MINUTES

To:	Board Members		
From:	Sledge (ext. 273)		
Subject:	Minutes of the July 12, 2006 Board Meeting	**Date:**	July 21, 2006
cc:	FASB: Bielstein, Smith, MacDonald, Cassel, Hood, Mechanick, Proestakes, Sledge, Zimmerman, Sarno, Polley, Carney, Allen, Sutay, FASB Intranet; GASB: K. Johnson; IASB: Hickey, Leisenring, McGeachin, Upton		

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, Interpretation, or FASB Staff Position.

Topics:	Postretirement Benefit Obligations, Including Pensions: Scope and Objectives; Retrospective Application Implementation Issues
Basis for Discussion:	Board Memorandum No. 13 dated June 30, 2006 Board Memorandum No. 14 dated June 30, 2006
Length of Discussion:	9:00–10:15 a.m.

Attendance:

Board members present:	Herz, Batavick, Crooch, Linsmeier (via telephone), Seidman, Trott, and Young
Board members absent:	None
Staff in charge of topic:	Proestakes
Other staff at Board table:	Bielstein, Hood, Sledge, and Zimmerman
Outside participants:	None

Summary of Decisions Reached:

The Board began redeliberations of its March 2006 Exposure Draft, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans,* in light of views communicated in respondents' comment letters and the feedback received at the June 27, 2006, public roundtable. (A summary of the comment letter responses is available on the FASB's website.) The Board discussed the scope and objectives of the project and considered several implementation issues related to retrospective application of the proposed changes. The Board made the following decisions:

1. The Board affirmed its decision to conduct the project in phases, enabling meaningful, near-term improvements in the financial reporting of pensions and other postretirement benefits, which will make balance sheets more complete, transparent, and understandable.

2. The Board affirmed its decision to require an employer that is a business entity to:

   a. Recognize in its statement of financial position the overfunded or underfunded status of a defined benefit postretirement plan measured as the difference between the fair value of plan assets and the benefit obligation. For a pension plan, the benefit obligation would be the projected benefit obligation; for any other postretirement benefit plan, such as a retiree health care plan, the benefit obligation would be the accumulated postretirement benefit obligation.

   b. Recognize as a component of other comprehensive income, net of tax, the actuarial gains and losses and the prior service costs and credits that arise during the period but pursuant to FASB Statements No. 87, *Employers' Accounting for Pensions,* and No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, are not recognized as components of net periodic benefit cost. Amounts recognized in accumulated other comprehensive income would be adjusted as they are subsequently recognized as components of net periodic benefit cost pursuant to the recognition and amortization provisions of Statements 87 and 106.

3. The Board decided that any transition asset or transition obligation remaining from the initial application of Statement 87 or 106 would be recognized as a component of other comprehensive income, net of tax, rather than as an adjustment to the opening balance of retained earnings (as was proposed in the Exposure Draft). Amounts recognized in accumulated other comprehensive income would be adjusted as they are subsequently recognized as components of net periodic benefit cost pursuant to the recognition and amortization provisions of Statements 87 and 106.

4. The Board decided not to require retrospective application of the accounting change for all financial statements presented, deciding instead to require recognition of the funded status in the statement of financial position as of the effective date of the final Statement. The Board directed the staff to discuss with users and preparers of financial statements the benefits and costs of providing, in notes to the financial statements, the pro forma effect of the changes in the financial position of the entity

as of the immediately preceding fiscal year end. The Board will decide whether to require such a disclosure at a future meeting.

Objective of Meeting:

The objective of the meeting was for the Board to redeliberate the scope and objectives of the project, including whether the project should be conducted in phases or as a single, comprehensive project. If the Board decided to continue with Phase 1, a further objective was to decide how pension and other postretirement benefit obligations should be measured and recognized in Phase 1, and consider several implementation issues related to retrospective application. The objectives of the meeting were met.

