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FASB'S PROPOSED STANDARD ON "EMPLOYERS' ACCOUNTING FOR DEFINED BENEFIT PENSION AND OTHER POST-RETIREMENT PLANS"

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

ON

EXAMINING A FINANCIAL ACCOUNTING STANDARDS BOARD (FASB) PROPOSAL THAT WILL PROVIDE ENHANCED TRANSPARENCY OF CORPORATE ACCOUNTING FOR DEFINED BENEFIT PENSION AND OTHER POST-RETIREMENT PLANS

JUNE 14, 2006

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FASB'S PROPOSED STANDARD ON "EMPLOYERS' ACCOUNTING FOR DEFINED BENEFIT PENSION AND OTHER POST-RETIREMENT PLANS"

WEDNESDAY, JUNE 14, 2006

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met, pursuant to notice, at 10:29 a.m., in room SD–538, Dirksen Senate Office Building, Senator Richard Shelby (Chairman of the Committee) presiding.

OPENING STATEMENT OF CHAIRMAN RICHARD SHELBY

Chairman SHELBY. Today, the Banking Committee will examine a Financial Accounting Standards Board (FASB) proposal that will provide enhanced transparency of corporate accounting for defined benefit pension and other post-retirement plans. Sound and transparent accounting standards are the lifeblood of the capital markets. Financial reporting must reflect economic reality. If it does not, investors will lose confidence in the integrity of our markets. It is that simple.

To establish high-quality accounting standards, the standard setter must have an open process to consider the views of all interested parties, and it must possess unquestioned independence. The FASB proposal, the first phase of a two-phase project, would require employers to recognize on their balance sheets the overfunded or underfunded status of their single employer benefit pension plans and other post-retirement benefits. This accounting change would make financial statements more accurate, complete, and reliable.

I applaud FASB for embarking on this important project and offer my continued support for their independent judgment. The effort to bring transparency to pension accounting is part of a larger effort to not only harmonize global accounting standards, but also to improve their quality. The Securities and Exchange Commission, the FASB, and the International Accounting Standards Board, IASB, are working together on this important endeavor.

This morning, we will hear testimony from two witnesses. Neither one is a stranger to the Committee. Mr. Robert Herz is Chairman of the FASB, and Sir David Tweedie is Chairman of the IASB. I welcome both of them back to the Committee and look forward to their statements.

Senator Sarbanes.

STATEMENT OF SENATOR PAUL SARBANES

Senator SARBANES. Well, Mr. Chairman, I want to commend you for your continued attention to the importance of the work of the Financial Accounting Standards Board and the International Accounting Standards Board. Of course, Bob Herz and Sir David Tweedie are no strangers to this Committee, and I am pleased to join with you in welcoming them back this morning.

The statements of both of our witnesses outline potential problems with the present accounting rules for defined benefit pension plans. Some of those potential problems are perhaps inherent in the nature of defined benefit pension plans themselves, especially the possibility that assets will shift in value or will not be adequately matched to the maturity of pension obligations.

Others may reflect difficulties of predicting future employment and industry health, difficulties not foreseen several decades ago, and others may reflect inconsistencies or loopholes in the statutes governing pension funding. But both organizations, as I understand it, have undertaken a serious reexamination of these issues, and that is now underway.

There is, of course, debate over implementation costs, when to measure benefit obligations and associated assets, appropriate effective dates, transition periods, and whether special rules are needed for nonpublic companies, nonprofit organizations, and cooperatives. Some have expressed concern about the impact immediate balance sheet disclosure could have on companies and, hence, their ability to continue to fund the benefit plans. Others, of course, have emphasized that an accounting system for public companies that does not adequately disclose the size and impact of obligations of this nature can hardly be called transparent. So I join with you in looking forward to learning more about these issues today, and I join with you, as always, in welcoming Sir David and Bob Herz back before the Committee.

Chairman SHELBY. Thank you, Senator Sarbanes.

Senator Allard.

STATEMENT OF SENATOR WAYNE ALLARD

Senator ALLARD. Well, Mr. Chairman, again, I would like to thank you for holding this hearing. This is a major proposal that will have significant implications for business, so I appreciate the opportunity to learn more about what FASB is doing. As part of this debate, we cannot lose sight of the voluntary nature of the current retirement benefit systems. Certainly it is important to have fair, consistent, accurate, and transparent reporting. However, we must also be cognizant of the potential to disincentivize employers from providing benefits. As with all important regulatory decisions, I hope that FASB is taking an appropriate amount of time and giving adequate consideration to the comments it receives. Such expansive decisions are better done right than done fast.

I look forward to the testimony of our witnesses, and it will be most helpful as we continue to monitor progress on this issue.

Thank you, Mr. Chairman.

Chairman SHELBY. Senator Enzi.

STATEMENT OF SENATOR MIKE ENZI

Senator ENZI. Thank you, Mr. Chairman, and I really appreciate your holding this hearing today on revising our Nation's accounting standards for pension plans and retirement health benefits and their convergence with the international accounting standards. This hearing could not be timelier as we approach the retirement of the baby-boom generation. Day after day, the newspaper headlines are filled with stories of large and small companies struggling with legacy costs, especially in the retirement benefits area.

After his last appearance before the Banking Committee a couple years ago, Sir David Tweedie and I had the opportunity to meet in the Committee's anteroom. The original topic of discussion was intended to be about the use of stock options grants in the United States and in Europe; however, the topic quickly changed to a discussion on accounting standards for retirement benefits. At that time both of us had agreed that accounting for retirement benefits was one of the bigger challenges for the accounting industry. We both thought the issue dwarfed the issue of stock options.

Sir David spoke of his experience with companies in legacy industries and the U.K.'s pension turmoil. We both recognized that the problem was looming over the horizon in the United States. Little did we know how correct that would be.

Mr. Chairman, as you know, last year I took over the chairmanship of the Committee on Health, Education, Labor, and Pensions. One of my first orders of business was to begin drafting legislation to revise our pension laws under ERISA to ensure that defined benefit pension plans are fully funded and do not become a burden on the Pension Benefit Guaranty Corporation, PBGC. Currently, we have convened a conference committee with the House to resolve the difference between the House and Senate bills. I have got to say this would be a whole lot easier if we were just initiating the policy for pensions to start, but they have been in effect for years and years, and any change that we make affects past actions as well as future actions. It is complicated because the plans already exist, so our option is not to start over. Our option is to transition so that we make sure that people that worked hard for years and years with the anticipation of retirement can retire and that the funds are made strong and complete.

Now, while pension accounting, pursuant to the funding rules for ERISA and the Tax Code, are much different than generally accepted accounting practices, there are vital lessons to be learned. FASB is making the right decision to update retirement benefits accounting standards at this time. The current standards do not accurately tell the story of the true cost of liability a company may owe for future obligations. The first stage may appear to be a modest change, but even a modest change in this volatile area can be significant, particularly when you take into consideration the changes that the pensions bill are going to be making at the same time. These are not being done in opposition to each other. They are being done in conjunction with each other. But it is important that there be a lot of communication so that one is not undoing the process of strengthening that the other is doing.

The real work will come when FASB engages in Phase 2 of its initiative to look at the methodologies behind the numbers. Today

we are on the verge of an evolution in our pension and retirement health care system. Companies are making the decision to no longer provide defined benefit plans and retirement health care due to escalating costs. In addition, study after study shows that Americans in general do not have enough money to live through their golden years.

Now, as FASB and the International Accounting Standards Board consider changes to accounting rules, I would offer them guidance to do so in a manner that would not cause companies to immediately stop retirement benefits. Any significant change must be done with sufficient transition periods in place and time for companies to adjust and to plan ahead. Our employees' retirement benefits are too important not to take the time to get this right the first time.

I have commended FASB before for having a Small Business Advisory Committee, and I think that has helped with some significant decisions. Perhaps there could be a temporary committee that would also work on the retirement benefit thing to bring in the expertise of people that have been working in that for years to make sure that what we are doing on pensions legislation and what you are doing on standards will be conjunctive rather than opposing.

