

8 May 2006

Sue Bielstein  
Technical Director  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

**Re: Exposure Draft – Proposed Statement of Financial Accounting Standards; *Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans: an amendment to FASB Statements No. 87, 88, 106, and 132(R)***

Dear Ms. Bielstein,

The CFA Centre for Financial Market Integrity (CFA Centre) of CFA Institute,<sup>1</sup> in consultation with its Corporate Disclosure Policy Council (CDPC)<sup>2</sup>, appreciates the opportunity to comment on the Financial Accounting Standards Board’s (“FASB”) Exposure Draft – Proposed Statement of Financial Accounting Standards; *Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans: an amendment to FASB Statements No. 87, 88, 106, and 132(R)*. The CFA Centre develops, promulgates, and maintains the highest ethical standards for the investment community including the CFA Institute *Code of Ethics and Standards of Professional Conduct*. The CFA Centre represents the views of investment professionals to standard setters, regulatory authorities, and legislative bodies worldwide to promote investor protection and efficient global capital markets.

### General Comments

We applaud the Board’s release of the ED and support strongly the proposed amendments to FASB Statements 87, 88, and 109, which are in summary to:

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<sup>1</sup> The CFA Centre for Financial Market Integrity is part of CFA Institute®. With headquarters in Charlottesville, VA and regional offices in New York, Hong Kong and London, CFA Institute, formerly the Association for Investment Management and Research®, is a global, non-profit professional association of more than 82,000 financial analysts, portfolio managers, and other investment professionals located in 126 countries of which more than 68,000 are holders of the Chartered Financial Analyst® (CFA®) designation. CFA Institute has 132 affiliated Member Societies and Chapters in 53 countries and territories.

<sup>2</sup> The objective of the CDPC is to foster the integrity of financial markets through its efforts to address issues affecting the quality of financial reporting and disclosure worldwide. The Council comprises individuals, who are investment professionals with extensive expertise and experience in the global capital markets, as well as CFA Institute member volunteers. In this capacity, the Council provides the practitioners’ perspective in the promotion of high-quality financial reporting and disclosures which meet the needs of investors.

1. Recognize the overfunded or underfunded status of a defined benefit postretirement plan in the financial statements rather than as note disclosures. This status represents the difference between the fair value of plan assets and the benefit obligation (measured as the projected benefit obligation for pensions and the accumulated postretirement benefit obligation for OPEBs).
2. Recognize as a component of other comprehensive income, net of tax, the actuarial gains and losses and the prior service costs and credits.
3. Recognize as an adjustment to the opening balance of retained earnings, net of tax, any transition asset or transition obligation remaining from the initial application of Statement 87 or 106.
4. Measure defined benefit plan assets and defined benefit plan obligations as of the date of the employer's annual statement of financial position.
5. Disclose additional information in the notes to the financial statements about certain effects on net periodic benefit cost in the upcoming fiscal year that arise from delayed recognition of the actuarial gains and losses and the prior service costs and credits.

We agree strongly with the Board's reasons for making these changes: (1) that financial reporting will be significantly improved and thereby, (2) improve the understandability and analysis of defined benefit plans by all users of this information – company management, pension regulators, employees, as well as investors. We have long been of the view that disclosure is not a substitute for recognition and measurement.<sup>3</sup> Simply, the proposed amendments to the current accounting of defined benefit plans are long over due.

### ***The need for complete recognition of defined benefit obligations***

For more than three decades, or since the FASB first began its deliberations of the accounting for defined benefit plans in the mid-1970s, we have advocated for improved accounting and complete recognition of the obligations and related costs associated with defined benefit plans, as covered by FASB Statements 87, 88 and 106. In our letter to the Board, dated January 26, 1976<sup>4</sup>, we noted that

*...pension plan accounting must be substantially directed toward future results. Liabilities are at best approximations and their determination is subject to retroactive changes. Users of pension plan reports will be interested not so much in the past, but in the uncertainties that surround the future liquidation of the Plan's liabilities. Users will also be concerned with the potential impact on the Plan's sponsor, including the potential loss of financial flexibility and future earning power that would result were it*

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<sup>3</sup> The position was expressed in the 1993 Report – *Financial Reporting in the 1990s and Beyond* and again, in the Centre's 2005 paper – *Comprehensive Business Reporting Model: Financial Reporting for Investors*.