Matters Discussed and Decisions Reached:

1. Mr. Proestakes opened the meeting by outlining the staff's agenda.

Scope and Objectives of the Project

2. The Board unanimously supported the staff's recommendation to continue to conduct the project in phases. Mr. Crooch stated that it was important to recognize the net asset or liability on the balance sheet first and then move forward to the comprehensive phase of the project. He added his belief that users consider amounts recognized in the financial statements to be more important than those contained in the footnotes. Mr. Batavick stated that putting the overfunded or underfunded status on the balance sheet was a way to improve financial reporting in the short term before a comprehensive project is initiated. Mr. Trott noted that respondents commented that recognizing the funded status on the balance sheet would cause users to react differently and that is a compelling argument for recognition. The goal is to try to improve communication and allow the marketplace to make appropriate capital allocation decisions. Mr. Young noted that the accounting for pensions has been biased for over 20 years, and waiting another 5 years before fixing the problem is inappropriate. Ms. Seidman stated that her support of the phased approach is based on her belief that the measurement question can be separately handled as part of the comprehensive project. Mr. Linsmeier also noted that the phased approach allows for

improvements in financial reporting on a more timely basis. Mr. Herz supported continuing with the phased approach as well.

Measurement and Recognition Approaches

3. The Board unanimously supported the staff's recommendation to measure pension obligations using the projected benefit obligation and other postretirement benefits using the accumulated postretirement benefit obligation. The Board also unanimously supported the basic approach for recognizing the funded status that was included in the Exposure Draft, specifically to recognize the over- or underfunded status (the difference between the fair value of plan assets and the projected benefit obligation for pensions and accumulated postretirement benefit obligation for other postretirement benefits) on the balance sheet with actuarial gains and losses and prior service costs, net of tax, in accumulated other comprehensive income. The amounts recognized in accumulated other comprehensive income would subsequently be recognized and amortized as components of net periodic benefit cost pursuant to the existing amortization requirements in Statements 87 and 106.

4. Mr. Batavick stated that the Board was carrying over principles from Statements 87 and 106. He acknowledged that there are arguments for both the accumulated benefit obligation and the projected benefit obligation, but on balance he considers the projected benefit obligation the better measure for the pension obligation and the accumulated postretirement benefit obligation for the other postretirement benefit obligations. Mr. Trott acknowledged that Statement 87 does require calculation and disclosure of the accumulated benefit obligation; however, it resulted from a compromise that led to the need for a basis for determining a minimum liability to be recognized for financial reporting purposes. He observed that compromise is no longer necessary and disclosures of pension funding status have always been based on the projected benefit obligation. Mr. Young noted that he believes the projected benefit obligation is better than the accumulated benefit obligation for predicting future cash flows. In addition, he acknowledged the arguments referencing the definition of a liability from the conceptual framework, but concluded that such arguments were not valid. Ms. Seidman added that in a flat-pay plan or a non-pay-

related plan the accumulated benefit obligation equals the projected benefit obligation, and she believes that plans that make promises based on future compensation increases should be accounted for differently. Mr. Herz explained that future compensation increases are not the only forward-looking component of either the accumulated benefit obligation or the projected benefit obligation. He noted that the question of whether and to what extent to include forward-looking information in the measurement of plan obligations will be considered as part of the comprehensive project, but for now the projected benefit obligation is a better measure than the accumulated benefit obligation. Mr. Crooch emphasized that an existing measurement of the obligation should be used for Phase 1 so that the net asset or obligation can be put on the financial statements ending after December 15, 2006, as proposed.

5. The Board unanimously supported the staff's recommendation to forego further analysis on two alternative recognition approaches suggested by respondents: (a) not amortizing amounts recognized in accumulated other comprehensive income and (b) recognizing deferred assets (and credits) instead of reductions (and increases) of accumulated other comprehensive income. Mr. Trott acknowledged the effect of the proposed change on entities with equity buy-sell agreements and other arrangements that are based on book values. However, he noted that the net asset or obligation meets all recognition criteria for being on the balance sheet, so this project is, in essence, correcting book value. He also noted that when the effective date is chosen, the Board will consider that preparers may have existing contractual arrangements based on metrics that will change dramatically with implementation.