Mr. Chairman, as this is a hearing on accounting standards, I would also like to add a comment on the recent revelations on the manipulation in the marketplace on stock options. If there can be good news out of this, it appears that the backdating scandal appears to have happened before the implementation of Sarbanes-Oxley. Thankfully, provisions in the act require much faster disclosure of executives who exercise stock options rights. This and vigilant oversight by the SEC should put an end to it. However, I am very disturbed by the Enron-type shenanigans that appear to have gone on with stock option backdating. This is just another lessons that the manipulation of accounting standards is wrong. It is criminal, and those who are manipulating the markets must be punished.

Now, when we discussed stock options and accounting a couple of years ago, the discussion I brought to the table was about entrepreneurship and broad-based employee stock option plans. I still believe that companies should have these tools available to them. Legislation introduced would have immediately expensed and disclosed executive stock options. Executives should not be permitted to manipulate executive stock options to the detriment of employees and shareholders. I fully support Chairman Cox and the SEC Enforcement Division to crack down on that abusive practice.

Mr. Chairman, I thank you for holding this hearing.

Chairman SHELBY. Senator Bunning.

Senator BUNNING. No opening statement. Thank you.

Chairman SHELBY. I want to welcome again both of you to the Committee. Sir David, I know you travel a lot. We are glad to have you here. Thank you. Your written testimony will be made part of the record. Bob, we will start with you.

STATEMENT OF ROBERT H. HERZ, CHAIRMAN, FINANCIAL ACCOUNTING STANDARDS BOARD

Mr. HERZ. Thank you, Chairman Shelby and Ranking Member Sarbanes, and other Members of the Committee. I am here on behalf of the Financial Accounting Standards Board, and I want to thank you for this opportunity to discuss our current project to improve the employers' accounting for defined benefit pension plans and other post-retirement benefits.

Our ultimate goal in that project is to develop, in cooperation with the IASB, a high-quality principles-based global standard for accounting for these obligations. I am therefore very pleased that Sir David is also here with me today.

As you probably know, we are working very closely with our international colleagues on a number of key projects, including the development of a common conceptual framework, topics like accounting for business combinations, financial instruments, financial statement presentation, revenue recognition, and a number of other projects designed to reduce the differences between U.S. GAAP and international financial reporting standards, and in the process to improve both of our respective standards. Sir David will elaborate further on these efforts to bring about high-quality global accounting standards.

With regard to the post-retirement benefit project, we have undertaken that project because current accounting standards do not provide complete and transparent information about employers' obligations and costs relating to these benefit promises. Our proposed changes in the first phase of our two-phase project would require employers to recognize the over or underfunded status of their defined benefit pension plans and other post-retirement benefit plans on their balance sheets. We believe these changes would more faithfully report the underlying economic effects of those plans and increase the transparency, completeness, and usefulness of financial statements for shareholders, creditors, employees, retirees, and others.

The second broader phase of the project, which will begin after completing the first phase, will address a broad range of accounting and reporting issues in the area of post-retirement benefits. Before discussing further details about this project, I would like to provide you with a little bit of background on the FASB.

We are, of course, an independent, private-sector organization. Our independence from enterprises, auditors, and others is fundamental to achieving our mission to establish and improve standards of financial accounting and reporting for both public and private enterprises. Through the FASB, accounting standards are set by an independent group of experts who carefully develop proposed rules through an open, public deliberative process which contributes to overall confidence in the capital markets.

Financial reporting is meant to tell it like it is and not to allow distortions or the skewing of information that favors particular companies or industries, particular types of transactions, or particular political, social, or economic goals other than that of sound reporting.

While bending standards to favor or retain a particular outcome may seem attractive to some, in the long run, biased accounting

standards can lead to mistakes in private and public investment decisions.

Because our actions affect so many organizations, our decision process must be open, thorough, and as objective as possible. So our rules of procedure require an extensive and thorough public due process. It involves public meetings, public roundtables, meetings with many interested parties, and exposure of our proposed standards to external scrutiny and public comment, and in making our judgments we must balance the often-conflicting perspectives of various interested parties in order to make independent, objective decisions guided by fundamental concepts and key qualitative characteristics of financial reporting.

In November of 2005, our Board unanimously decided to add a comprehensive project to our agenda to reconsider the existing accounting guidance for defined benefit pension plans and other post-retirement benefits. That decision responded to many requests from users of financial statements, preparers and auditors, our advisory committees, the staff of the Securities and Exchange Commission, the Pension Benefit Guaranty Corporation, and many others, to remedy deficient rules that have resulted in unclear and misleading financial reporting for defined benefit plans and other post-retirement benefits.

What are the key concerns? First, the current standards permit an employer sponsoring such plans to delay recognition through a complex series of smoothing mechanisms of the economic events that result in great distortions of the costs and obligations that are reported. Current requirements also relegate important information about the benefit plans and their status to the notes in the financial statements. Additionally, the existing reporting of benefit costs obscures the employers' reported results of operations by combining the effects of compensation, investing, and financing activities.

We decided to conduct our project in two phases. The first phase of the project focuses on recognizing on the employers' balance sheet the overfunded or underfunded status of its post-retirement benefit plans. The second, broader phase of the project will address other more complex issues, including how best to recognize and display in reported earnings or other comprehensive income, the various elements that affect the cost of providing post-retirement benefits. A key issue to be explored there will be whether and to what extent should the current smoothing mechanisms relating to pension costs and other post-retirement benefit costs be allowed to continue, or should it be eliminated or at least simplified.

We will also examine issues such as how best to measure the obligations, in particular, obligations under plans with lump sum benefit features, cash balance plans and multi-employer plans, and whether more or different guidance should be provided regarding measurement assumptions.

Since our November 2005 decision, the Board and staff have held three public meetings to discuss the Phase 1 project. We have discussed it at meetings with our advisory committees and with other interested groups. We have also discussed it at numerous venues across the country.

So after about 4 months of public due process, in March of this year we unanimously agreed to issue the Phase 1 proposal for public comment. The Phase 1 proposal would require employers to recognize the overfunded or underfunded status of their post-retirement benefit plans on their balance sheets. For example, for defined benefit pension plans, the amount of what is called the projected benefit obligation would be compared to the value of the related plan assets. If the projected benefit obligation exceeds the plan assets, the difference would be reported as a liability on the employers' balance sheet, that is, it is in an underfunded position with a corresponding decrease net of any tax effects to the employers' reported equity. Conversely, if the value of the plan assets exceeds the projected benefit obligation, the difference would be reported as an asset with a corresponding increase net of any tax effects in the employers' reported equity.

The Phase 1 proposal would also require that employers measure the plan assets and obligations as of the date of their financial statements. In contrast, current accounting standards permit them to be measured at dates up to 3 months earlier. The proposed changes would require recognition of the overfunded or underfunded status by the end of this fiscal year for calendar year-end companies. For public companies, the change in the measurement dates to bring it to the fiscal year end would be delayed for another year to 2007, and for private companies, they would be given another year, to 2008.

The comment period for the Phase 1 proposal ended on May 31. The Board plans to hold public roundtable meetings later this month on the proposal to ensure that we understand the views and positions of interested parties. While our staff is currently analyzing and summarizing the over 200 comment letters we have received, from my own reading of the letters, some of the key issues and concerns raised by respondents focus on the measurement of the underfunded or overfunded status, the proposed effective dates, and the proposed requirement to measure plan assets and liabilities as of the employers' fiscal year end.

After the roundtable meetings, the Board will then begin public redeliberations on the Phase 1 proposal. Our redeliberations will focus on the key issues raised by constituents, and only after carefully evaluating the input received will the Board consider whether to issue a final standard on Phase 1, which, of course, requires approval by a majority of our Board. Once we do that, assuming we do it, the Board will begin Phase 2 of the project.

Chairman Shelby, before handing over to Sir David, I would like to take this opportunity to thank you and Senator Sarbanes and other Members of the Committee for all your efforts in recent years to improve the integrity of financial reporting, and for your support of our work. Many thanks.

Chairman SHELBY. Sir David.

STATEMENT OF SIR DAVID TWEEDIE, CHAIRMAN, INTERNATIONAL ACCOUNTING STANDARDS BOARD

Mr. TWEEDIE. Thank you very much, Mr. Chairman, Ranking Member Sarbanes, Members of the Committee. May I say, as ever,

it is a great pleasure to be here in the United States, the finest country that anyone ever stole.

[Laughter.]

Mr. TWEEDIE. I must say that it is a great opportunity to discuss a topic that I care deeply about, as Senator Enzi reminds me. I am a baby boomer, and this is an issue—I may not look it—but this is an issue that does start to creep up on you.

