



26 September 2008

Sir David Tweedie  
Chair, International Accounting Standards Board  
30 Cannon Street  
London EC4M 6Xh  
United Kingdom

**Re: *Discussion Paper; Preliminary View on Amendments to IAS 19 Employee Benefits***

Dear Sir David,

The CFA Institute Centre for Financial Market Integrity (“the Centre”)<sup>1</sup> and the Corporate Disclosure Policy Committee (“the CDPC”)<sup>2</sup> appreciates the opportunity to comment on the IASB Discussion Paper: *Preliminary Views on Amendments to IAS 19 Employee Benefits*.

The CFA Institute Centre represents the views of its members, including portfolio managers, investment analysts, and advisors, worldwide. Central tenets of the CFA Institute Centre mission are to promote fair and transparent global capital markets, and to advocate for investor protection. An integral part of our efforts toward meeting those goals is ensuring that the quality of corporate financial reporting and disclosures provided to investors and other end users is of high quality. The CFA Institute Centre also develops, promulgates, and maintains guidelines encouraging the highest ethical standards for the global investment community through standards such as the CFA Institute Code of Ethics and Standards of Professional Conduct.

### **Executive Summary**

With the issuance of its discussion paper, *Preliminary Views on Amendments to IAS 19 Employee Benefits* (PV), the International Accounting Standards Board (IASB) begins to address issues which have plagued pension accounting for years. We support the IASB in its efforts to deal with the problems and criticisms presented by International Accounting Standard No. 19 *Employee Benefits* (IAS 19). There are compelling reasons for the IASB to undertake this project to address deficiencies in the financial reporting for post-employment benefits. Among the most notable

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<sup>1</sup> The CFA Institute Centre for Financial Market Integrity is part of CFA Institute. With offices in Charlottesville, VA, New York, Hong Kong, and London, CFA Institute is a global, not-for-profit professional association of more than 96,000 investment professionals in 134 countries, of whom nearly 83,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 135 member societies in 56 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 is comprised of investment professionals with extensive expertise and experience in the global capital markets, some of whom are also CFA Institute member volunteers. In this capacity, the Council provides the practitioners’ perspective in the promotion of high-quality financial reporting and disclosures that meet the needs of investors.



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issues addressed in this PV are user concerns about the deferred recognition model permitted by IAS 19 and the financial statement presentation of post-employment benefit costs.

We believe that the Board should pursue its objective of improving the financial reporting of post-employment promises in order to make the accounting model and its disclosures more useful and understandable. This current project is an important first-step taken to address the immediate issues. However in the long-term; the Board must undertake a more comprehensive review to develop a common standard on post-employment benefits. We appreciate the Board's efforts to improve the accounting for employee benefits and urge the Board to move as quickly as possible to issuing an Exposure Draft incorporating these proposals with our suggestions as noted in the remainder of this letter.

While we make a number of points in our letter we stress the following key points:

- The new standard should require immediate recognition of all changes in the value of plan assets and in the post-employment obligation in the period in which they occur.
- All changes in the defined benefit obligation and in the value of plan assets should be presented in profit or loss.
- Presentation and disclosure should be improved to provide sufficient qualitative information regarding funded status and risk exposures.

In the balance of this letter, we address these and other areas in further detail. We hope our views will assist the IASB to develop an improved employee benefits accounting standard which will provide users with the information needed to make prudent investment decisions.

## **Comments on Specific Proposals**

### **Scope of the Project**

This project is an important first step in establishing a comprehensive standard for post-employment benefits, and accordingly the Board limited the scope to the following:

- the deferred recognition of some gains and losses arising from defined benefit plans
- presentation of defined liabilities
- accounting for benefits that are based on contributions and a promised return
- accounting for benefit promises with a 'higher of' option



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We agree with the limited scope given the full agenda of the Board and its target to complete projects related to the Memorandum of Understanding<sup>3</sup> by 2011. Our agreement with the scope is predicated on the assumption that the Board will conduct a second phase to address other unresolved issues. The Board notes that other issues could be considered such as:

- application of discount rates
- recognition of the obligation based on the benefit formula
- measurement of the obligation
- presentation of a net obligation, rather than consolidation of gross pension assets and gross liabilities in the sponsor's financial statements (we offer an example presentation of consolidation later in this paper)
- multi-employer plans