<sup>4</sup> Comment letter issued by the Financial Accounting Policy Committee (FAPC) of the Financial Analysts Federation (FAF) (predecessors to the CDPC and the CFA Centre, addressing the FASB's Discussion Memorandum on Accounting and Reporting for Employee Benefit Plans.

*necessary in future periods to divert a disproportionate percentage of the sponsor's available resources to fund a shortfall in the pension plan.* [Emphasis added]

These statements predicted with chilling accuracy the current, severely underfunded state of many companies' large defined benefit plans. Indeed, it is unfortunate that the accounting— recognition and measurement—for such plans has not reflected a more accurate representation of the uncertainties and potential impact on a company's financial condition. Our view is that the current accounting has enabled companies to mask shortfalls in their defined benefit plans and thus, to defer taking the necessary action to address the problems to the detriment of many.

According to a recent study based on data provided in the 2005 10-Ks of the S&P 500 companies, there is an estimated \$472 billion of unrecorded obligation for pension and other postretirement employee benefits.<sup>5</sup> This study estimates that the after tax effect, assuming a 35% tax rate, would be a reduction of shareholders' equity of \$248 billion. This reduction could be even larger because it is uncertain whether these companies will generate enough taxable income to use their deferred tax assets. Clearly, the current accounting needs to be amended to properly report these obligations.

Therefore, we urge the Board to stand firm on the proposed changes, and not to delay the implementation of these changes. Moreover, we hope that the Board will proceed expeditiously in completing Phase 2 of this project to improve the measurement of a company's current obligation and to reflect completely the effect that defined benefit plans have on a company's financial condition.

### **Centre's Response to Questions in the Exposure Draft**

#### ***Costs of Implementing the Proposed Statement's Requirement to Recognize a Plan's Overfunded or Underfunded Status in the Employer's Statement of Financial Position***

**Issue 1:** The Board concluded that the costs of implementing the proposed requirement to recognize the overfunded or underfunded status of a defined benefit postretirement plan in the employer's statement of financial position would not be significant. That is because the amounts that would be recognized are presently required to be disclosed in notes to financial statements, and, therefore, new information or new computations, other than those related to income tax effects, would not be required.

*Do you agree that implementation of this proposed Statement would not require information (other than that related to income tax effects) that is not already available, and, therefore, the costs of implementation would not be significant? Why or why not?*

Given that the proposed changes involve the recognition of items already calculated as part of the disclosure for defined benefit plans, we believe that the cost to implement the changes would be insignificant compared to the benefits derived. The most significant benefits to be realized are: (1) the

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<sup>5</sup> David Zion, CFA, CPA; Bill Carcache, CPA; Amit Varshney, FRM - Credit Suisse Equity Research, May 2006.

simplification of these accounting standards and (2) the improved transparency of the economic impact of the plans on a company's financial performance and financial condition.

### ***The Employer's Measurement Date***

**Issue 2:** Unless a plan is sponsored by a subsidiary that is consolidated using a fiscal period that differs from the parent's, this proposed Statement would require that plan assets and benefit obligations be measured as of the date of the employer's statement of financial position. This proposed Statement would eliminate the provisions in Statements 87 and 106 that permit measurement as of a date that is not more than three months earlier than the date of the employer's statement of financial position.