I think the real area though is the fact that between the FASB and the IASB, we could make real progress in changing accounting systems that are deficient, distort behavior, have intergenerational consequences, and could lead to great cost, as Senator Enzi emphasized, to taxpayers.

We are in the process now of adding a project onto our active agenda. We intend to work very closely, as Bob said, with the FASB, and I am delighted that Bob is here with me today. He has been a great advocate of international standards, and has provided essential leadership in our convergence program with the United States'.

Perhaps before I turn to post-retirement benefits, I could put IASB's work into context. The FASB and the SEC helped form our constitution, which makes it quite clear that our objective is to come up with one single set of high-quality global standards. Since I first appeared before this Committee in February of 2002, 100 countries now allow or require international standards to be used, including the European Union, which requires them for consolidated accounts of listed companies. This also includes Australasia and South Africa. China is starting next year. Canada is going to shift in a few years time. Japan, we have a major convergence program with. Israel is coming in in 2008, and Chile the following year.

In all of this, the cooperation of the FASB has been essential, and our major objective now is to converge with the United States so we do indeed have one single set of standards and not two, as we have at present. The idea is, companies worldwide want access to markets on both sides of the Atlantic, and the convergence program is a major way of getting there.

Shortly after Bob became Chairman, we signed the Norwalk Agreement with the FASB, whereby we were trying to remove the differences in our various standards. By 2010, 1,000 companies using international standards will be registered with the SEC, and we see that number growing. It was taking too long, however, to get rid of these differences, and with the help of Bob and the SEC, we produced what is known as the Roadmap, a way in which we can get rid of these differences rather faster, and a method by which we can remove the reconciliation required when you list in the U.S. markets, using standards from another jurisdiction, and that has become a source of major contention among companies worldwide, and probably stopping several of them coming to the United States. We hope we can get rid of the need for reconciliation in the next 2 to 3 years.

The program is split into two parts. First there is a short-term phase, whereby we look at differences we know we can get rid of quite quickly, and we will just make a few changes to paragraphs in standards. FASB are doing some and we are doing some. Others,

where the standards are perhaps outdated or too complicated, while we could converge them, we think that would be a waste of resources, and we intend to write jointly a new standard. These cover various issues including financial instruments. If you have read the International Financial Instrument Standard, if you understand it, you have not read it properly. These are the sort of situations that affect, I think, probably the U.S. standard too, and what we want to do is write a new one. Post-retirement benefits fit into this class as well.

Bob and I often hear that accounting should not affect behavior, but the trouble is poor accounting masks the problem and leads to bad behavior. The overall deficit about a year ago, and the European Union companies in the Dow Jones Stoxx Index was $146 billion at today's exchange rates. The U.K. FTSE Index, the top 100 U.K. companies, showed deficits of $68 billion this time last year. The trouble is the international standard and present U.S. GAAP obscures the issue. To put it very simply, if we had a pension fund which had assets of $40 million and liabilities of $40 million, and the assets fell by $10 million, you would have a deficit of $10 million. That is not how they are generally shown.

What happens is we have smoothing mechanisms. The first comes in to say, well, some of that deficit will be market noise, we measure that at 10 percent or whatever is the higher, the liabilities or assets. The liabilities are the higher at 40. We take $4 million off the deficit of 10. We then spread that deficit of $10 million over the active working lives of the employees, say 10 years, and you end up with a deficit shown in the accounts of $600,000.

Now, as I have often said, explain that one to your grandmother. You may as well take the $10 million and divide it by the cube root of the number of miles to the moon and multiply it by your shoe size.

[Laughter.]

Mr. TWEEDIE. It really does not mean a thing. Nor disclosure, as we have discovered, in the case of share auction option accounting does not help. It really is not taken seriously enough, and that is why in the United Kingdom, one of the last things I did while I was Chairman of the U.K. Standards Board was introduce a new standard on pensions, FRS 17 which actually shows a whole deficit on balance sheet, and this is very similar to what Bob and the FASB are doing just now.

I thought it might be helpful to the Committee to explain what happened when we did that. When we first announced it, British companies split 50/50 for and against. The main argument was this was just a snapshot and could be distorted. We also required though that the trend is shown, so this deficit or surplus over the last 5 years is shown, and that very quickly showed that the deficits were getting worse. The problem exposed was we launched at not an ideal time. We launched at the beginning of the bear markets, so asset values fell. But what people did not realize was the effect on liabilities.

The first thing that happened, people have developed a very bad habit of living longer, and it has just got to stop.

[Laughter.]

Mr. TWEEDIE. The second factor was that interest rates fell. Now, that is normally a good thing, but the trouble was so did annuity rates. So if you promise someone a pension of 10,000 and annuity rates are at 10 percent, that will be a capital sum required of 100,000. If they fall to 5 percent, you need 200,000. So what happened was assets fell and liabilities rose in the funds at the same time, and it was not noticed.

The interesting thing, 2 or 3 years after we introduced the standard, the atmosphere had completely changed. As several senior executives said to me, pensions are now being discussed in the board room, it is no longer a hidden matter which was never revealed in the accounts.

We decided, when we became the IASB, to amend our pension standard to allow the U.K. proposal to be one of the options. Interestingly enough, 15 major U.K. companies wrote in, all of them suggesting that we do allow the FRS 17 approach, and two of the major business groups, the Association of British Insurers and the Confederation of British Industry, also supported it. That is quite a change from a few years earlier. Companies now see what they can promise.

This, as I know you are aware, is a huge issue. Our job is to make sure that people can make informed decisions, the question of the risk to the company, the question of the risk to the individual, and if the company cannot make the promises, the risk to the taxpayer.

FRS 17, like the FASB's first stage, was an incremental change. There are still defects that are in Phase 2 of Bob's project in which we hope to join in. We still allow an assumed return on assets for the future, and some of these assumed returns have been heroic. Now we need to look at the issue in a more comprehensive manner. We intend to add to the agenda, and again, like Bob, we intend to try and do it in two phases.

We will join in, I suspect, and do something very similar to that Bob has already proposed. We also intend that while the timing of our first phase and some of the things that we deal with may differ slightly from Bob's, we will still end up with a common standard. It is just a case of the movement toward it. We are intending to look at not only the smoothing mechanisms, but can we do something on the gains and assets, the curtailments, the presentations, the disclosures?

FASB is leapfrogging us at the moment, and we will catch up with our first phase, and then we will end up with the same standard. The work that we do will help FASB. The work FASB does will help us.

Retirement income depends on state-provided pensions, private savings and company schemes. Our job is to make sure that companies' schemes are on the same basis, and if they are not, people at least are aware of that. Good accounting will not solve the problem, but it makes the issues transparent. It helps the company. It means that they have to manage it. The problem is obvious. It is not an instant liability as a payable on inventory would be. It is simply something that has to be met. It helps investors because they see the cash-flow implications. It helps employees because

they now understand the risk, and it helps public officials because they now realize what the problem really is.

Interestingly, we are finding British companies are now explaining the problem quite clearly. We are getting disclosures something like, "We have a deficit of 50 million. We intend to put an extra 5 million a year into the fund. We intend to change the fund slightly. We expect the return on the existing assets to be in the region of 4 percent. If that all happens, we will be back in equilibrium in 2010. The effect on profits, assuming they are maintained at current levels, will be 1.3 percent, and the problem is starting to disappear and be managed."

It will not be easy. I always liken standard setting to American football. To an outsider American football is really just a big committee meeting, punctuated by extreme moments of violence——

[Laughter.]

Mr. TWEEDIE. And I expect that this process may be something similar.

It is important very much to get all views. As Bob said, we have major due process, but this—and I very much agree with Senator Enzi—is one of the major issues facing us, not only in accounting, but in public policy too.

Thank you, sir.

Chairman SHELBY. Thank you both. Harmonizing international accounting standards is an important project and has been given added importance recently by the cross-border consolidation exchanges. We will start with you, Sir David. Would you just touch again on the major accounting issues that you see that are likely to present the most difficult challenges with respect to convergence in that context?

Mr. TWEEDIE. I do not see them being a challenge to convergence because I think both boards are very keen that we do converge, and we have had nothing but cooperation, but I think the issues that are going to be controversial are certainly out there. We know, for example, leases is one where again we are thinking of putting that on our agenda right now.