### **Recognition and Presentation of Defined Benefit Liabilities**

#### *Immediate Recognition*

We strongly favor the Board's preliminary view that entities should recognize all changes in the value of plan assets and in the post-employment benefit obligation in the financial statements in the period in which they occur. This includes changes resulting from plan amendments, curtailments, and settlements. As noted in the PV, immediate recognition is consistent with the *Framework* and other IFRSs. We agree with the other arguments for immediate recognition:

- The *Framework* requires that the 'effects of transactions and other events are recognized when they occur...and are recorded in the accounting records and reported in the financial statements of periods to which they relate.'
- Immediate recognition of actuarial gains and losses is consistent with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.
- IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* requires changes in liabilities, including changes in long-term liabilities (such as asset retirement obligations) to be recognized in the period they occur.

The Board provides additional support for its PV by identifying the advantages of immediate recognition namely:

- It represents faithfully the entity's financial position. An entity will recognize an asset only when its plan has a surplus and it will recognize a liability only when its plan has a deficit.
- It results in amounts that are transparent and easy to understand in the statements of financial position and comprehensive. The approach generates income and expense items that provide

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<sup>3</sup> See Memorandum of Understanding between the FASB and IASB at <http://www.iasb.org/NR/rdonlyres/874B63FB-56DB-4B78-B7AF-49BBA18C98D9/0/MoU.pdf>

information about changes in the post-employment benefit obligation and plan assets in that period.

- It improves comparability across entities by eliminating the options currently allowed by IAS 19.

As stated in our *Comprehensive Business Reporting Model*:

*Completeness requires the financial statement recognition and measurement of economic events that can affect investors' wealth, including changes in fair value, as they occur. Thus no accounting standard should permit assets or liabilities, and changes in them that can affect shareowners' wealth, to escape recognition at the time they occur in the financial statements.<sup>4</sup>*

The Board's decision to eliminate deferred recognition of actuarial gains and losses that exceed the corridor is in keeping with the completeness principle stated above. Furthermore, financial reporting must be neutral. To that end, it has long been established that an accounting treatment must be based solely on what method best captures the economic substance of an item or most faithfully represents the transaction or event and not on the form of the transaction or consequences of the reporting.

#### *Consideration of IASB Proposed Approaches for Reporting Changes*

Of the three alternatives for reporting changes in the defined benefit obligation and the value of plan assets we support Approach 1, whereby entities present these items in profit or loss. Central to our support is that this approach is clearly the least complex to implement and understand. It is consistent with the *Framework* and IAS 1, *Presentation of Financial Statements* and is the most consistent with other IFRSs. The Board notes in the PV that this approach avoids the need for arbitrary and potentially complex rules about the allocation of cost to profit or loss and in other comprehensive income. Avoiding these complex rules adds greatly to the simplicity and understandability of the changes. Furthermore, this approach is consistent with our belief that all changes in the values of assets, including changes in fair value should be recorded in the income statement and be highly transparent.

Some supporters of Approach 1 believe that pension cost should be disaggregated into separate components that would then be aggregated with similar line items in the income statement. Based on our experience of how investors utilize pension information in valuation models, we believe disaggregation of pension effects into operating and financing impacts would needlessly complicate financial analysis without providing benefit to users. We believe disclosure by nature is the simplest, most useful, and most transparent form of financial statement presentation.

We agree with the Board's views that there are practical issues with Approaches 2 and 3. Under Approaches 2 and 3, entities would be required to divide actuarial gains and losses into those arising from interest rate changes and other changes. The Board recognizes the need to specify

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<sup>4</sup> CFA Institute Centre for Financial Market Integrity, *A Comprehensive Business Reporting Model*



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how to calculate those amounts to ensure consistency. This specificity would be difficult to develop and would add to the complexity of those two approaches. Furthermore with regard to Approach 3, we agree with the Board that because information about interest income is not presently required by IAS 19, it is deemed to be the most complex approach to implement.

In summary, Approach 1 is the least complex and most understandable of the three alternatives. Disaggregating between profit and loss and other comprehensive income as required by the other approaches requires prescriptive rules and is inconsistent with a principles-based approach adopted by the IASB for accounting standards.