Implementation Issues Related to Retrospective Application

6. The Board unanimously supported the staff's recommendation to recognize transition assets or obligations resulting from the initial adoption of Statements 87 and 106 as an adjustment to accumulated other comprehensive income with subsequent amortization as a component of net periodic benefit cost pursuant to the existing amortization requirements in Statements 87 and 106. Mr. Trott clarified that this was a change from the Exposure Draft, which states that the transition assets or

obligations would be recognized in retained earnings and no longer amortized. Ms. Seidman noted that at the time the Exposure Draft was drafted, she believed that the provision would simplify things. However, she realized after reading the comment letters that it would not. She also concluded that doing away with the amortization would violate the premise that Phase 1 would not change the measurement of net periodic benefit cost. Mr. Young explained that he was worried about comparability issues if the amortization of the transition asset/obligation was included in pension expense one year and not the next. Mr. Crooch stated his belief that the Board was initially doing constituents a favor, but that it turned out not to be much of a favor. Mr. Batavick emphasized how the process of soliciting constituents' feedback through comment letters and the roundtable sessions had brought new information to the Board's attention about the implementation issues associated with this provision.

7. The Board unanimously supported the staff's recommendation not to require full retrospective application to each prior period reported because of the complexity of assessing the realizability of deferred tax assets, challenges in restating historical summaries of financial data, and independence issues relating to predecessor auditors. Mr. Batavick stated that the comment letters and the roundtable discussions regarding implementation issues had convinced him that the costs of retrospective application would exceed the benefits, particularly if requiring retrospective application would delay the effective date. Ms. Seidman added that users at the roundtable sessions indicated that timely implementation was more important than retrospective application.

8. The Board did not reach a consensus whether to require disclosure in an audited footnote of the effect on the financial statements for the year immediately preceding the year of initial application or instead to require prospective application only. Mr. Batavick stated that while the additional disclosure might be useful to users, he is concerned about possible implementation issues and would prefer to require prospective application. Mr. Crooch concurred with Mr. Batavick. Ms. Seidman stated that she also has some doubts about the usefulness of the additional disclosure and does not want it to delay implementation. Mr. Trott expressed his preference for

the additional disclosure, as users had expressed a desire for a reference point and preparers were in the best position to assess the need for a valuation allowance for the deferred tax assets at minimal cost. He added that an impracticability exception would still be provided. Mr. Young agreed with Mr. Trott, although he questions the value of the deferred tax valuation allowances. Mr. Linsmeier indicated his desire for the staff to obtain more information about the costs and benefits of both alternatives before making a decision. He recalled that the users at the roundtable sessions expressed a desire for a comparative number to use as a basis for interpreting the initial financial statements under the new Statement. He stated that his concern with prospective application was that it would only create a benchmark number that would not become useful until the following year. Mr. Herz expressed a marginal preference for the additional disclosure so that analysts could perform comparative ratio analysis.

9. The Board directed the staff to obtain additional information regarding the costs and benefits of both alternatives from users and preparers and report back to the Board at a subsequent meeting for final consideration.

10. Mr. Proestakes reviewed the timeline for subsequent Board redeliberations of Phase 1. Mr. Herz closed by noting that all Board members had expressed the desire to have the final Standard effective for public companies with fiscal years ending after December 15, 2006, and that the Board would separately discuss effective dates for non-public companies at a subsequent meeting.

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

The staff will obtain additional information about the costs and benefits of requiring an additional footnote disclosure of the retrospective effects on the prior year or requiring prospective application only. That issue will be redeliberated at a subsequent Board meeting.

<u>General Announcements</u>:

None.