

FASB Emerging Issues Task Force

Issue No. 06-2

Title: Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43, *Accounting for Compensated Absences*

Document: Issue Summary No. 1, Supplement No. 1*

Date Prepared: May 24, 2006

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Dates Previously Discussed: March 16, 2006

Previously Distributed EITF Materials: Issue Summary No. 1, dated March 2, 2006

References:

FASB Statement No. 43, *Accounting for Compensated Absences* (FAS 143)

FASB Statement No. 87, *Employers' Accounting for Pensions* (FAS 87)

FASB Statement No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits* (FAS 88)

FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions* (FAS 106)

FASB Statement No. 112, *Employers' Accounting for Postemployment Benefits* (FAS 112)

FASB Statement No. 154, *Accounting Changes and Error Corrections* (FAS 154)

FASB Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* (FAS 146)

FASB Concepts Statement No. 6, *Elements of Financial Statements* (CON 6)

International Accounting Standard No. 19, *Employee Benefits* (IAS 19)

* **The alternative views presented in this Issue Summary Supplement are for purposes of discussion by the EITF. No individual views are to be presumed to be acceptable or unacceptable applications of Generally Accepted Accounting Principles until the Task Force makes such a determination, exposes it for public comment, and it is ratified by the Board.**

Background

1. At the March 16, 2006 EITF meeting, the Task Force reached a tentative conclusion on this Issue and directed the staff to pursue the issuance of a draft abstract for public comment. The draft abstract was posted to the FASB website on April 4, 2006, for a 30-day comment period that ended May 4, 2006.

2. Comment letters received on the draft abstract have been distributed to members of the Task Force and have been analyzed by the FASB staff. At the June 15, 2006 EITF meeting, the Task Force will have the opportunity to consider those comment letters as it redeliberates the tentative conclusion in the draft abstract and addresses the issues raised in this Supplement. The Task Force will then be asked to affirm its tentative conclusion on this Issue as a consensus.

Summary of Comment Letters

3. Two comment letters were received from financial statement preparers on the draft abstract. One respondent generally agreed with the proposed accounting contained within the draft abstract, while the other respondent disagreed with the proposed accounting. Both respondents, however, provided comments on the proposed transition method and the timing of the effective date of the draft abstract in the event that the EITF affirms as a consensus the tentative conclusion as it is currently drafted and that consensus is ratified by the Board.

4. The respondent who generally agreed with the tentative conclusion disagreed, however, with the proposed transition and effective date of the draft abstract due in part to the time that would be required to assess and implement the Issue. The respondent indicated that for many academic institutions with fiscal years that end on June 30, implementation of this Issue would be an administrative burden that would likely require additional time to review and to possibly amend existing contractual arrangements to minimize the effect of the Issue on their financial statements. Therefore, the respondent proposed that the Task Force consider including an option for prospective application beginning no earlier than January 1, 2007.

5. In addition to the proposed revisions to the transition guidance and effective date, the respondent also suggested that the Task Force consider amending the draft abstract to (a)

explicitly acknowledge the subjectivity involved in determining whether a sabbatical is beneficial to the employer and (b) expand its scope to explicitly include joint sabbatical programs. In a joint sabbatical program, an employee may be required to provide service to two or more academic institutions to be eligible for a sabbatical benefit.

6. The respondent who disagreed with the proposed accounting for sabbaticals believes that the adoption of this Issue provides little improvement in an entity's financial reporting when compared to the administrative burden and the substantial and costly changes that would be required for that entity's information systems. The respondent also stated that its current method of accounting (recognition at the time of the sabbatical is taken) does not result in misleading financial information since there is no incremental cost to the company when the employee takes the sabbatical and since the amount of compensation expense recorded in any given year under the tentative conclusion is relatively minor given the lengthy service requirement for the employee.

7. The respondent also disagreed with the proposed transition method and suggested that the Task Force allow companies the option of adopting the Issue prospectively for sabbaticals offered after the effective date of the consensus given the high cost associated with reconstructing the information for companies that have numerous international locations and due to the relatively high threshold for meeting the impracticability exception established in FAS 154.

8. The FASB staff noted that some of the comments provided by the respondents were previously considered by the Task Force during its initial deliberations. Therefore, the FASB staff believes that only the following comments warrant consideration by the Task Force at the June 15, 2006 EITF meeting.