#### *Improving the Approaches to Provide Useful Information to Users*

All events and transactions which affect assets and liabilities should be recognized in the financial statements of an entity. Accounting standards should refrain from having important financial activities off-balance sheet where the entity's risks are not transparent. The risk profile of an entity's pension plan assets, corresponding liabilities, and funded status have a direct impact on its cost of capital and as such, should be recorded in the financial statements. Recording assets and liabilities on the balance sheet by nature (i.e., displayed as pension plan assets and pension plan liabilities, not as net funded status) and by providing sufficient qualitative disclosure will result in more transparency. More comprehensive information about the composition of and risks associated with plan assets will allow the investor to forecast future returns and the potential for future cash contributions. We therefore urge the Board to require consolidation of pension plan assets and liabilities as noted in the discussion below.

We provide a comprehensive example of financial statement presentation and note reconciliation in Appendix A. We draw your attention to the following key points as you consider our example:

- The income statement, balance sheet, cash flows and note reconciliation track all activity by nature. The example assumes that there is a pension plan, a contribution based (CB) plan and other-post-employment benefits (OPEB). Each of these is clearly shown in each of the statements and individual reconciliations with a total reconciliation.
- The statement of cash flows reconciles all cash activity between years. Investors are able to consider cash activity changes related to obligation payments to employees in addition to recurring changes in asset fair values and liability re-measurements.
- Each of the individual plans has a stand alone reconciliation displaying all cash flow activity changes between years. These individual summaries are summarized for all plans.

This example, when accompanied by transparent disclosures such as those discussed later in this letter (and shown in Appendix B), would provide investors with the information needed to thoroughly assess pension plan obligations and risks. We encourage the Board to adopt presentation and disclosure standards in line with our examples.



## **Measurement of Contribution-Based Promises**

### *Identification of Plans as Contribution-based Promises*

As previously noted, we believe that due to limitations in the scope of the project, the Board has identified the appropriate contribution-based promises. However, we again emphasize that this response assumes that a second more comprehensive phase will be conducted whereby other plans may be identified and classified in this category. It might be useful to users to understand the basis for the Board's decision to address these kinds of plans in this amendment.

### *Measurement of Contribution-based Promises*

We support the Board's preliminary view that an entity should measure its liability for a contribution-based promise at fair value. When selecting a measurement attribute for a contribution-based promise, the Board's principal objective was to give users of financial statements useful information about the amount, timing, and uncertainty of future cash flows resulting from the promises. The characteristics listed below are relevant under the circumstances and should appropriately result in the measurement of the liability at fair value:

- an estimate of the future cash flows
- the effect of the time value of money
- the effect of risk

We agree with the Board's view that there should be consistency of accounting for an obligation throughout its life; therefore, the liability for benefits in the payout and deferment phases should be measured in the same way as the accumulation phase. The associated liability for benefits should be measured at fair value in the same manner. We also support the elimination of valuations based on the expected return on plan assets. This does not provide meaningful information and due to the arbitrary nature of applying an appropriate discount rate, could be misleading.

## **Disaggregation, Presentation and Disclosure of Contribution-Based Promises**

We support the Board's preliminary view that changes in the value of a contribution-based liability should be disaggregated into service cost and other value changes. Furthermore we agree that all changes in the value of the liability and plan assets should be presented in profit and loss. This will ensure consistency and comparability with defined benefit promises.

## **Disclosures**

Disclosures must provide additional information investors require to understand the items recognized in the financial statements, their measurement properties, and their risk characteristics.

In CFA Institute corporate disclosure surveys conducted in 2007 and 2003, respondents were asked to rate both the importance and quality of note disclosures regarding pension plans and

risks. On a five-point scale, the respondents rated the importance of such disclosures at 3.8 and 4.1<sup>5</sup>. Significant gaps in the quality of information were reported as indicated in the table below:

Importance	Survey Year	
	2007	2003
Pension and other retirement or post-employment benefit plans	3.8	4.3
Risks and exposures to risks (e.g., business, financial and market risk factors)	4.1	4.1

Quality	Survey Year	
	2007	2003
Pension and other retirement or post-employment benefit plans	3.2	2.8
Risks and exposures to risks (e.g., business, financial and market risk factors)	3.1	2.8

We encourage the Board to develop pension disclosures according to the following general guidelines:

- (a) financial statements should contain adequate disclosure about the cost of providing pension benefits and any related gains, losses, assets, and liabilities;
- (b) users of financial statements should be able to obtain a clear view of the risks and rewards arising from liabilities to pay pension benefits and the assets held to fund those benefits;
- (c) the funding obligations of the entity, in relation to liabilities to pay pension benefits, should be clearly identified; and
- (d) disclosure of acquired underfunded plans and the excess paid to settle or curtail an underfunded plan should be clearly disclosed.