Chairman SHELBY. Leases?

Mr. TWEEDIE. Leases, yes. One of my big ambitions is actually flying an aircraft that is on an airline's balance sheet before I die.

[Laughter.]

Mr. TWEEDIE. Basically, the leasing standards worldwide are harmonized, but none of them work. There are massive off-balance sheet amounts that are reflected both in the rights to the asset on the asset side, but also liabilities that companies cannot escape from. These are missing.

Financial instruments is going to be a challenge. It took our predecessors 12 years to come up with our present controversial standard. That is another one we are working actively with the FASB to look at.

Consolidations, the question of special purpose vehicles, we too are looking at what is being done in the United States and seeing if that is the answer internationally, whether we can improve upon it, if we can. We will obviously be back discussing it with the FASB. The whole question of consolidation here is, when should you bring a company in as a subsidiary. Is it when you have 50

percent plus one of the equity or is it when you control it? And these are issues, big, deep, philosophical issues that we have to resolve.

Chairman SHELBY. Bob, you want to comment on that?

Mr. HERZ. Yes, I would add just one or two other issues that I think are important. One is the whole area of intangibles. We are doing a lot of projects on the—I call it the liability side of the balance sheet, so to speak, but on the asset side the area of intangibles is one where accounting right now does not capture the value drivers of many businesses in the modern era, and so figuring out whether or not financial statements can better capture that, or is there other information that can be provided, I think——

Chairman SHELBY. How substantial is this?

Mr. HERZ. Well, since it is very hard to measure, what we do know, rightly or wrongly, is that the difference between the market value of many companies and their book value, there is a big gap there. Some of that goes up and down with the stock market, but there is often a big gap that remains. It depends on what type of company, but certainly we also know that when one company buys another company or when people are analyzing a company seriously to make major investments in it, they look at all these kinds of things, really, what are the value drivers of the business, the know-how, the people assets, the customer loyalty and retention, those kinds of things. In U.S. accounting, those are only generally captured when they are either purchased or there is a business combination. If they are internally generated, there is no accounting for that asset, whereas, actually in the international standards, sometimes there is some accounting where there is ability to demonstrate that it is likely to prove to be beneficial with some degree of certainty. I think that is a real important area.

I think the area of fair value also, and to what degree beyond where you have established markets should that be used versus historical cost notions, is a very important one and one that we are going to be taking up starting later this year in our joint project to relook and merge our respective conceptual frameworks.

Chairman SHELBY. Bob, I have another question. Mr. Chairman, I should say. The comment period for your proposal ended a couple of weeks ago. FASB has received more than 200 comment letters, I understand. Could you describe somewhat to the Committee what some of the more common reactions have been?

Mr. HERZ. Yes. And, again, this is from my own reading. I read the letters as they come in. Our staff then produces a very comprehensive analysis of the comment letters, which they are in the process of doing right now. But from my own reading, some of the issues that commentators have focused on—well, first of all, I think most people agree that the current accounting model needs fixing.

One of the issues in Phase 1 that they focused on is whether the measurement of the underfunded or overfunded status should be what is called the projected benefit obligation, or what is called the accumulated benefit obligation. The projected benefit obligation includes what is called a salary progression assumption for future increases in salary that would then, in effect, determine what the benefits—the value of the benefits that you have earned today by

current service. The accumulated benefit obligation excludes those future salary potential increases.

I think a number of companies have focused also on the issue of what we propose that for a calendar year-end company, that they put these liabilities, or in some cases, assets on their balance sheet by the end of this fiscal reporting year, so 12/31. Some companies said they do not know if they have enough time to do that. I do not think it is the issue of making the calculations because the calculations are already made and disclosed in the footnotes, so all that is available, but it is the issue of things like they may have loan covenant issues, other plans, internal compensation plans that may work on book value numbers, for example. This will obviously change book values. That is another comment.

A third set of comments relates to our proposal that the measurements be done as of the end of the company's fiscal year end. Right now the rules allow companies to do those measurements up to 3 months before the fiscal year end, and people are saying that with tighter reporting deadlines that have been put in place in the last few years, that just adds an extra degree of burden. So those are all comments, and many other comments that we will carefully consider.

Chairman SHELBY. Sir David, would you just briefly describe for the Committee for the record, you have the role of the Securities and Exchange Commission and the Roadmap, which aims to eliminate by 2009 the reconciliation requirements for foreign companies listed in the United States. We have talked about this before I think in London one time.

Mr. TWEEDIE. Indeed, sir. The SEC has played a major role, along with the FASB. It has become quite clear that as we move on convergence, companies outside the United States are really saying, well, where is the reward for this? If we are doing this, do we still have to keep reconciling to U.S. standards? Do we have to wait until they are identical? We think probably by about 2011 we will be getting pretty well the same answers, whether it is international or U.S. standards. That is now leading I think to political pressure in some countries, leading to the threat that, well, if we have to reconcile, why shouldn't U.S. companies across here, which may have debt borrowings or whatever, why should they not have to reconcile as well? That is a waste of resource and something that should not really be resorted to.

So I think the SEC is helping us by trying to set out this Roadmap, things we can do quickly and are pretty confident we can do that, and also they have helped us set out the agenda of the issues they think are really important to them. What they are really saying is we know you do not have to complete these when we consider whether or not to remove the reconciliation, but provided the program is continuing and it is quite clear there is going to be a convergence toward the end, then we are willing to consider that, probably in a couple of years time.

I think that has assuaged a lot of the concern. Internationally it has been a very constructive move and we are very grateful to them for bringing forward the idea.

Chairman SHELBY. Thank you.

Senator Sarbanes.

Senator SARBANES. Thank you very much, Mr. Chairman. I want to welcome both of our witnesses again before the Committee. It is very helpful to have their testimony.

First of all, I take it there is complete agreement that the objective here is to develop a single set of international accounting standards that will be used worldwide? Is that correct?

Mr. TWEEDIE. It is indeed. We, for example, think with the post-retirement standard, we will end up with an almost identical standard. The idea is we can get it in identical words. Americans have a congenital inability to spell properly, but apart from that, we want them to be exactly the same there.

[Laughter.]

Senator SARBANES. What is your time frame for achieving this objective?

Mr. HERZ. I will hazard a kind of a speculated, somewhat educated prognostication.

Senator SARBANES. Well, you have got it obfuscated pretty well already.

[Laughter.]

Mr. HERZ. Yes, thank you. As Sir David said, I think that around the rest of the world, good parts of the world are adopting international financial reporting standards and continue to do that. You then look at which of the major markets that have not done that and what is going on. One of them is clearly us. We have our program of closely working with Sir David. Another one is Japan, where we have actually started to almost triangulate the effort. Their standards have historically been patterned more on ours, but they also want to move toward international standards.

The third major market is Canada, and they have announced that within 5 or so years they will try and move from their standards, which again are very similar to U.S. standards, to international standards.

So the real key has become us and Japan, I think, in terms of at least major global capital markets. I could foresee one chain of events being—and, again, this is just one possibility, but certainly one genuine possibility—that we continue our efforts; other things that are going on, including the SEC, will start to review the filings of international financial reporting standards filers that are coming into the United States now. They are going to embark on a program to look at those carefully over the next years to understand whether there seems to be consistency or not in their application. You know, are they applied relatively consistently in Greece versus in Australia, which I would suspect the first time around for people who have adopted whole new standards, is quite a challenge, and you cannot expect perfection to begin with. But I think effort at continuous improvement over the next few years would enable the SEC to consider and probably lifting that reconciliation requirement.

If that happens, I think there will probably be some U.S. filers that in certain industries where a lot of their competitors are using international standards, who will say, well, why cannot we also use those standards? I think that will probably be studied, and then sometime, given that we are continuing to make them more and more similar and common, the SEC will say, OK, for U.S. domestic

filers, you can also use the international standards. After a couple years of that maybe people will say, gee, they seem like you have made enough progress on convergence to say why are we maintaining two sets of standards at this point? The differences are not significant enough any more. I think that will be the point at which we have essentially met this objective.

I think it is still a 8- to 10-year process in my own view, even being optimistic.

Senator SARBANES. Want to add anything to that, Sir David?

