REVISED MINUTES

Financial Accounting Standards Board

To:	Board Members		
From:	Strange (ext. 442)		
Subject:	Revised Minutes of the December 14, 2005 Board Meeting	**Date:**	December 28, 2005
cc:	FASB: Bielstein, Smith, Petrone, Proestakes, Strange, Cassel, Carney, Polley, Gabriele, Mahoney, Sutay, FASB Intranet; IASB: Leisenring, Upton, McGeachin, Hickey		

The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Statement or Interpretation.

Topic: Postretirement Benefit Obligations, Including Pensions

Basis for Discussion: Board Memorandum No. 2 dated November 30, 2005, and Board Supplemental Memorandum No. 2A dated December 2, 2005.

Length of Discussion: 9:40–10:40 a.m.

Attendance:

- Board members present: Herz, Batavick, Crooch, Schipper, Seidman, Trott, and Young
- Board members absent: None
- Staff in charge of topic: Proestakes
- Other staff at Board table: Bielstein, Cassel, and Strange
- Outside participants: None

<u>Summary of Decisions Reached</u>:

The Board deliberated issues relating to the limited-scope, first phase of its project to reconsider the accounting for postretirement benefits. The Board decided:

1. That the objectives and scope of phase 1 are as follows:

   a. To improve the reporting of employers' obligations for pensions and other postretirement benefits by recognizing the overfunded or underfunded status of defined benefit postretirement plans as an asset or a liability in the statement of financial position. This means that a sponsoring entity will recognize all previously unrecognized items (such as unrecognized actuarial gains and losses), even when the plan is fully funded.

   b. Not to change how plan assets and benefit obligations are measured under FASB Statements No. 87, *Employers' Accounting for Pensions*, and No. 106, Employers' *Accounting for Postretirement Benefits Other Than Pensions.* The asset or liability (overfunded or underfunded status) would be measured as the difference between the fair value of plan assets and benefit obligations (that is, the projected benefit obligation (PBO) for pensions and the accumulated postretirement benefit obligation (APBO) for other postretirement benefits).

   c. Not to change the basic approach for measuring the amount of annual net benefit cost reported in earnings.

   d. Implement phase 1 improvements as quickly as possible with a goal of making them effective for years ending after December 15, 2006.

2. To eliminate the provisions in Statements 87 and 106 that permit plan assets and obligations to be measured as of a date not more than three months prior to the balance sheet (that is, to require entities to report the overfunded or underfunded status measured as of the date of the financial statements).

3. Not to change the current accounting for defined benefit plans in interim-period financial statements.

4. To require recognition of an asset for overfunded plans and a separate liability for underfunded plans.

5. Previously unrecognized items would be recognized as follows:

   a. Previously unrecognized actuarial gains or losses would be recognized as a credit or charge to other comprehensive income (OCI). Gains or losses recognized in OCI would be recycled out of OCI into earnings based on the amortization and recognition requirements in Statements 87 and 106.

b. Previously unrecognized prior service costs or credits also would be recognized as a charge or credit to OCI. These items would be recycled out of OCI into earnings based on the amortization and recognition requirements in Statements 87 and 106.

c. Previously unrecognized net transition assets or obligations would be recognized an adjustment of retained earnings. Those amounts would not be subsequently "recycled" through earnings.

6. To codify into Statement 87 the guidance in Q&A 41 of *A Guide to implementation of Statement 87 on Employers' Accounting for Pensions,* that articulates the present requirement to recognize the current and noncurrent portions of the assets and liabilities recognized for postretirement benefits.

7. Not to require separate line item presentation of amounts recognized in the balance sheet. In making that decision, the Board noted that amounts recognized in OCI would be subject to the separate presentation requirements of FASB Statement No. 130, *Reporting Comprehensive Income* (that is, classified based on the nature of the item).

Objective of Meeting:

The objective of the meeting was for the Board to discuss proposed changes in the financial reporting by employers that sponsor defined benefit pension and other postretirement plans. The proposed changes are part of the first phase of the comprehensive project on employers' accounting for postretirement benefits including pensions. The goal of phase 1 is to recognize previously unrecognized gains and losses and unrecognized prior service costs, thereby recognizing in the balance sheet the overfunded or underfunded status of defined benefit postretirement plans. The objective of the meeting was met.