We propose that the Board develop comprehensive disclosures relative to the risks associated with pension benefit obligations. These disclosures should contain information that allows the users to fully understand exposures relative to asset/liability duration and cash flow mismatch; also, we believe investors should understand the credit and market risks associated with the underlying assets. In essence the entity should disclose information regarding extreme risk factors, including asset concentrations and asset volatility relative to the market. Investors have particular interests in the following disclosures:

<sup>5</sup> Importance scale: 1= not important to 5=very important; Quality scale: 1=not useful and/or not provided to 5=very useful. The ratings shown represent the weighted average mean based on the total responses for each question and/or specific item set within a given question. If respondents selected “no opinion” or did not make a selection, this response or lack thereof is not included in the total responses used to calculate the mean rating.

- Situations where required returns appear uninvestible/unhedgeable
- Concentrated positions in individual securities or industries
- Actuarial models used
- Control of investment decisions

A critical issue for investors is developing a complete understanding of the degree of mismatch risk being undertaken and whether the net expected return on the overall risk exposure is adequate.

Appendix B provides examples of disclosures that we believe would meet investors' needs.

We expect that some entities will argue that they do not have access to the necessary information regarding their plans to furnish investors with these disclosures. In these circumstances we urge the Board to include a disclosure requirement that would require entities to disclose when they do not have access to required information and to explain why this information is unavailable. We would like to see interim disclosures for pension costs to reflect changes in plan assets for each interim period presented.

Also, with regard to plan asset disclosures we would urge the Board to require disclosure details similar to those provided by mutual funds to their investors. The reason for this request is that, in essence, the equity investor bears the risk that plan assets will be insufficient to fund plan payments. For that reason investors should have information required to evaluate the risk and return characteristics of plan assets. Disclosures similar to those provided by mutual funds would allow an investor to estimate pension plan performance between periods and forecast future returns. For example the following disclosure would allow an investor to obtain a reasonable understanding of plan characteristics:

- Plan performance quarter-to-date, year-to-date, 1 year, 3 years, 5 years and since inception
- A list of top 10 holdings and fund weights
- A sector allocation table (in addition to concentrated positions in certain industries where portfolio allocations materially exceed the allocations of a market portfolio)
- Fund characteristics and fund information (dividend yield, average PE ratio, number of holdings, primary benchmark, etc.)

We recommend that the Board review the discussion paper, *The Financial Reporting of Pensions*<sup>6</sup> issued by the Accounting Standards Board for purposes of developing transparent pension plan disclosure requirements. This paper contains proposed disclosures which would enable investors to understand the risks and reward arising from the provision of pension benefits.

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<sup>6</sup> Accounting Standards Board *The Financial Reporting of Pensions*  
<http://www.frc.org.uk/asb/technical/projects/project0065.html>





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### **Closing Remarks**

We commend the Board for taking steps to improve the post-employment benefit accounting standard. We believe that steps taken in this first phase have the potential to provide relevant information to the users of financial statements. This first step when combined with the expectation that a second phase will be conducted should add measurably to financial reporting for post-employment benefits.

If you, other board members or your staff have questions or seek further elaboration of our views, please contact either Matthew Waldron or Patrick Finnegan by phone (424-951-5321/212-754 8350) or by email ([Matthew.Waldron@cfainstitute.org](mailto:Matthew.Waldron@cfainstitute.org) / [Patrick.Finnegan@cfainstitute.org](mailto:Patrick.Finnegan@cfainstitute.org) ).

Sincerely,

*/s/ Kurt N. Schacht*

Kurt N. Schacht, CFA  
Managing Director

*/s/ Gerald I. White*

Gerald I. White, CFA  
Chair, Corporate Disclosure Policy Council

cc: Corporate Disclosure Policy Council



**Appendix A**

<b>Income Statement Excerpts</b>	
Pension plan asset gain/(loss)	\$100
Pension obligation expense	(145)
OPEB plan asset gain/(loss)	-
OPEB obligation expense	(71)
Contribution-based promise plan asset gain/(loss)	25
Contribution-based promise obligation expense	(52)

  

<b>Balance Sheet Excerpts</b>	
<b>ASSETS</b>	
Pensions	\$1,160
OPEB	-
Contribution-based promises exposing company to return risk	582
<b>LIABILITIES</b>	
Pensions	\$1,090
OPEB	548
Contribution-based promises exposing company to return risk	582