Mr. TWEEDIE. I think to finalize it, looking even at this project, the FASB has projected an 8-year period to finally finish the pensions project. We can do a lot in the meantime. I think probably in 5 years time, the differences will be pretty small, we will be really getting very close. There will still be a few, but we will be working on those, and I see it in about an 8-year time frame if I had to say when.

Senator SARBANES. I wanted to just follow up on that, and as something that Bob Herz sort of mentioned in the course of his answer just now. It is one thing to get convergence on the standards, it seems to me another thing to get convergence or acceptability on the implementation of the standards. What is your view on that part of the question?

Mr. HERZ. Well, I think probably Sir David is better at answering that. I think the issue is, the one that I mentioned, is that to what extent and over what period will there be consistent application in different jurisdictions around the world where they are coming from? They are used to their old standards and the different cultural differences.

Senator SARBANES. Do you use standards that have been adopted, which are the international standards, as I understand it, are they being—the International Financial Reporting Standards, are they being enforced or monitored by a EU organization or by separate national organizations in each of the EU countries?

Mr. TWEEDIE. It is a mixture of the two, Senator. What is happening in Europe, there is a committee of the securities regulators called CESRFin, and it is really trying to pool together the national regulators who in fact they have a common enforcement mechanism, and there is a lot of peer review going in, views about decisions taken, interpretations and so on. So they are trying to coordinate on a European wide basis.

I think, as Bob was hinting at—and the SEC has been very clear about it—that the standard setters can only provide one leg of this stool. We also need good auditing, because if the standards are not audited properly, then it will not work, as we have seen from the past in your work, sir on the Sarbanes-Oxley Act. We need corporate governance to make sure that their decisions are taken in the atmosphere of trying to produce a fair presentation, and the forfeit is enforcement. So all of these are going to come together. I suspect the SEC may well be selective, saying, well, this part of the world is doing it properly, this part is not, and we do not trust it in the meantime. And they may well decide to break on these bases. Even though the standards are being used, we are not quite sure how well they are being used, and that is what the SEC is going to check.

Senator SARBANES. If I could put one final question.

Chairman SHELBY. Go ahead.

Senator SARBANES. Senator Enzi raised this, and I think Senator Allard also alluded to it. In considering the pension issue, which is now under examination, as I understand it, how much attention is being paid to the fact that these business enterprises were allowed to proceed in a certain way in dealing with a pension issue. It is now being proposed, well, those standards are inadequate and they do not provide an accurate reflection, and therefore, they should be changed. Senator Enzi, I think, said something about, well, you know, there is not much problem if it had been that way from the very beginning, but it has not been that way. So we are confronted, I guess, to some extent with a transition problem, or alternatively, what the impact would be of requiring an immediate change on these defined benefit retirement plans, which are under attack for other reasons as well at the moment.

So it does raise some difficult questions about what the impact would be on retirement plans that have been in effect for a substantial period of time, that people, in effect, have done all their planning in relation to and relied upon, and some are even saying that an immediate change, that some of these enterprises would go under. They would be catapulted into the red in a substantial manner. Now, that only to some extent underscores the nature of the problem that you are seeking to correct, but it does confront you with an important transition problem it seems to me. What is the thinking on that?

Mr. HERZ. Well, I think the thinking in our Phase 1 proposal was limited to the balance sheet and to put that right, so to speak. Most of the comments we got in leading up to that was that more of the controversy and the notion that this will be the final straw that will abandon the plan, freeze the benefits. More of the commentary came around Phase 2. What are you going to do with reported earnings, which are not affected in Phase 1?

I would also say that it is very hard to predict these kinds of things. What we do now is that there has been a pronounced flight away already over the last 20 years or so from defined benefit plans. I think statistics I saw from the Department of Labor were that over the last 20 or so years, the number of defined benefit plans has gone down by something like 80 percent, and that is long before we talked about doing anything in terms of the accounting.

We also hear that the reactions of some companies will be, well, in order—if I have to present the liability, maybe I ought to do some more funding in order to reduce the liability or get on a program to reduce it, à la what Sir David described as some of the U.K. reaction. Some of it has also been that whether it is real or speculation, that there may be a move by some companies to change the way they invest the plan assets, to more closely match fund the obligation. Therefore, they might switch from less equities to more bonds in their portfolio.

Again, as a layman, that seems to me that increasing the funding and better matching the obligation would seem to better secure the benefits. I think part of the problem is that the existing accounting has gotten us to this point of masking some of the issues, and that may have led to over promising of benefits, and certainly

some of the accounting mechanics Sir David talked about, the assumed rate of return assumption, have in many minds led to very undesirable behaviors as far as the investment profile of the pension plan assets.

A wise man told me once in this whole area—which I am sure you all know public policy very much—but certainly in accounting, that when you make changes, things will change, behavior will change, but it is not like a basketball, it does not bounce straight up and down. It is kind of like a football, it bounces side to side and hard to predict.

Senator SARBANES. Did you have to deal with that problem?

Mr. TWEEDIE. No, and I think the interesting thing, looking at the U.K. position—and there are others more expert than I that could give you details on this—but since we produced the pension standard, there has been a marked change in the debate. The national financial papers are full of pension issues, and many companies, I think, have now realized for the first time—and so have their employees. British Airways, for example, a couple of years ago I think its deficit was somewhere in the region of, if it was in dollars, it would be something like $2.4 billion, which is about 44 percent of its market capitalization at the time. That was a huge deficit. And they have been in discussions with their employees. They have stopped paying dividends because they feel they have to fill this hole. They have put more money into the fund. They are now suggesting that their employees are going to have to work longer and perhaps some of the benefits might have to change, but they have made promises that it is very difficult to keep I think. So they are looking at it very carefully, how they can manage their way out of it.

The advantage, I think, of showing the numbers is that we are talking about a long-term issue, it does not have to be funded tomorrow. So the question is how do they do it over the period in which they have to meet the commitments? And I think a lot of companies are doing it very seriously. They are taking the details and the problems of the schemes into account. They are trying to do it over a long term, but they have actually got a serious debate going now, and they are planning their way through it, whereas, the danger was that suddenly they realized they could not possibly meet this under any circumstances, and then bankruptcies follow and the pension falls to pieces. It has now become a big issue in the United Kingdom in takeovers, where the pension regulator is demanding money is put into funds to hold the deficits rather than just be distributed to shareholders and so on.

So there is a lot of behavioral change which has actually safeguarded pensions.

Chairman SHELBY. Senator Allard.

Senator ALLARD. Thank you, Mr. Chairman. I found this hearing enlightening, and thank you for holding it.

Senator Enzi, who had to leave here earlier, has asked me to make sure that we protected his ability to be able to submit questions.

Chairman SHELBY. We will leave the record open. He is very interested in this issue and is a very good member of this Committee. We will leave the record open for his questions.

Senator ALLARD. Yes, for his questions, if you would, please.

I have a question to Mr. Herz to start with. You said that you had an opportunity to look at a lot of the responses that were coming in. Were you able to assess a difference between the responses from large companies as opposed to medium and small companies? Was there any differential that you could pick up in their response?

Mr. HERZ. I guess the one thing that I recall from some of the letters is that when you are dealing with smaller companies, particularly private companies, they have a lot more arrangements related to their book value. They have the book value stock plans, for example. Their loan covenants may be crafted differently, as well in some public companies. So any time you do something that will affect their stockholders equity, those things become a matter of discussion.

Other than that, I think there were some—there are the issues of resource availability to change the measurement date, and I think we took that into account by giving the private companies a 2-year window in order to get—recognizes there may be only so many actuaries to go around at a point in time.

Senator ALLARD. This is for Sir David. You have co-ops in the United Kingdom like we have co-ops here. My understanding is that with the post-retirement kind of proposal we have here, you had some problems with that in the United Kingdom in the fact that some of those co-ops were closing; is that correct?

Mr. TWEEDIE. Not so much because of the pension schemes. I think there were other reasons for that. But certainly——

Senator ALLARD. Go into that detail for me, how that is——

Mr. TWEEDIE. I would have to come back to you, Senator, really on the detail of that, because it did not become a huge issue when we did it with the co-ops, frankly. This may have emerged later, but—and I am not so familiar with the United Kingdom as I used to be—basically, the issue, a lot of the companies had actually defined contribution schemes, so they were not caught up in the benefit issue. And a lot of our smaller companies have those too. This may be something that I will have to ask the U.K. Standards Board to see what problems they have. They are coming to see us next week to deal with leasing and pensions, so it will be well worthwhile having a discussion with them, and I will raise that point and get back to you if I may.

