American Federation of Labor and Congress of Industrial Organizations



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EXECUTIVE VICE PRESIDENT

October 5, 2001

Timothy S. Lucas
Director of Research and Technical Activities
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

Dear Mr. Lucas:

This comment is submitted on behalf of the American Federation of Labor and Congress of Industrial Organizations ("AFL-CIO") in response to the Financial Accounting Standards Board's ("FASB's") request for comments on a potential new agenda project on "Disclosure of Information About Intangible Assets not Recognized in Financial Statements." Collectively bargained pension funds providing retirement security to AFL-CIO union members hold over \$3.5 trillion in assets, including over \$400 billion in funds directly sponsored by AFL-CIO affiliate unions.

We wholeheartedly support the idea of a new FASB project on disclosure regarding intangible assets. Worker funds approach the question of intellectual capital reporting as long-term investors seeking to obtain the best returns to provide for beneficiaries' retirement security. But they also have the distinct perspective of workershareholders, a perspective that is particularly attuned to the importance of workers' knowledge, skills and commitment to the creation of value for shareholders. Although this comment letter focuses on human capital disclosure, we do not mean to imply that FASB's work should be addressed only to that issue.

As discussed in FASB's request for comment and the reports cited therein, the world's leading economies are increasingly knowledge-based. Yet financial reporting has not changed to reflect those new economic realities. While value is more and more created by the skills of a company's workforce, financial reporting is still overwhelmingly focused on tangible assets.

Shareholders recognize the importance of intangible assets to a company's success. This awareness is evident from the fact that the stocks of successful companies trade at significant multiples of book value. Shareholders, then, see a firm's brands, the loyalty of its customers and the human capital of its workforce as critical.

Shareholders have also shown an interest in receiving more information on these intangibles. Shareholder proposals seeking disclosure of information on diversity and equal employment opportunity are supported by substantial numbers of shareholders. And a significant number of shareholders have also backed proposals to require executive pay to be linked to employee-related measures, which would lead to a more in-depth discussion of those measures in the company proxy statement. Indeed, UAL Corporation, the parent of United Air Lines, recently implemented a shareholder proposal asking for human-capital-related measures such as employee satisfaction, training and participation to be used in setting executive pay.

Currently, investments in intangibles such as human capital, which produce revenue over a number of years, are treated as current expenses. That treatment violates the basic accounting principle of matching expenses and revenues. We believe that it is appropriate to capitalize expenditures that create value, and we view the work of Lev and Zarowin as suggesting avenues of appropriate inquiry for FASB. We believe that in the context of the ongoing effort to harmonize global accounting standards, FASB should be sensitive to differing approaches among major economics to disclosure in this area, particularly in regard to workforce training and development expenses. However, because there is strong empirical evidence on the returns to such investments, some form of reporting of such expenses should be required.

In addition, we believe that additional disclosure regarding intangibles will bring a much-needed long-term focus to the process for setting executive compensation. Currently, executive incentive compensation usually defines performance by reference to stock price or certain selected accounting measures, none of which may accurately capture a company's investment in intellectual capital. Requiring companies to quantify their human capital investments as a distinct financial reporting item and to provide additional information that allows comparisons between companies will encourage boards of directors to use measures of intellectual capital preservation and development in setting executive pay.

In sum, the increasing importance of human capital and other intangibles is a trend that is not likely to be reversed. As long as financial reporting remains primarily focused on tangible investments, there will be an ever-widening gap between what is shown on a company's balance sheet and both its historic expenditures and its current real value-creating assets.

We would be pleased to be of further assistance to FASB as it explores these issues. I can be reached at (202) 637-3900. Thank you for your consideration.

Very truly yours,

Bill Patterson

Director, Office of Investment