**Appendix A.1**

<b>Caption in Balance Sheet</b>	<b>2006 Balance Sheet</b>	<b>Total Cash Flows Inflow(outflow)</b>	<b>Caption in Statement of Cash Flows</b>	<b>Inflow/(outflow) not affecting income</b>	<b>Contractual accruals</b>	<b>Allocations &amp; other non-re-measurements</b>	<b>Recurring fair value changes</b>	<b>Comprehensive Income</b>	<b>Caption in Statement of Comprehensive Income</b>	<b>2007 Balance Sheet</b>
Defined benefit pension plan assets	\$ 1,080	\$ (20)	Net pension plan asset outflow	\$ (20)	\$ -	\$ -	\$ 100	\$ 100	Pension plan asset gain(loss)	\$ 1,160
Defined benefit pension plan liabilities	(1,025)	80	Net pension plan obligation payments (net of employee contributions)	80	-	-	(145)	(145)	Pension plan obligation expense	(1,090)
Pension plan funded status	55	60	Company's cash contribution to pension plans	60	-	-	(45)	(45)	Net pension inc (exp)	70
OPEB plan assets	-	-	Net OPEB plan asset outflow	-	-	-	-	-	OPEB plan asset gain(loss)	-
OPEB plan liabilities	(517)	40	Net OPEB plan obligation payments (net of employee contributions)	40	-	-	(71)	(71)	OPEB plan obligation expense	(548)
OPEB plan funded status	(517)	40	Company's cash contribution to OPEB plans	40	-	-	(71)	(71)	Net OPEB inc (exp)	(548)
CB promise plan assets	540	17	Net CB promise plan asset outflow	17	-	-	25	25	CB promise plan asset gain(loss)	582
CB promise plan liabilities	(540)	10	Net CB promise plan obligation payments (net of employee contributions)	10	-	-	(52)	(52)	CB promise plan obligation expense	(582)
CB promise plan funded status	-	27	Company's cash contribution to CB promise plans	27	-	-	(27)	(27)	Net CB promise plan inc (exp)	-
Net operating assets	\$ (462)	\$ 127	Net cash provided by operating activities	\$ 127	\$ -	\$ -	\$ (143)	\$ (143)	Comprehensive operating income	\$ (478)

**Note Disclosure**  
**Pension Plan**

**Appendix A.2**

<b>Fair Value of Plan Assets</b>	<b>2006</b>	<b>2007</b>	<b>Cash Inflow (Outflow)</b>	<b>Recurring Fair Value Changes</b>	<b>Year over year Change</b>
Beginning of year	\$1,000	\$1,080	\$ -	\$ -	
Actual return on plan assets	75	80	-	80	
Company contribution	50	50	50	-	
Employee contribution	10	10	10	-	
Benefits paid	(85)	(90)	(90)	-	
Net acquisitions/divestitures	10	10	10	-	
Curtailments, settlements and other	10	10	-	10	
Foreign exchange impact	10	10	-	10	
End of year	1,080	1,160	(20)	100	80
<b>Projected Benefit Obligation</b>					
Beginning of year	1,000	1,025	-	-	
Service cost	45	50	-	50	
Interest cost	50	51	-	51	
Employee contribution	10	10	10	-	
Amendments	4	8	-	8	
Actuarial (gain)loss from discount rate change	15	20	-	20	
Actuarial (gain)loss from other sources	(33)	(6)	-	(6)	
Benefits paid	(85)	(90)	(90)	-	
Termination benefits	3	5	-	5	
Net acquisitions/divestitures	6	7	-	7	
Curtailments, settlements and other	4	4	-	4	
Foreign exchange impact	6	6	-	6	
End of year	1,025	1,090	(80)	145	65
<b>Funded Status</b>					
Over (under) funded amount	55	70			15
<b>Pension plan asset cash flows</b>					
Pension cash inflows			70		
Pension cash (outflows)			(90)		
Net plan inflow (outflow)			(20)		
<b>Pension plan obligation cash flows</b>					
Plan cash (inflows)			(10)		
Plan cash outflows			90		
Net plan inflow (outflow)			80		
<b>Total net pension plan cash flows</b>					
Plan cash (inflows)			60		
Plan cash outflows			-		
Net plan inflow (outflow)			60		