Comment 1: Entities should have the option of applying the consensus on this Issue either prospectively for sabbaticals offered after the effective date or by using the transition method described in the tentative conclusion.

Comment 2: The effective date should be delayed to allow entities adequate time to implement this Issue.

Accounting Issues and Alternatives

Issue 1: Whether entities should have the option of applying a consensus on Issue 06-2 prospectively for sabbaticals offered after the effective date of this Issue in addition to the transition method described in the tentative conclusion in the draft abstract.

9. As discussed in the Summary of Comment Letters Section above, both respondents highlighted their concern about the administrative burden and excessive cost that entities would incur in attempting to reconstruct the historical data necessary to apply the Issue retrospectively. Both respondents also acknowledged that there would be little improvement in financial reporting in exchange for that burden. In addition, while both respondents suggested that the Task Force consider including the option of applying the Issue prospectively for sabbaticals offered after the effective date of this Issue, one respondent's rationale for proposing that option was to address the relatively high level of evidence required to meet the impracticability exception in FAS 154, which that respondent felt would likely be unavailable to most preparers without undue cost.

FASB Staff Analysis

10. The FASB staff believes that entities should not be given the option of applying the transition guidance in Issue 06-2 prospectively. The FASB staff understands that the average length of service required before the typical sabbatical is earned ranges from 5 to 15 years. Therefore, to the extent that the Task Force allows an option for prospective transition for new sabbatical arrangements, it may take several years for an entity to recognize the full impact of the adoption of this Issue in its financial statements. The FASB staff does not support the creation of an additional transition option for prospective treatment for sabbaticals offered after the effective date since it would not improve comparability between entities. However, in order to alleviate some of the cost and administrative burden to entities adopting this Issue, the FASB staff recommends that the Task Force consider a view that allows entities to adopt the consensus on

this Issue as a change in accounting principle through a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption.

View A: Entities should recognize the effect of applying the consensus in this Issue as a change in accounting principle through retrospective application to all prior periods unless it is impracticable to do so consistent with the tentative conclusion reached by the Task Force and described in the draft abstract.

View B: Entities should recognize the effect of applying the consensus reached in this Issue as a change in accounting principle through a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption.

Issue 2: Whether the effective date of Issue 06-2 should be delayed to allow entities adequate time for implementation.

11. As discussed in the Summary of Comment Letters Section above, both respondents requested that the Task Force consider delaying the effective date to allow companies adequate time to consider the effects of Issue 06-2 on an entity's contractual arrangements and adequate time to upgrade their information systems to track the data necessary to develop those estimates.

FASB Staff Analysis

12. The staff believes that the Task Force should consider delaying the effective date of Issue 06-2 to allow entities additional time to develop the estimates and reconstruct the data necessary to apply the provisions of this Issue.

View A: The effective date of Issue 06-2 should continue to be for fiscal years beginning after the ratification of this consensus consistent with the tentative conclusion reached by the Task Force.

View B: The effective date of Issue 06-2 should be for fiscal years beginning after December 15, 2006.

Other Comments Received on the Draft Abstract

13. The staff received other comments on the draft abstract that are not specifically addressed herein, such as comments suggesting that specific application guidance be included. Suggested changes to the wording in the draft abstract that the staff has determined are not significant enough to warrant specific consideration are included in the marked draft abstract included as Exhibit 06-2A along with the FASB staff's recommendations to address the comments that have been brought to the Task Force for consideration by this Supplement.

EITF Abstracts (DRAFT)

Issue No. 06-2

Title: Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43

Dates Discussed: March 16, 2006; [June 15, 2006]

References: FASB Statement No. 49, *Accounting for Product Financing Arrangements*
FASB Statement No. 43, *Accounting for Compensated Absences*
FASB Statement No. 87, *Employers' Accounting for Pensions*
FASB Statement No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*
FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*
FASB Statement No. 112, *Employers' Accounting for Postemployment Benefits*
FASB Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*
FASB Concepts Statement No. 6, *Elements of Financial Statements*
International Accounting Standard No. 19, *Employee Benefits*