Matters Discussed and Decisions Reached:

1. Mr. Proestakes began the discussion by stating that at the November 10, 2005 agenda decision Board meeting, the Board discussed the objectives and scope of the initial phase of the project. Mr. Proestakes asked whether the Board agreed with the staff that the objectives and scope of phase 1 are as follows:

   a. Improve understandability and representational faithfulness of amounts reported in the balance sheet by recognizing the overfunded or underfunded status of defined benefit postretirement plans as an asset or a liability. This includes recognizing all previously unrecognized items even when the plan is fully funded.

b. Not to change how plan assets and benefit obligations are measured. The asset or liability would be measured as the difference between the fair value of plan assets and benefit obligations (that is, the PBO for pensions and the APBO for other postretirement benefits).

c. Not to change the basic approach for measuring the amount of annual net benefit cost reported in earnings.

d. Implement phase 1 improvements as quickly as possible with a goal of making them effective for years ending after December 15, 2006.

2. All Board members agreed with the staff. Mr. Young clarified that there will be changes in earnings if the Board agrees with the staff's other recommendations. Mr. Proestakes agreed that there may be some change in net benefit cost recognized in earnings going forward. However, he explained that the staff does not propose any change to the *basic methodology* to measuring annual net benefit costs. Mr. Young also asked whether the staff could consider disclosures to help users better understand the smoothing devices an entity is permitted to use in the short-term under Statements 87 and 106.

3. Mr. Proestakes stated that in order to make the balance sheet more useful, understandable, and have postretirement items consistent with the treatment of other assets and liabilities, the staff recommends the Board eliminate the provisions of Statements 87 and 106 that permit use of a reporting date other than the balance sheet date. Mr. Proestakes added that many large companies already use a year-end measurement date and that existing Statements allow certain data gathering to be performed ahead of time and rolled forward, which helps the burden for year-end reporting.

4. Ms. Schipper agrees with the staff's recommendation based on the analysis provided by the staff. However, she would withdraw her support if the Board received information that suggested this change would either alter *how* the plan assets and benefit obligations were measured (as opposed to *when*) or delay the Board's goal of an effective Statement for years ending after December 15, 2006. She accepts the

staff's recommendation so long as it does not prove to be a disruptive change for constituents and does not deter the project's timetable.

5. Ms. Seidman voiced the same sentiments as Ms. Schipper. While she does agree conceptually with the staff that all measurements should be as of the reporting date, Ms. Seidman expressed concern whether the change would be practicable for all the Board's constituents. She believes that the cost-benefit rationale explaining the Board's decision in Statement 87 may still hold true today. Ms. Seidman also would be willing to sacrifice the measurement date as of the reporting date if it impairs the Board's ability to meet the objectives for phase 1.

6. Mr. Trott voiced strong support for the staff's recommendation. He warned that the Statement should use careful wording so as not to change the current provisions in Statements 87 and 106 that allow a foreign subsidiary with a different year-end from the parent company to evaluate and report the plans as of the subsidiary's reporting date. He stated that the three month deferral results in much greater complexity for both preparers and auditors, and he cited the difficulty surrounding treatment of subsequent events for plans not reported as of the financial statement date. He stated that there are essentially two types of work the Board's decisions would impact:

    a. Actuarial work focused on the measurement of the obligation and the allocation of net benefit cost

    b. Calculation of the fair value of assets that have been set aside for the plan

    Mr. Trott believes that if there are cost-benefit considerations, they would only be related to measurement of the benefit obligation (that is, actuarial work).

7. Ms. Schipper noted that the complexity Mr. Trott referred to is avoidable because entities currently can elect to report as of the end of the fiscal year. The election to adopt an earlier measurement date implies that preparers must believe the cost of complexity is lower than the cost to adopt a year-end measurement date. Mr. Proestakes stated that much of the complexity is due to considerations that preparers may not have anticipated when electing a measurement date (that is, plan amendments, curtailments, and settlements accounted for in an accounting period different than when the event occurred).

8. Mr. Young indicated his support for the staff's recommendation as long as the effective date of the other changes to be made in the first phase of the project was not deferred.

9. Mr. Batavick stated that while he was not originally in favor of the staff's recommendation, given information on the number of companies who have migrated to reporting using a year-end measurement date, he agrees the requirement should be included in the Exposure Draft. He also indicated similar sentiments to Messes. Seidman and Schipper that this provision should not delay the Board's objectives for phase 1. He stated that he would like to see a separate and robust question in the Exposure Draft's Notice for Recipients concerning the cost-benefit implications of this change, especially for small public companies. Ms. Seidman added that she would like to include a description of the implementation complexity for entities that adopt an earlier date in the basis of conclusions and also include a specific question in the Notice for Recipients asking how companies are currently making cost-benefit tradeoffs regarding measurement date.