**Note Disclosure  
 OPEB Reconciliation**

**Appendix A.3**

<b>Fair Value of Plan Assets</b>	<b>2006</b>	<b>2007</b>	<b>Cash Inflow (Outflow)</b>	<b>Recurring Fair Value Changes</b>	<b>Year over year Change</b>
Beginning of year	\$ -	\$ -	\$ -	\$ -	
Actual return on plan assets					
Company contribution	35	40	40	-	
Employee contribution	5	5	5	-	
Benefits paid	(40)	(45)	(45)	-	
Net acquisitions/divestitures	-	-	-	-	
Curtailments, settlements and other	-	-	-	-	
Foreign exchange impact	-	-	-	-	
End of year	-	-	-	-	-
<b>Projected Benefit Obligation</b>					
Beginning of year	500	517	-	-	
Service cost	22	23	-	23	
Interest cost	25	26	-	26	
Employee contribution	5	5	5	-	
Amendments	2	3	-	3	
Actuarial (gain)loss from discount rate change	7	8	-	8	
Actuarial (gain)loss from other sources	(15)	(6)	-	(6)	
Benefits paid	(40)	(45)	(45)	-	
Termination benefits	3	4	-	4	
Net acquisitions/divestitures	3	8	-	8	
Curtailments, settlements and other	2	3	-	3	
Foreign exchange impact	3	2	-	2	
End of year	517	548	(40)	71	31
<b>Funded Status</b>					
Over (under) funded amount	(517)	(548)			(31)
<b>OPEB plan cash flows</b>					
Pension cash inflows			45		
Pension cash (outflows)			(45)		
Net plan inflow (outflow)			-		
<b>OPEB plan obligation cash flows</b>					
Plan cash (inflows)			(5)		
Plan cash outflows			45		
Net plan inflow (outflow)			40		
<b>Total net OPEB plan cash flows</b>					
Plan cash (inflows)			40		
Plan cash outflows			-		
Net plan inflow (outflow)			40		

**Note Disclosure**  
**CB Promises Exposing Company to Return Risk**  
**Reconciliation**

**Appendix A.4**

<b>Fair Value of Plan Assets</b>	<b>2006</b>	<b>2007</b>	<b>Cash Inflow (Outflow)</b>	<b>Recurring Fair Value Changes</b>	<b>Year over year Change</b>
Beginning of year	\$ 500	\$ 540	\$ -	\$ -	
Actual return on plan assets	25	25	-	25	
Company contribution	25	27	27	-	
Employee contribution	-	-	-	-	
Benefits paid	(10)	(10)	(10)	-	
Net acquisitions/divestitures	-	-	-	-	
Curtailments, settlements and other	-	-	-	-	
Foreign exchange impact	-	-	-	-	
End of year	540	582	17	25	42
<b>Projected Benefit Obligation</b>					
Beginning of year	500	540	-	-	
Service cost	25	25	-	25	
Interest cost	25	27	-	27	
Employee contribution	-	-	-	-	
Amendments	-	-	-	-	
Actuarial (gain)loss from discount rate change	-	-	-	-	
Actuarial (gain)loss from other sources	-	-	-	-	
Benefits paid	(10)	(10)	(10)	-	
Termination benefits	-	-	-	-	
Net acquisitions/divestitures	-	-	-	-	
Curtailments, settlements and other	-	-	-	-	
Foreign exchange impact	-	-	-	-	
End of year	540	582	(10)	52	42
<b>Funded Status</b>					
Over (under) funded amount					
<b>CB promise plan asset cash flows</b>					
Pension cash inflows			27		
Pension cash (outflows)			(10)		
Net plan inflow (outflow)			17		
<b>CB promise plan obligation cash flows</b>					
Plan cash (inflows)					
Plan cash outflows			10		
Net plan inflow (outflow)			10		
<b>Total net CB promise plan cash flows</b>					
Plan cash (inflows)			27		
Plan cash outflows			-		
Net plan inflow (outflow)			27		