*Are there any specific implementation issues associated with this requirement that differ significantly from the issues that apply to other assets and liabilities that are recognized as of the date of the statement of financial position?*

We agree strongly with the Board's decision to eliminate the choice of a measurement date other than the company's fiscal year end. It has been our long-standing view<sup>6</sup> that the measurement date, for both the plan assets and benefit obligations, should be the same date as the company's fiscal year end. Requiring the same measurement date simplifies the reporting of these plans. Additional disclosures would not be needed to explain significant changes in plan asset values and/or the rebalancing of plan assets for contributions made after the measurement date but before the reported year end. Consequently, the analysis of these plans is simplified if investors do not have to make adjustments to estimate the net plan obligation as of the reported year end. Furthermore, this change should also improve the comparability of this information among companies which previously had different measurement dates.

### ***Effective Dates and Transition***

#### **Recognition of the Overfunded or Underfunded Status**

**Issue 3(a):** The Board's goal is to issue a final Statement by September 2006. The proposed requirement to recognize the over- or underfunded statuses of defined benefit postretirement plans would be effective for fiscal years ending after December 15, 2006. Retrospective application would be required unless it is deemed impracticable for the reason discussed below.

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<sup>6</sup> FAPC comment letter issued to the FASB, dated November 28, 1983, addressing the Board's *Preliminary Views (on major issues) and Discussion Memorandum (on additional issues) related to Employers' Accounting for Pensions and Other Postemployment Benefits*.

An entity would be exempt from retrospective application only if the entity determines that it is impracticable to assess the realizability of deferred tax assets that would be recognized in prior periods as a result of applying the proposed Statement.

*Should the Board provide an impracticability exemption related to the assessment of the realizability of deferred tax assets? Why or why not? Are there other reasons that retrospective application might be impracticable that the Board should be aware of? (See paragraphs B61–B64 for the basis for the Board’s conclusions.)*

Although we prefer a retrospective application of the proposed changes, we acknowledge that there may be difficulty in determining the recoverability of deferred tax assets for prior periods. If a company does not apply the proposed changes retrospectively as noted in the ED, it should be required to disclose why it is impractical. It should also disclose the application method used for implementing the changes as outlined in paragraph 17 of FASB Statement 154, *Accounting Changes and Error Corrections*.

**Issue 3(b):** Some nonpublic entities (and possibly some public entities) may have contractual arrangements other than debt covenants that reference metrics based on financial statement amounts, such as book value, return-on-equity, and debt-to-equity. The calculations of those metrics are affected by most new accounting standards, including this proposed Statement.

*The Board is interested in gathering information for use in determining the time required to implement this proposed Statement by entities that have such arrangements other than debt covenants. That information includes (a) the types of contractual arrangements that would be affected and what changes to those arrangements, if any, would need to be considered, (b) how the economic status of postretirement plans that is presently included in note disclosures is currently considered in those arrangements, and (c) how the effects of the current requirement in Statement 87 to recognize a minimum pension liability previously were addressed for those contractual arrangements.*

We do not believe that the proposed changes in accounting should necessarily be a factor regarding debt covenants. It is our understanding that companies and their debt holders have renegotiated contractual arrangements and covenants to accommodate previously mandated changes in accounting standards.

## **Measurement Date**

**Issue 4:** This proposed Statement would require a public entity that currently measures plan assets and benefit obligations as of a date other than the date of its statement of financial position to implement the change in measurement date as of the beginning of the fiscal year beginning after December 15, 2006. If that entity enters into a transaction that results in a settlement or experiences an event that causes a curtailment in the last quarter of the fiscal year ending after December 15, 2006, the gain or loss would be recognized in earnings in that quarter. Net periodic benefit cost in the year in which the measurement date is changed would be based on measurements as of the beginning of that year.