10. Mr. Herz stated that the complexity may be compounded once the Board requires the funded status to be recognized on the balance sheet because, unfortunately, preparers may pay more attention to the difficult judgments in postretirement benefits once the amounts appear on the face of the financial statements.

11. Mr. Cassel added that entities may not have considered future complexity when they made their initial choice to have an earlier measurement date. Therefore, the fact that some entities continue to report on the earlier date may not be due to cost-benefit concerns; instead, it may be inertia.

12. Mr. Crooch stated that he agrees with the staff that measurement at year-end is the right conceptual answer; however, he expressed the belief that the project's true direction is to put the funded status of plans on the balance sheet. Because Mr. Crooch feels this is much more important than the measurement date issue, he would not want it to slow the project down.

13. In summary, the Board unanimously voted to accept the staff's recommendation concerning measurement date; however, the vote was qualified by several Board

members who indicated the decision should not conflict with the objectives of phase 1.

14. Mr. Proestakes then asked the Board to consider the current accounting for defined benefit plans in interim period financial statements. He stated the cost and administrative burden of requiring remeasurement of pension obligations for each interim period, as well as the resulting additional reported volatility and change to the net benefit cost recognized throughout the year, has lead the staff to recommend no change to the current interim period accounting in the initial phase of the project. Instead, the staff recommends the subject be considered during the comprehensive phase of the project. The Board unanimously agreed with the staff's recommendation.

15. Mr. Proestakes then asked the Board to consider how to treat previously unrecognized actuarial gains or losses. He stated that in most cases this amount represents the largest difference between true economic status and the amounts in the balance sheet. He stated that the staff recommends previously unrecognized actuarial gains or losses be recognized in OCI, which is consistent with the existing treatment for actuarial losses when an additional minimum pension liability is recognized. Gains or losses recognized in OCI would be recycled out of OCI into earnings based on the amortization and recognition methodologies required in Statements 87 and 106. The Board unanimously agreed with the staff's recommendation. Mr. Trott noted that although the Board will not explicitly deal with smoothing in the initial phase, unrecognized actuarial gains or losses are the biggest impact of smoothing and the change in the initial phase will result in numbers on the balance sheet (in OCI), making the impact of smoothing more evident.

16. Mr. Proestakes then stated that in regard to unrecognized prior service costs or credits (that is, costs resulting from plan amendments that increase benefits or credits resulting from plan amendments that reduce benefits), the staff recommends that a net intangible asset be recognized to the extent that prior service costs have not previously been recognized in earnings. The staff also recommends that a net negative intangible asset be recognized to the extent that prior service credits have not been recognized in earnings. This treatment would be consistent with the current

practice of recognizing an intangible asset when an additional minimum liability is recognized and unrecognized prior service costs exist.

17. Mr. Proestakes explained that prior service costs and credits would be classified in the balance sheet as a net intangible asset or net intangible negative asset on an aggregate basis for all plans. Prior service costs or credits would be recycled into earnings based on the amortization requirements in Statements 87 and 106.

18. Mr. Proestakes stated it is the staff's belief that the Board decide whether all or a portion of prior service costs or credits represent an asset and how to measure that asset should be part of the comprehensive phase of the project along with deliberating what constitutes a liability. If the Board rejects the staff's recommendation, that rejection would alter one of the fundamental decisions made by the Board in Statements 87 and 106 that influenced what should be considered outside the scope of phase 1.

19. Ms. Schipper stated that she agrees with paragraph 286 of Statement 106:

> Although some intangible economic benefits of a plan initiation or amendment may be received in future periods from benefit improvements for active plan participants, [some Board members] believe that those intangible benefits do not qualify for recognition of an asset.

That is, Ms. Schipper believes the intangible benefit does not qualify for treatment as an asset. However, the Board has agreed that phase 1 of this project will not reconsider recognition and measurement provisions of Statements 87 and 106. Therefore, she agrees with the staff's recommendation that the treatment of prior service costs (or credits) should be addressed during the comprehensive phase of this project.