**Note Disclosure**  
**Total Reconciliation**

<b>Fair Value of Plan Assets</b>	<b>2006</b>	<b>2007</b>	<b>Cash Inflow (Outflow)</b>	<b>Recurring Fair Value Changes</b>	<b>Year over year Change</b>
Beginning of year	\$1,500	\$ 1,620	\$ -	\$ -	
Actual return on plan assets	100	105	-	105	
Company contribution	110	117	117	-	
Employee contribution	15	15	15	-	
Benefits paid	(135)	(145)	(145)	-	
Net acquisitions/divestitures	10	10	10	-	
Curtailments, settlements and other	10	10	-	10	
Foreign exchange impact	10	10	-	10	
End of year	1,620	1,742	(3)	125	122
<b>Projected Benefit Obligation</b>					
Beginning of year	2,000	2,082	-	-	
Service cost	92	98	-	98	
Interest cost	100	104	-	104	
Employee contribution	15	15	15	-	
Amendments	6	11	-	11	
Actuarial (gain)loss from discount rate change	22	28	-	28	
Actuarial (gain)loss from other sources	(48)	(12)	-	(12)	
Benefits paid	(135)	(145)	(145)	-	
Termination benefits	6	9	-	9	
Net acquisitions/divestitures	9	15	-	15	
Curtailments, settlements and other	6	7	-	7	
Foreign exchange impact	9	8	-	8	
End of year	2,082	2,220	(130)	268	138
<b>Funded Status</b>					
Over (under) funded amount	(462)	(478)			(16)
<b>Aggregate plans asset cash flows</b>					
Pension cash inflows			142		
Pension cash (outflows)			(145)		
Net plan inflow (outflow)			(3)		
<b>Aggregate plans obligation cash flows</b>					
Plan cash (inflows)			(15)		
Plan cash outflows			145		
Net plan inflow (outflow)			130		
<b>Aggregate net plans cash flows</b>					
Plan cash (inflows)			127		
Plan cash outflows			-		
Net plan inflow (outflow)			127		



## Appendix B

### Examples of Note Disclosures

1. *Situations where Required Returns Appear Uninvestible/Unhedgeable:*

Some of our contribution-based promises stipulate that we provide a required annual return of 10% on all plan assets. This required-return provision is mandated by the Government of Antarctica. Based on our evaluation of market instruments, we do not believe that we are capable of investing in market instruments that will provide such a stream of guaranteed returns and, thus we do not believe this guaranteed return exposure can be hedged using a market instrument. The company currently has PBO obligations of \$1,000 with such guaranteed return exposures.

2. *Concentrated Positions in Individual Securities or Industries:*

The pension plan currently has concentrated positions in certain securities. The following is a list of individual securities constituting more than 3% of pension plan assets and the percentage of plan assets represented by those securities:

<u>Ticker</u>	<u>Type of Investment</u>	<u>% of Plan Assets</u>
AAAA	Equity - Common Stock	3%
BBBB	Equity - Preferred Stock	9%
N/A	Fixed Income - XYZ MBS	12%
N/A	Private Equity - Widget Co.	4%

Furthermore, 40% of our plan assets (\$10 billion) are in concentrated positions in 20 securities in the biotech industry.

As of December 31, 20XX, the duration of the assets that supported pension liabilities was 13.5 years. The duration of pension liabilities as of December 31, 20XX was 11 years. Management believes there are sufficient liquid assets to meet all pension liabilities expected to be paid during the next 12 months.

3. *Actuarial Model:*

The Company uses the RP-2000 projected 2015 mortality table in calculating the pension obligation.





**Appendix B continued**

4. *Control of Investment Decisions:*

Example 1

The management of the company does not have control of the investment decisions of pension plan assets. Mr. X who makes the primary investment decisions for our pension plans is not employed by the company, but rather he is an independent employee of the pension trust. As a result, the company has limited ability to influence investment decisions or take actions to control, influence, hire, or terminate pension plan investment decision makers. A significant risk to shareholders is that the plan administrator will make investment decisions that are not in the best interest of shareholders and the company will have no recourse in response to the impact of these investment decisions.

Example 2

***Who Manages the Portfolio***

**XY L.P.** (“XY LP”), New York, New York. XY LP has been the Adviser to the Portfolio and its predecessor registered investment company since the predecessor commenced operations. XY LP manages investments for investment companies, endowment funds, insurance companies, foreign entities, qualified and non-tax qualified corporate funds, public and private pension and profit-sharing plans, foundations and tax-exempt organizations. As of December 31, 2007, XY LP had approximately \$200 billion in assets under management.