Senator ALLARD. I would appreciate that very much. I think it would be very helpful in our deliberations here.

Mr. Herz, have you given us a time frame in which you intend to complete this project on pension funds?

Mr. HERZ. Well, right now, we, for Phase 1, our current plan would be to begin redeliberations based upon the input we get through that over the summer, and finish probably by the end of the third quarter on Phase 1. Phase 2, I think, our staff has not drawn up a detailed project plan yet, but I think it will be a more than 1-year and probably 2- or 3-year exercise because there are a number of very complicated issues.

Senator ALLARD. Then once you have put things into place, then there is going to be an implementation period after that.

Mr. HERZ. Right.

Senator ALLARD. I gather from your comments, this is going to be a phased-in implementation process?

Mr. HERZ. Well, for Phase 1, the putting of the assets and liabilities on the employers' balance sheets, we are proposing that to be done at the end of the companies' fiscal year ends that end starting with the December 31 fiscal year end reports. The measurement dates, change in the measurement date to bring it to year end, rather than 3 months before. By the way, a lot of companies already do it as of year end. It is probably 50/50 as to whether people avail themselves of that lag option. That is phased in. For public companies it would be phased in in 2007, or for private companies 2008.

As to once we look at Phase 2 and whatever we come up with, whether there will be a phase-in period for that, certainly there will be a gap between when we finalize any Phase 2 standard and when it would have to be implemented.

Senator ALLARD. So you will be talking about everybody being on the same fiscal year; is that what you are——

Mr. HERZ. Not the same fiscal years. They will have to measure the plan assets and liabilities as of their fiscal year end.

Senator ALLARD. I see, OK. That is going to take us a while to get all through this process.

Mr. HERZ. I think by the time we have a comprehensive, reworked global standard—because we are going to be working very closely with the IASB on that—in place, it may be 3 or more years is my best guess.

Senator ALLARD. I would like to have you just kind of go over some of the issues that you saw that sort of spurred you to move forward to address pension and other post-retirement benefit accounting, and also, when was the last time that we really addressed this issue?

Mr. HERZ. Well, going to the second part of your question, the existing standard for defined benefit pension plans was issued I think in 1985. The existing standard for other post-retirement benefits, which are primarily retiree health care coverage, was issued I think in 1990 or 1991. There have been some tweaks since then. There has been enhanced footnote disclosures put in since then as well, but not a comprehensive relook at it.

I think the issue started to really come to light at the turn of this century, at the turn of the Millennium with what people called the perfect storm of pensions. The equity values went way down because the stock market bubble, the value of the liabilities, as Sir David gave in his example, went up because of decreasing interest rates, and so the degree of underfunding became more and more pronounced, and, of course, in some cases was almost all the companies could take in certain industries.

I think that coupled with that, there began to become a realization that the mechanics of the existing accounting, which borrow a lot from some of the actuarial approaches, particularly this assumed rate of return assumption that Sir David mentioned. And just to kind of give you a simple example of how this kind of works, if you had a billion dollars in value in a pension plan, big company, the current accounting says assume a long-term rate of return, and that depends on your asset mix. The typical asset mix in a pension

plan might be 60 percent equities and 40 percent bonds, for example, and so people would assume a long-term rate of return of, say, 8 percent. The current accounting says take that 8 percent on the billion dollars, and assume that you are going to make $80 million this year, and you do not only assume it but you actually credit, you report of $80 million for that year. Let's say the pension assets actually tumble by $200 million, as they did in 2001–2002. That difference of $280 million, first what you assume versus what actually happened, gets spread over very long periods of time. It could be 20 or more years.

So you are reporting $80 million in earnings, and you are taking the $280 million deficit and spreading it over, say, 20 years, which would be a $14 million number if I am doing my math right. And so you would net report pension income that year of $66 million, even though your pension plan went down by $200 million. A lot of people—Sir David said, "How can this be?" The answer was, traditionally, the idea was that over a long period of time things would even out. But of course, what we found was that in a number of companies and industries it did not even out. They went over the cliff.

Senator ALLARD. Thank you.

Thank you, Mr. Chairman.

Chairman SHELBY. Basically, what you are trying to do, as I understand it, with accounting, pension accounting reform, is get to the truth of the matter. That is what accounting is about, is it not? I know Senator Sarbanes has been very active in this whole area, as we all know, of corporate governance and accounting standards and seeking the truth and the value of something. So this puts a value on a company. I know we, Senator Sarbanes and I, worked together on making sure they did not politically try to change the way stock options were valued because they did have a value or they did not. You know the deal there. You are working on it still. Well, at this time, is your plan to give companies an opportunity to grow out of their dilemma, out of their problems, but to realistically point out they have got a real problem, as some of them do?

Mr. HERZ. Yes. I think, as with the analogy with the United Kingdom example, our plan is by——

Chairman SHELBY. Sir David pointed out British Airways.

Mr. HERZ [continuing]. ——Phase 1 to highlight the issue by putting the issue on the balance sheet which I think there puts it front and square. As I said, the issue of broader controversy is then how then you report the earnings, should there be any smoothing or not? I think people think the assumed rate of return thing that I just described needs to go, but the debate over whether you should continue any smoothing or not is a genuine debate. And I could say——

Chairman SHELBY. How prevalent is the smoothing today going on in corporate pension accounting, or has been?

Mr. HERZ. Everybody does it. They do not have to do it but there is an election to do basically ongoing mark to market accounting in full. They do not have to avail themselves of all these smoothing mechanisms, but everybody does.

Chairman SHELBY. But if you keep doing this, you are going to suffer under the illusion of problems, you maybe brush them aside,

you ignore them, and this and that, and then the workers who are depending on this are going to be holding the bag, will they not, Sir David?

Mr. TWEEDIE. That is exactly the problem. What the FASB is doing now and what happened in the United Kingdom will highlight the issue. The other bits, if you like, are refinements. We are not saying that we have got the measurement exactly right. We know that there is quite a lot of controversy by the interest rates, whether, as Bob said, it is a projected measure of an accrued measure. All of this is up for discussion in the long-term project, but the fact is, they are not in equilibrium, these schemes, and they are showing these deficits. And what it has done, I think, as you put it quite rightly, Mr. Chairman, is given the company the opportunity to say, well, we do not have to pay all this out for 20–30 years, but we had better start working on how we fund it because at the moment we are not funded. That is what I think it has done, it has given them a breathing space.

I think this reform that Bob is bringing in will save a lot of companies that otherwise might have just gone straight into the mountainside. They would not realize until too late they could not climb high enough.

Chairman SHELBY. It seems to me that a lot of pension accounting that I understand has been a joke in a sense, not really counting, no transparency, interest rates, you know, the returns what they say they are and all this kind of stuff. Is that not a real problem for you, Mr. Herz?

Mr. HERZ. Yes. That is exactly why we are taking up this project.

Chairman SHELBY. Thank you for doing it. There will be opposition in America and probably across the water to doing this, but ultimately, accuracy of accounting and the truth of a situation is what it is all about, is it not?

Mr. HERZ. Absolutely, and that is why again I wanted to take this opportunity to thank the both of you for all your efforts in that regard and for the strong message in that regard.

Chairman SHELBY. I think you have no other alternative but do it and do it right.

We appreciate both of you appearing here today, and your input. Sir David, we are going to continue to work together on convergence and a lot of other things that come together because of Sarbanes-Oxley and my colleague's legislation.

Mr. TWEEDIE. Thank you, sir. Can I echo what Bob has said? It is a great pleasure to come here and to discuss things with yourself and Senator Sarbanes. We do very much appreciate that your idea is the same as ours, transparency and helping the economies, and that is exactly what we are after. Thank you for your support, sir.

Chairman SHELBY. Senator Sarbanes, you have any comments? None?

Thank you very much. The Committee is adjourned.

[Whereupon, at 11:41 a.m., the Committee was adjourned.]

