

Disclosure of the long-term rate of return, presented on a weighted-average basis. The Exposure Draft appears to require that the long-term rate of return assumption be constructed using the building-block method. Under that method, assumptions are made about the long-term rate of return for each asset category and then a single long-term rate of return is calculated as the weighted average of the long-term rates of return assumed for each asset category.

¹ A portion of which was formerly known as Buck Consultants, Inc.

One Pennsylvania Plaza • New York, NY 10119-4798

(212) 330-1000 Office • (212) 695-4184 Fax

Mr. Lawrence W. Smith 10/27/2003 Page 2 of 5

FAS 87 and FAS 106 do not require the use of a building block method to determine the expected return on assets. The relevant Actuarial Standard of Practice² states that the building-block method is one of a number of acceptable methods and it describes one other method in detail.

For companies which do not now select the expected long-term rate of return using the building block method, this "disclosure" requirement would be a substantive change in required accounting practices. We believe that a substantive change should not be made as part of a review of pension disclosures, and strongly recommend that this complex issue be given the substantive review it deserves.

Issue 2 – Disclosure of Accumulated Benefit Obligation (ABO)

The Accumulated Benefit Obligation is important under FAS 87 because it can trigger the booking of additional liability. The ABO is readily available and it should be disclosed.

Issue 3 - Cash Flow Information

Benefit Payments. The proposed standard would require the disclosure of estimated future benefit "payments" for each of the next five years and for all years thereafter. The benefit payments to be shown would be those implicit in the determination of the benefit obligation as of the measurement date, i.e., those benefits accrued to date but reflecting future increases in pay levels and cost-of-living adjustments. This disclosure would not be a good representation of the expected cash flow of the fund because the expected payments disclosed would not include the future benefit growth due to additional service anticipated after the measurement date and before the date of payment. We are particularly concerned that some users of financial statements will misunderstand this disclosure and think that the amounts shown do reflect total expected benefit payments.

We doubt the usefulness of disclosing expected benefit payouts for *all* future years. The reliability of an estimate of future cash flow generally declines as the deferral period lengthens. The Board has already rejected a requirement to disclose future expected employer contributions partly because of the difficulty of making reliable estimates. Using the same rationale, the Board should not require the disclosure of aggregate benefit payments to be made more than five years after the statement date.

We also wish to comment on the practicality of requiring this disclosure given the relatively short time period before the proposed effective date. Current valuation systems do not usually produce the benefit stream implicit in the calculation of the benefit obligation, and it will take some time to modify and test the applicable systems that must produce that benefit stream. It is not realistic to believe that systems can be modified and tested in time for December 31, 2003 disclosures.

It should be noted that most valuation systems can more readily produce a benefit stream based on total expected benefit payments, i.e., a benefit stream reflecting future service and salary increases. As mentioned above, we feel that disclosure of this benefit stream would be more meaningful than disclosure of the obligation benefit stream if the purpose of the disclosure is to examine the cash outflow requirements of the fund. However, even for this benefit stream, a year-by-year cash

ASOP No. 27 §3.6.2. http://www.actuarialstandardsboard.org/pdf/asops/asop27.PDF



Mr. Lawrence W. Smith 10/27/2003 Page 3 of 5

projection is not always generated as part of a routine actuarial valuation and it would be difficult to modify procedures to produce this information for December 31, 2003 disclosures.

Contributions for the coming year separated between required and discretionary contributions. Our experience is that many plan sponsors are unable to determine their required contributions for a year until well into the following year. In the United States, for example, the required contribution under ERISA may not be known until eight-and-a-half months after the end of the fiscal year. If the value of the plan's assets is close to the value of the "current liability," the minimum required contribution can be highly leveraged and an early disclosure is likely to be misleading. Also, it is unclear from the proposed Standard whether the entire contribution necessary to meet the minimum funding requirements for a plan year should be recorded as a required contribution for the year if the preparer can legally defer the date of payment until the following year.

The estimated amount of a discretionary contribution is even less reliable. Plan sponsors decide on a contribution level at any time up to the due date of the contribution. The amount of any discretionary contribution for the year often depends on the amount of the required contribution for the year as well as on other business needs for cash. In some cases (e.g., when the plan is near the 80%/90% current liability funding threshold, or the plan might need to pay PBGC variable premiums), a discretionary contribution can, in fact, reduce net cash outflow below the level that would be necessary if only the required contribution were made. Further complications may arise because of differences between the plan year and the employer's fiscal year.

There is also an issue with the distinction between required and discretionary contributions for unfunded plans. The contribution to an unfunded plan is often measured by the amount necessary to pay current plan benefits to participants. It is not clear whether these "contributions" should be considered required or discretionary under the standard. In some cases, there an enforceable contractual obligation on the employer to provide the benefits defined under the plan. In these cases, we presume that the expected cash benefit costs can be considered "required" by a legally enforceable contract. However, in many cases involving retiree medical plans, there may be no ongoing enforceable contractual obligation.