20. Ms. Seidman stated that this is a very debatable conceptual issue and for simplicity she prefers consistent treatment of prior service costs and credits. She noted that while the precedent included in Statement 87 supports treatment as an intangible asset, she also could argue for recognition through OCI, which is consistent with the Board's decision for unrecognized actuarial gains and losses. She explained that she thought carefully about what users would find more useful in the interim period

before the comprehensive project is completed and decided to put both unrecognized prior service costs and credits through OCI. She believes this would result in simpler, more transparent, and symmetrical accounting.

21. Mr. Trott stated that he agrees with Ms. Seidman. He feels that creation of an intangible asset is yet another form of smoothing and he does not see a sufficient distinction between unrecognized actuarial gains or losses and unrecognized prior service costs or credits to support different treatment. Mr. Trott stated that the decision to put unrecognized prior service costs and credits through OCI does not impact measurement, it only impacts display on the balance sheet. Mr. Young also stated his preference to recognize unrecognized prior service costs or credits through OCI so long as it does not hamper the Board's stated schedule.

22. Mr. Proestakes clarified that the recommendation to create an intangible asset or negative asset simply carries forward the treatment contained in Statement 87. If the Board bases a decision on what fits the definition of an asset, it could be asked to consider whether the current pension obligation satisfies the definition of a liability. The staff believes changing how prior service costs are characterized moves away from the current practice in Statement 87 and 106 and should be considered as part of the comprehensive project.

23. Mr. Trott stated his belief that the staff's proposal would be a major change because it would require recognition of an asset that previously was not recognized as an asset. Mr. Trott also stated that he feels the Board would be making a bigger step by not getting in front of the definition of an asset and putting the amount in OCI.

24. Mr. Cassel stated that the staff feels uncomfortable using OCI without conceptual reason. He explained that OCI should be thought of as gains and losses not recognized in earnings, not a "dumping ground." On a convergence note, IAS 19, *Employee Benefits,* states that unrecognized prior service costs are treated as an expense (either immediately or amortized into expense over the vesting period). Therefore, treating unrecognized prior service costs as a loss would contradict IAS 19. Mr. Cassel stated that the staff believes the Board should refrain from addressing phase 2 issues in phase 1. If it does decide to include phase 2 issues in phase 1, the

Board should be comfortable with the significant effect its decision to treat unrecognized prior service costs as losses (through OCI) would have on debt-to-equity ratios.

25. Mr. Batavick stated that while he would not object if the Board selects OCI, he believes the project's objective is best served by not revising the definitions of assets and liabilities as they are defined in Statements 87 and 106. For those reasons, Mr. Batavick supports the staff's recommendation.

26. Mr. Crooch stated his belief that prior service costs are an expense on the date the plan amendments are granted. However, he agrees with Ms. Schipper's logic that while he does not agree conceptually, he will support the staff's recommendation because treatment through OCI is beyond the scope of the initial phase of the project.

27. Mr. Herz stated that he believes a main issue of phase 1 is to clean up the balance sheet. He stated that he does not believe prior service costs constitute an asset. If the Board really wants to clean up the balance sheet, it should not perpetuate recognizing an asset the Board did not support. Mr. Herz stated that he has a strong desire for prior service costs to be recognized through OCI. He noted that this issue should be considered in redeliberations. In summary, four Board members (RHH, LFS, EWT, DMY) voted to reject the staff's recommendation. Those Board members prefer to require that all prior service costs be recognized through OCI. Three Board members (KAS, GMC, GJB) supported the staff's recommendation. Consistent with the Board's decision regarding unrecognized prior service costs, the Board also rejected the staff's recommendation concerning prior service credits, instead preferring to require those credits be recognized through OCI.

28. Mr. Proestakes then stated the staff's recommendation that the unrecognized net transition asset or obligation be recognized as an adjustment (write-off) through retained earnings. Those amounts would not be subsequently recognized in earnings. That treatment would be consistent with a change in accounting principle. The staff believes its recommendation would improve comparability going forward between companies with and without remaining transition amounts and would reduce recordkeeping.

29. Ms. Schipper stated she supports the staff's recommendation because it appears to be a sensible and simple solution, and Statement 106 contains this treatment alternative. Mr. Herz noted that the staff's recommendation would change the expense measurement. Mr. Trott and Ms. Seidman supported the staff's recommendation because it is simple. Ms. Seidman noted it is preferable to consider this change part of the cumulative effect subject to the Board's future decisions on transition. The Board unanimously voted to support the staff's recommendation.