[Prepared statements, response to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF ROBERT H. HERZ

CHAIRMAN, FINANCIAL ACCOUNTING STANDARDS BOARD

JUNE 14, 2006

Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee:

I am Robert Herz, Chairman of the Financial Accounting Standards Board ("FASB" or "Board"). I am pleased to appear before you today on behalf of the FASB. I want to thank you for the opportunity to discuss the Board's current project to improve the accounting for retiree healthcare, pensions, and other employer-sponsored postretirement benefits.

My testimony includes a brief overview of (1) the FASB, including the importance of the Board's independence and the ability to conduct its work in a systematic, open, and objective manner, (2) the process the FASB follows in developing accounting standards, (3) the FASB's current activities relating to international convergence, (4) the basis for the Board's decision in November 2005 to add a comprehensive project to its agenda to improve the accounting for postretirement benefits, (5) the Board's current plans for the project, (6) the requirements of the Board's March 31, 2006 proposal and how it would improve reporting, (7) the input received to date in response to the proposal, and (8) the current status of, and the FASB's plans relating to, the proposal, as well as (9) some concluding remarks.

The FASB

The FASB is an independent private-sector organization.[1] We are not part of the federal government. Our independence from enterprises, auditors, and the federal government is fundamental to achieving our mission—to establish and improve standards of financial accounting and reporting for both public and private enterprises, including small businesses and not-for-profit organizations. Those standards are essential to the efficient functioning and operation of the capital markets and the United States ("US") economy because investors, creditors, and other consumers of financial reports rely heavily on sound, honest, and unbiased financial information to make rational resource allocation decisions.

The FASB's independence, the importance of which was reaffirmed by the Sarbanes-Oxley Act of 2002 ("Act"),[2] is fundamental to our mission because our standards are the basis to measure and report on the underlying economic transactions of business enterprises. Like investors and creditors, Congress and other policy makers need an independent FASB to maintain the integrity of the standards in order to obtain the financial information necessary to properly assess and implement public policy.

Our work is technical in nature, designed to provide preparers with the guidance necessary to report information about their economic activities. Financial reporting is meant to tell it like it is, not to allow the continuation of distortions or the skewing of information to favor particular industries, particular types of transactions, or particular political, social, or economic goals other than sound and honest reporting. While bending the standards to favor or retain a particular outcome may seem attractive to some in the short run, in the long run a biased accounting standard is harmful to investors, creditors, the capital markets, and the US economy.

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[1] See Attachment 1 for information about the Financial Accounting Standards Board. (See Committee file.)
[2] Sarbanes-Oxley Act of 2002, Public Law Number 107-204, Sections 108-109.

The FASB's authority with respect to public enterprises comes from the US Securities and Exchange Commission ("SEC"). The SEC has the statutory authority to establish financial accounting and reporting standards for publicly held enterprises. For over 30 years, the SEC has looked to the FASB for leadership in establishing and improving those standards. In response to the requirements of the Act, the SEC issued a Policy Statement reaffirming this longstanding relationship.[3]

The Policy Statement, consistent with the language and intent of the Act, also reemphasizes the importance of the FASB's independence .[4] It states:

> By virtue of today's Commission determination, the FASB will continue its role as the preeminent accounting standard setter in the private sector. In performing this role, the FASB must use independent judgment in setting standards and should not be constrained in its exploration and discussion of issues. This is necessary to ensure that the standards developed are free from bias and have the maximum credibility in the business and investing communities.[5]

The SEC, together with the FASB's private-sector parent organization, the Financial Accounting Foundation ("FAF"),[6] maintains active oversight of the Board's activities.

What Process Does the FASB Follow in Developing Accounting Standards?

Because the actions of the FASB affect so many organizations, its decision-making process must be open, thorough, and as objective as possible. The FASB carefully considers the views of all interested parties, including users, auditors, and preparers of financial reports of both public and private enterprises.

Our Rules of Procedure require an extensive and thorough public due process.[7] That process involves public meetings, public roundtables, liaison meetings with interested parties, and exposure of our proposed standards to external scrutiny and public comment. The FASB members and staff also regularly meet informally with a wide range of interested parties to obtain their input and to better our understanding of their views. The Board makes final decisions only after carefully considering and analyzing the input of all interested parties.

While our process is similar to the Administrative Procedure Act process used for federal agency rule making, it provides for far more public deliberations of the relevant issues and far greater opportunities for interaction with the Board by all interested parties. It also is focused on making technical, rather than policy or legal, judgments. The

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[3] "Policy Statement: Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter," Exchange Act Release Nos. 33-8221; 34-47743; IC-26028; FR-70 (April 28, 2003).

[4] Sarbanes-Oxley Act of 2002, Sections 108-109. The legislative history of the Sarbanes-Oxley Act of 2002 is clear that the provisions of the Act relating to the FASB were intended to "strengthen the independence of the FASB . . . from . . . companies whose financial statements must conform to FASB's rules." Senate Report 107-205, 107th Congress, 2d Session (July 3, 2002), page 13.

[5] Policy Statement, page 5 of 8.

[6] See Attachment 1 for information about the Financial Accounting Foundation. (See Committee file.)

[7] See Attachment 1 for information about the FASB's due process. (See Committee file.)

FASB's Mission Statement and Rules of Procedure require that in making those judgments the Board must balance the often conflicting perspectives of various interested parties and make independent, objective decisions guided by the fundamental concepts and key qualitative characteristics of financial reporting set forth in our conceptual framework.

The FASB and the FAF, in consultation with interested parties, periodically review the FASB's due process procedures to ensure that the process is working efficiently and effectively for users, auditors, and preparers of financial reports. In recent years, the FASB and the FAF have undertaken a significant number of actions to improve the Board's due process procedures, including increasing the quality and breadth of input in to our process.[8]

What Are the FASB's Current Activities Relating to Efforts To Converge US and International Accounting Standards?

A major focus of the Board's current activities are efforts to converge US and international financial accounting and reporting standards. The FASB's objective for participating in these international activities is to increase the international comparability and the quality of standards used in the US. This objective is consistent with the FASB's obligation to its domestic constituents, who benefit from accounting standards that result in more transparent and more comparable information across national borders. The FASB pursues that objective in cooperation with the International Accounting Standards Board ("IASB") and other national standard setters.

The Board believes that the ideal outcome of cooperative international accounting standard-setting efforts would be the worldwide use of a single set of high-quality accounting standards for both domestic and cross-border financial reporting. At present, a single set of high-quality international accounting standards that is accepted in all capital markets does not exist. In the US, for example, domestic firms that are registrants with the SEC must file financial reports using US generally accepted accounting principles. Foreign firms filing with the SEC can use US generally accepted accounting principles ("GAAP"), their home country GAAP, or international financial reporting standards ("IFRS")—although if they use their home country GAAP or IFRS, foreign issuers must provide a reconciliation to US GAAP.

The most significant effort in this area has been our ongoing joint activities with the IASB, since their formation in 2001. On February 27, 2006, the FASB entered into a Memorandum of Understanding ("MOU") with the IASB that reaffirms the boards' shared objective of developing high quality, common accounting standards for use in the world's capital markets.[9] Both boards believe that a common set of high quality accounting standards will enhance the consistency, comparability and efficiency of financial statements, enabling global markets to move with less friction.

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[8] As part of the development of its 2003 Policy Statement, the SEC reviewed the FASB's due process and concluded that "the FASB has the capacity . . . and is capable of improving both the accuracy and effectiveness of financial reporting . . ." Policy Statement, page 5 of 8.

[9] "A Roadmap for Convergence between IFRSs and US GAAP – 2006-2008, MOU Between the FASB and the IASB," February 27, 2006; www.fasb.org. Attachment 2.

The MOU is a further elaboration of the objectives and principles first described in the boards' Norwalk Agreement published in October 2002. While the MOU does not represent a change in the boards' convergence work program, it does, however, reflect the context of the 'roadmap' for the SEC's consideration of the removal of the reconciliation requirement for non-US companies that use IFRS and are registered in the US. It also reflects the work undertaken by the Committee of European Securities Regulators ("CESR") to identify areas for improvement of accounting standards.