*Are there any specific impediments to implementation that would make the proposed effective date impracticable for a public entity? How would a delay in implementation to fiscal years ending after December 15, 2007, alleviate those impediments?*

Please refer to our response to **Issue 2**. Instead of delaying the effective date, we recommend that a rollforward be provided in the transition year - or for the first year ending after December 15, 2006 - to alleviate any impediments to implementing the proposed amendments. This rollforward would start with data as of the plan's measurement date and provide the best estimates at the time, for example, changes in actuarial assumptions, payments out of and contributions into the plan, etc., to roll forward the plan information to the company's fiscal year end. We expect that obtaining the fair value of plan assets as of the company's fiscal year end would not pose a problem, and consequently, we have not proposed a roll-forward of plan assets. The second year of implementation, or the first year ending after December 15, 2007, the measurement date would be the same as the fiscal year end, thereby, eliminating the need to have the rollforward in this and future periods.

### **Not-for-Profit Organizations and Other Entities That Do Not Report Other Comprehensive Income**

**Issue 5:** This proposed Statement would apply to not-for-profit organizations and other entities that do not report other comprehensive income in accordance with the provisions of FASB Statement No. 130, *Reporting Comprehensive Income*. Paragraphs 7–13 of this proposed Statement provide guidance for reporting the actuarial gains and losses and the prior service costs and credits by those organizations and entities.

*Do you agree that those standards provide appropriate guidance for such entities? If not, what additional guidance should be provided?*

We concur with the Board's decision to require not-for-profit organizations and other entities, which do not report other comprehensive income, to measure plan assets and benefit obligations as of the date of the employer's statement of financial position as noted paragraphs 5 -7 of the ED.

Generally, we do not support differential accounting and/or disclosures for similar economic activities and transactions depending on whether they are conducted by a public company or nonpublic company. Therefore, we question the need to distinguish between nonpublic and public entities with regard to implementing the proposed amendments to FASB Statements 87 and 106.

### **Closing Remarks**

For investors to be able to properly assess and value an investment's potential risk and return, it is essential that they have complete, clear, and accurate financial information. Defined benefit plans can

be a significant drain on companies' current and future resources. Unfortunately, the full financial impact from these obligations is currently hidden off the balance sheet in obscure note disclosures and the associated costs are not accurately and completely stated in the income statement. Hence, investors must expend much effort to adjust the financial statements for these deficiencies, a task that requires considerable knowledge and skill. We believe that the proposals in this ED represent an important improvement in financial reporting and will do much to enhance the clarity, completeness, and usefulness of the financial statements.

The CFA Centre for Financial Market Integrity, together with its Corporate Disclosure Policy Council, appreciates the opportunity to provide comments to the FASB regarding the first phase of its project to amend FASB Statements 87, 88, 106 and 132(R). If you or your staff have questions or seek further elaboration of our views, please contact Georgene B. Palacky, by phone at +1.434.951.5326 or by e-mail at [georgene.palacky@cfainstitute.org](mailto:georgene.palacky@cfainstitute.org).

Sincerely,

*/s/ Rebecca T. McEnally*

Rebecca T. McEnally, CFA, PhD  
Director, CFA Centre

*/s/ Georgene B. Palacky*

Georgene B. Palacky, CPA  
Sr. Policy Analyst, CFA Centre

Our comments have benefited from substantive input of the Corporate Disclosure Policy Council. The members of the Council are:

**Patricia A. McConnell, CPA – Chair**  
Bear, Stearns & Co., Inc.

**Jane B. Adams, CPA**  
Maverick Capital Ltd.

**Anthony Good, ASIP**  
Equity Research Consultant

**David E. Runkle, CFA**  
Piper Jaffray & Co.

**Ted Stevens, CFA**  
Blackrock Inc.

**Barry L. Ehrlich, CFA**  
MCT Asset Management

**Robert F. Morgan, CFA**  
Forbes Morgan Consulting

**Toshihiko Saito, CFA**  
Capital International Research

**Gerald I. White, CFA**  
Grace & White, Inc.

Cc: Corporate Disclosure Policy Council  
Ray DeAngelo, Managing Director, Members and Society Division, CFA Institute  
Kurt N. Schacht, CFA, JD, Executive Director, CFA Centre