The management of and investment decisions for the Portfolio are made by the Policy Team, comprised of senior Blend portfolio managers. The Policy Team relies heavily on XY LP’s growth, value and fixed-income investment teams and, in turn, the fundamental research of XY LP’s large internal research staff. The primary day-to-day responsibilities for coordinating the Portfolio’s investments resides with Mr. Smith, the Chief Investment Officer (“CIO”) of the Blend Investment Policy Team.

Mr. Smith has served as CIO — Style Equity Services and headed the US and global style blend teams since 2002. He serves on XY LP’s Executive Committee, a group of key senior professionals responsible for managing the firm, enacting key strategic initiatives and allocating resources. Mr. Smith joined XY LP in 1995. He is a CFA charterholder and he received BS and MBA degrees from New York University.

**Appendix B continued**

Example 3

**(D) Plan Investment Policies**

The investment policies and strategies for the assets of our pension and retiree medical and retiree life insurance plans are established by the Fiduciary Committee (the “Committee”), which is responsible for investment decisions and management oversight of each plan. The stated philosophy of the Committee is to manage these assets in a manner consistent with the purpose for which the plans were established and the time frame over which the plans’ obligations need to be met. The objectives of the investment management program are to (1) meet or exceed plan actuarial earnings assumptions over the long term and (2) provide a reasonable return on assets within established risk tolerance guidelines and liquidity needs of the plans with the goal of paying benefit and expense obligations when due. In seeking to meet these objectives, the Committee recognizes that prudent investing requires taking reasonable risks in order to raise the likelihood of achieving the targeted investment returns. In order to reduce portfolio risk and volatility, the Committee has adopted a strategy of using multiple asset classes.

As of December 31, 2007, the following target asset allocation ranges were in effect for our pension plans:

	<b>Minimum</b>	<b>Target</b>	<b>Maximum</b>
Cash	0%	0%	5%
Fixed Income	20%	30%	40%
Equity	55%	65%	75%
Alternative			
Investments	0%	5%	10%

As of December 31, 2007, the following target asset allocation ranges were in effect for our retiree medical and retiree life insurance plans:

	<b>Minimum</b>	<b>Target</b>	<b>Maximum</b>
Cash	0%	5%	15%
Fixed Income	15%	25%	35%
Equity	60%	70%	80%

In order to achieve enhanced diversification, the equity category is further subdivided into sub-categories with respect to small cap vs. large cap, value vs. growth and international vs. domestic, each with its own target asset allocation. Historically, our plans have allowed for up to 10% (15% with asset appreciation) of the plans’ assets to be held in ZZ, Inc. common stock. During the fourth quarter of 2006, all investments in ZZ, Inc. common stock held by the plans were systematically liquidated at the discretion of



## **Appendix B continued**

our independent fiduciary. As a result of the sale of these assets, at December 31, 2006, the cash position in our pension plan was above the maximum allocation (15.6% vs. 5% maximum allocation) and the large cap equity position (32.8%) was slightly above the minimum large cap allocation (30%) but below the target allocation (40%). In the first quarter of 2007, the Committee rebalanced the plans' portfolios to be within the allocation ranges specified by investment policies.

In implementing its investment policies and strategies, the Committee has engaged a professional investment advisor to assist with its decision making process and has engaged professional money managers to manage plan assets. The Committee believes that such active investment management will achieve superior returns with comparable risk in comparison to passive management. Consistent with its goal of reasonable diversification, no manager of an equity portfolio for the plan is allowed to have more than 10% of the market value of the portfolio in a single security or weight a single economic sector more than twice the weighting of that sector in the appropriate market index. Finally, investment managers are not permitted to invest or engage in the following equity transactions unless specific permission is given in writing (which permission has not been requested or granted by the Committee to-date): derivative instruments, except for the purpose of asset value protection (such as writing covered calls), direct ownership of letter stock, restricted stock, limited partnership units (unless the security is registered and listed on a domestic exchange), venture capital, short sales, margin purchases or borrowing money, stock loans and commodities. In addition, fixed income holdings in the following investments are prohibited without written permission: private placements, except medium-term notes and securities issued under SEC Rule 144a; foreign bonds (non-dollar denominated); municipal or other tax exempt securities, except taxable municipals; margin purchases or borrowing money to effect leverage in the portfolio; inverse floaters, interest only and principle only mortgage structures; and derivative investments (futures or option contracts) used for speculative purposes. Certain other types of investments such as hedge funds and land purchases are not prohibited as a matter of policy but have not, as yet, been adopted as an asset class or received any allocation of fund assets.