ISSUE

1. An entity may provide its employees with a benefit in the form of a compensated absence known as a sabbatical leave (sabbatical) whereby the employee is entitled to paid time off after working for an entity for a specified period of time. During the sabbatical, the individual continues to be a compensated employee and is not required to perform any duties for the entity.
2. In determining whether and, if so, when the cost of a sabbatical or other similar benefit arrangement should be accrued, entities have historically applied the guidance in paragraph 6 of Statement 43. Paragraph 6 of Statement 43 states in part that "an employer shall accrue a liability for employees' compensation for future absences if... (b) the obligation relates to rights that vest or accumulate" (footnote references omitted). In practice, questions have been raised with respect to the interpretation of paragraph 6(b) of Statement 43 as to whether, in the absence of a vesting condition, a sabbatical **accumulates**.
3. The issue is whether an employee's right to a compensated absence under a sabbatical or other similar benefit arrangement (a) that requires the completion of a minimum service period and (b) in which the benefit does not increase with additional years of service accumulates

pursuant to paragraph 6(b) of Statement 43. The scope of this Issue is limited to those arrangements under which the sabbatical or other similar benefit arrangement is unrestricted (that is, the employee is not required to perform any direct or indirect services for or on behalf of the entity during the absence). Arrangements in which employees are required to engage in research or public service to enhance the reputation of or otherwise benefit the employer are not within the scope of this Issue .

EITF DISCUSSION

4. The Task Force reached a [consensus] that an employee's right to a compensated absence under a sabbatical or other similar benefit arrangement (a) that requires the completion of a minimum service period and (b) in which the benefit does not increase with additional years of service accumulates pursuant to paragraph 6(b) of Statement 43 for arrangements in which the individual continues to be a compensated employee and is not required to perform duties for the entity during the absence. Therefore, assuming all of the other conditions of paragraph 6 of Statement 43 are met, the compensation cost associated with a sabbatical or other similar benefit arrangement should be accrued over the requisite service period.

Transition

5. The Task Force reached a [consensus] that this Issue should be applied in financial reports for fiscal years beginning after December 15, 2006~~the date the [consensus] is ratified by the Board~~. Earlier adoption is permitted as of the beginning of an entity's fiscal year, provided the entity has not yet issued financial statements, including interim financial statements, for any period of that fiscal year. Entities should recognize the effects of applying the [consensus] on this Issue as a change in accounting principle through ~~retrospective application to all prior periods~~ a cumulative-effect adjustment to retained earnings or other components of equity or net assets in the statement of financial position as of the beginning of the year of adoption. ~~This~~An entity should include the recognition and disclosure the cumulative effect of the change on retained earnings or other components of equity or net assets in the statement of financial position:-

- a. ~~The cumulative effect of the change to the new accounting principle on periods prior to those presented reflected in the carrying amounts of assets and liabilities as of the beginning of the first period presented~~
- b. ~~The cumulative effect of the change on retained earnings or other components of equity or net assets in the statement of financial position~~
- c. ~~Adjustments to financial statements for each individual prior period presented to reflect the period specific effects of applying the new accounting principle.~~

6. ~~If the cumulative effect of applying the change in accounting principle to all prior periods can be determined but it is impracticable to determine the period specific effects of that change on all prior periods presented, the cumulative effect of the change should be applied to the carrying amounts of assets and liabilities as of the beginning of the earliest period to which the new accounting principle can be applied. An offsetting adjustment, if any, should be made to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) for that period. If it is impracticable to determine the~~

~~cumulative effect of applying a change in accounting principle to any prior period, the new accounting principle should be applied as if the change was made prospectively as of the earliest date practicable.~~

~~7. Upon application of this Issue, the following should be disclosed:~~

- ~~a. A description of the prior period information that has been retrospectively adjusted, if any~~
- ~~b. The effect of the change on income from continuing operations, net income (or other appropriate captions of changes in the applicable net assets or performance indicator), any other affected financial statement line item, and any affected per share amounts for the current period and for any prior periods retrospectively adjusted~~
- ~~c. The cumulative effect of the change on retained earnings or other components of equity or net assets in the statement of financial position, as of the beginning of the earliest period presented.~~

Board Ratification

~~68. At its [June 28, 2006] meeting, the Board ratified the [consensuses] reached by the Task Force in this Issue.~~

STATUS

~~79. No further EITF discussion is planned.~~