30. Mr. Proestakes then presented the staff's recommendation for the Board to prescribe that an entity recognize an asset for overfunded plans and a separate liability for underfunded plans because there is no legal right of offset. The Board unanimously agreed with the staff's recommendation.

31. For the issue of current-noncurrent classification of amounts recognized in the balance sheet, Mr. Proestakes stated that the staff recommends that Statements 87 and 106 more clearly and explicitly articulate the present requirement to recognize the current and noncurrent portions of the assets and liabilities recognized for postretirement benefits. In response to Ms. Schipper's question as to whether the staff proposal is to codify existing guidance or to develop new guidance, the staff indicated that they expect to codify existing guidance (along the lines of Implementation Issue 41 to Statement 87) as opposed to creating new guidance concerning current and noncurrent classification. With this clarification, the Board unanimously voted to adopt the staff's recommendation.

32. Mr. Proestakes stated that the staff does not recommend requiring separate line item presentation of amounts recognized in the balance sheet. Amounts recognized in OCI would be subject to the separate presentation requirements of Statement 130 (that is, classified based on the nature of the item). Plan assets and obligations are significant for many entities. Some people may view them as unique when compared with other assets and liabilities and believe the Board should improve their transparency by requiring specific discrete line items on the balance sheet. However, the staff believes the Board should leave display to the discretion of the reporting entity. Mr. Proestakes noted that the footnotes provide adequate disclosure and that SEC registrants are already subject to certain 5 percent reporting requirements.

33. Mr. Trott noted his support of the requirement to have separate line item display. He noted that the materiality exemption (to not have to apply GAAP if the amount is immaterial) would assist those entities that do not have material plans from having to comply with any display requirements. Mr. Trott believes the initial phase of the project mainly creates communication with constituents, and separate display on the face of the financial statements is a part of that communication.

34. Mr. Batavick agreed with Mr. Trott's assertion that it would be remiss of the Board when "fixing" the balance sheet to not require separate display. He noted that the natural conclusion is that one should be able to look at a balance sheet and identify where an asset or liability is located. He suggested that parenthetical disclosure may be a possible compromise because it would put the information on the face of the balance sheet without separate line item presentation.

35. Mr. Herz agreed with Messrs. Trott and Batavick so long as display for the current obligation would not be required (that is, display would only be required for noncurrent items). Mr. Herz stated he would like to have, at the minimum, separate line items for the underfunded and overfunded plans (that is, there would be two separate line items if the entity had both an asset and liability) on the face of the balance sheet.

36. Ms. Seidman supported the staff's recommendation to not require separate display due to the already extensive disclosure requirements. Ms. Bielstein reminded the Board that the SEC's materiality rules could result in entities separately displaying this amount anyway.

37. Mr. Young also agreed with the staff's recommendation. He did not feel this category was distinctive enough from other assets and liabilities to require separate display. He noted that users could find extensive disclosure in the footnotes.

38. Ms. Schipper pointed out that in several projects the Board has recently discussed questions of possible disaggregation based on heterogeneity, and this separate display debate is yet another instance of that issue. She stated that in its recent decisions the Board indicated a preference for disaggregation for a single (aggregated) balance sheet item whose components have different measurement bases (for example, total

servicing rights that may contain components measured at fair value and at lower-of-cost-or market). Ms. Schipper stated that at least one Board member prefers disaggregation based on how the measurement was arrived at (by price or measurement technique). However, Ms. Schipper believes that Board member's preference for disaggregation for postretirement benefits seems to be based on the nature of the item (that is, current versus noncurrent, pensions versus healthcare versus other benefits). She questioned what principle is the foundation for Board members' preferences for disaggregated balance sheet display, and how that principle would apply to (aggregated) postretirement benefits.. Ms. Schipper stated that she agrees with the staff's recommendation; however, she would not object to separate display as long as the display was not parenthetical. Mr. Crooch also agreed with the staff's recommendation.

39. In summary, four Board members (KAS, GMC, LFS, DMY) voted to support the staff's recommendation and three Board members (RHH, EWT, GJB) voted to require separate display.

40. Mr. Proestakes indicated that the staff expects to return to the Board in January to discuss the accounting for the deferred tax effects relating to today's decisions and effective date, transition, and footnote disclosures.

<u>Follow-up Items:</u>

None.

<u>General Announcements:</u>

None.