For the reasons stated above, we expect that employers will have great difficulty in allocating the expected contribution between required and discretionary amounts. Because disclosure of expected contributions would provide useful information on the cash outflows of the preparer, the Board should require the disclosure of the year's expected contribution but should eliminate the requirement to distinguish between required and discretionary components.

Lastly, preparers should be permitted to disclose the expected employer contribution to the plan as a range of values, rather than as a single dollar estimate. Disclosing a range would tend to align the disclosure with employer budgeting practices, and would also provide users with a sense of the variability of the estimate.

Issue 4 - Tables of the Principal Assumptions

Disclosure of the principal actuarial assumptions in tabular form would be helpful in understanding the other disclosures. The final standard should require this disclosure. We request that the final standard clarify that the required disclosures (either in the table or otherwise) do not include a



Mr. Lawrence W. Smith 10/27/2003 Page 4 of 5

disclosure of the expected rate of return that would be used in measuring expense for the period starting with the disclosure date.

Issue 6 - Sensitivity of Financial Results to Changes in Certain Actuarial Assumptions

We agree with the Board that it generally would be misleading to disclose the financial effect of changing an economic assumption while holding all other economic assumptions constant.

Issue 7 - Measurement Date/Economic Change

Measurement dates that differ from the date of the financial statement should be disclosed in all cases. This disclosure would facilitate the comparison of benefit obligations and costs between entities and would be inexpensive to produce. In contrast, there would be an additional burden on the preparer if the disclosure was only required when a significant economic event or change in economic conditions occurred in the interim between measurement and statement date. In the latter case, the preparer would have to perform measurements at both dates to determine if there had been a significant change.

We are opposed to requiring the disclosure of the effect of a change in economic conditions between the measurement date and the statement date. Users of financial statements should be presumed to be aware of major changes in the financial markets and their likely effect on the benefit plans of the preparer.

Issue 8 - Reconciliations

The Board has proposed to eliminate the requirement to provide reconciliations of changes in the benefit obligations and plan assets during the year. Key elements of the information previously included in the reconciliations would be disclosed elsewhere under the proposed standard. We feel that users are familiar with the current disclosure format. The reconciliations should be retained in their current form.

Issue 9 - Disclosures Considered but Not Proposed

We agree with the Board's judgment, with one exception, that certain disclosures not be required. The rejected items would generally add little to the usefulness or understandability of the statements. In particular, the pension benefit obligation and funded status on a plan termination basis would be difficult to estimate in many cases, costly to produce, and inconsistent with the going-concern basis for pension accounting.

As discussed earlier, we do favor the inclusion of a description of the preparer's investment policies and strategies. This disclosure would go to the heart of what is being sought in Issues 1 and 3 – the extent to which the preparer is matching assets and liabilities and the degree of conservatism in the choice of investments.



Issue 10 - Disclosures in Interim Financial Reports

The proposed Standard would require the disclosure in interim financial reports of pension expense recognized, broken down by components, and the disclosure of the employer's contribution paid or expected to be paid, broken down between required and discretionary contributions.

The year's pension expense is often not determined until the second or third quarter of the year. In the interim, companies typically recognize cost in accordance with a budgeted amount that is not broken down into components. The additional cost to determine the components of a single budgeted amount does not appear to be justified by the little additional value provided to analysts.

Expected employer contributions are not usually known with any reliability until late in the year. For the reasons expressed in Issue 3, we suggest that expected contributions be disclosed as a range in the interim financial statements, without any breakdown between required and discretionary amounts. The Board should encourage disclosure of actual contributions made during the period.

Issue 11 - Effective Date and Transition

We recommend that the effective date of the new standard be delayed for at least six months after publication of the final statement (with earlier adoption encouraged) for the following reasons.

- Time will be required to change actuarial valuation and other systems to produce the new
 disclosure items, particularly expected benefit payments. Testing and production of the
 results from the modified systems will take additional time.
- Preparers, particularly those that sponsor plans outside of the U.S., may have difficulty in
 obtaining timely reports from their investment custodians that show allocations by asset
 category.
- The accumulation of information required by FAS 132 may have already started, particularly for those preparers using early measurement dates. The announcement of the final standard in November or December would make compliance with the proposed effective date extremely difficult, particularly in the context of the accelerated SEC reporting schedule.

If you need any further clarification of our position, please feel free to call me at 201-902-2585 or e-mail me at simon.r@mellon.com.

Very truly yours,

Robin B. Simon Chief Actuary

DOC: L01150R.DOC