The MOU highlights the FASB's strong commitment to continue to work together with the IASB to bring about a common set of accounting standards that will enhance the quality, comparability and consistency of global financial reporting, enabling the world's capital markets to operate more effectively. In the MOU, the FASB and the IASB note that the SEC's consideration of removing the current reconciliation requirements will require continued progress on the boards' convergence program. Accordingly, the MOU sets out milestones that the FASB and the IASB believe are achievable. The roadmap also addresses auditing and enforcement, topics that are not accounting standard-setting issues and will require the co-operation of regulators and auditors. In developing the MOU, representatives of the boards have held discussions over the past year with representatives of the European Commission and the SEC staff, with the boards' respective advisory councils, and with other interested parties. The boards agreed that trying to eliminate differences between accounting standards that are both in need of significant improvement is not the best use of resources—instead, new common standards should be developed. Consistent with that principle, convergence work will continue to proceed on the following two tracks:

- First, the FASB and IASB will reach a conclusion about whether major differences in focused areas should be eliminated through one or more short-term standard-setting projects, and, if so, the goal is to complete or substantially complete work in those areas by 2008.

- Second, the FASB and the IASB will seek to make continued progress in other areas identified by both boards where accounting practices under US GAAP and IFRSs are regarded as candidates for improvement.

Finally, in the MOU, the boards point out that their work programs are not limited to the items listed in the MOU. The FASB and the IASB will follow their normal due process when adding items to their agendas.

The FASB believes the MOU shows the strength of globally beneficial cooperation between accounting standard setters. We also believe the initiatives being embarked upon will only bring greater harmonization to accounting standards, and will help to unify the financial reporting of all companies within and without the borders of the US and, thus, strengthen the global economy.

Why Did the Board Add a Project to Its Agenda To Improve the Accounting for Postretirement Benefits?

In November 2005, at a public meeting, the Board unanimously decided to add a comprehensive multi-phase project to its agenda to reconsider the existing accounting guidance for retiree healthcare, pensions, and other employer-sponsored postretirement

benefits.[10] The decision was in response to requests from many users, preparers, and auditors of financial reports, including members of the Financial Accounting Standards Advisory Council ("FASAC"),[11] the FASB's User Advisory Council ("UAC"),[12] as well as the SEC staff.[13] Those parties and others expressed concerns that the current accounting for postretirement benefits needed to be revisited to improve the usefulness, transparency, and completeness of the effects of those obligations on the financial statements.

Many concerns arise from several criticisms of the specific features of the existing standards on accounting for postretirement benefits and can generally be summarized as follows:

- The standards permit an employer that sponsors a defined benefit plan not to recognize the economic events that affect the cost of providing postretirement benefits—the changes in plan assets and benefit obligations—as those changes take place. For example, it has been reported that the Standard & Poor's ("S&P") 500 recognized approximately $500 billion of expected returns on benefit plan assets in their earnings for the 5-year period ending December 2004, which exceeded actual returns on those assets by approximately $300 billion.[14]

- The standards relegate important information about postretirement benefit plans to the footnotes to the financial statements, in the form of reconciliations of the overfunded or underfunded statuses to amounts recognized in the balance sheet. For example, it has been reported that the footnotes to the financial statements of the S&P 500 reveal that the aggregate net liability (difference between assets and liabilities) for retiree healthcare, pensions, and other employer-sponsored postretirement benefits was approximately $500 billion for the year ended 2005,

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[10] The existing accounting guidance is largely contained in FASB Statements No. 87, *Employers' Accounting for Pensions* (December 1985), No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits* (December 1985), and No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions* (December 1990). In addition, since the issuance of Statements 87, 88, and 106, the Board has twice improved the footnote disclosures for pensions and other postretirement benefits in FASB Statement No. 132, *Employers' Disclosures about Pensions and Other Postretirement Benefits* (February 1998) and No. 132 (revised 2003), *Employers' Disclosures about Pensions and Other Postretirement Benefits*.

[11] Financial Accounting Standards Advisory Council, *Summary of Responses to the Annual FASAC Survey—Priorities of the Financial Accounting Standards Board* (October 2005), page 4 (FASAC members ranking the area of pension accounting and other postretirement benefits as second only to revenue recognition as issues that the Board should give priority to addressing) (See Attachment 3 for excerpts from Annual FASAC survey); Financial Accounting Standards Advisory Council, Minutes of the Meeting (September 22, 2005), pages 8-9 (summarizing FASAC member views, including the appropriate scope for a project to improve the accounting for postretirement benefit obligations). (See also http://www.fasb.org/fasac_mtg_minutes.shtml.)

[12] FASB User Advisory Council, Minutes of the Meeting (September 29, 2005), pages 5-6 (summarizing UAC member concerns and advice about the existing accounting for postretirement benefits).

[13] Office of the Chief Accountant, Office of Economic Analysis, Division of Corporation Finance, SEC, *Report and Recommendations Pursuant to Section 401(c) of the Sarbanes-Oxley Act of 2002 on Arrangements with Off-Balance Sheet Implications, Special Purpose Entities, and Transparency of Filings by Issuers* (June 2005), pages 107-109 (recommending that the Board add a project to its technical agenda to reconsider the accounting for defined-benefit retirement arrangements).

[14] John T. Ciesielski, President, R.G. Associates, Inc., *The Analyst's Accounting Observer*, "Pondering Pensions: How They Affected the S&P 500 in 2004" (May 27, 2005), pages 14-15. (See Attachment 4 for Recent Article about FASB's Proposed Standard on Employers' Accounting for Defined Benefit Pension and Other Postretirement Benefits.)

exceeding the aggregate net liability those enterprises reported on the face of their balance sheets by approximately $400 billion.[15]

- The existing reporting of benefit costs obscures the employer's reported results of operations by combining the effects of compensation, investing, and financing activities.[16]

The Board acknowledged pragmatic compromises when it developed its initial standard on accounting for pensions, Statement No. 87, *Employers' Accounting for Pensions*, in 1985 ("Statement 87").[17] The Board noted that "it would be conceptually appropriate and preferable to recognize a net pension liability or asset measured as the difference between the projected benefit obligation [("PBO")][18] and plan assets, either with no delay in recognition of gains and losses, or perhaps with gains and losses reported currently in equity or comprehensive income but not in earnings. However it concluded that those approaches would be too great a change from past practice to be adopted at the present time."[19] The Board also noted in Statement 87 that "because gains and losses may reflect refinements in estimates as well as real changes in economic values and because some gains in one period may be offset by losses in another or vice versa, this Statement does not require recognition of gains and losses as components of net pension cost of the period in which they arise."[20] Those compromises resulted in accounting commonly referred to as "smoothing," because economic gains and losses related to the plans are generally not recognized in the periods they occur but instead are spread into future periods.

Similar compromises were reached by the Board during the development of FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions* ("Statement 106").[21] Issued in 1990, Statement 106 addresses the accounting for postretirement benefits other than pensions, including retiree healthcare.

As indicated in the following excerpts, some of the current and most severe criticisms of Statements 87 and 106 are directly related to the aforementioned Board compromises:

> Current "smoothing" is a vehicle to mitigate the economic realities. . . . Let the realities speak for themselves and let the markets and analysts/users, rather

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[15] David Zion, Bill Carcache, Amit Varshney, Research Analysts, Credit Suisse, "The Hit to Equity—Bringing Pension and OPEB Funded Status on Balance Sheet," (May 5, 2006), page 3.

[16] John T. Ciesielski, President, R.G. Associates, Inc., "Ugly OPEBs of the S&P 500: Searching for a Sense in the Figures," (November 29, 2005), pages 13 and 20.

[17] Statement 87, paragraph 107.

[18] The projected benefit obligation or PBO is defined as the actuarial present value as of a date of all benefits attributed by the pension benefit formula to employee service rendered prior to that date. The projected benefit obligation is measured using assumptions as to future compensation levels if the pension benefit formula is based on those future compensation levels. *Id.* at paragraph 264.

[19] *Id.* at paragraph 107.

[20] *Id.* at paragraph 29 (footnote omitted).

[21] FASB Exposure Draft, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, paragraph B5.

than the accounting conventions, determine the corporate economic valuation adjustments . . . ."

Jeremy Bean, Vice President, Morgan Stanley, October 2005 (FASAC Member)

First, we need to bring transparency and honesty back to . . . accounting. Currently, there is far too much subjectivity and outright guesswork. The real economic liability . . . and the actual value of assets that will be used to meet that obligation are often not reflected on the balance sheet. Instead, the rules allow companies to hide the obligations in footnotes that sometimes not even the most skilled analysts can understand, and to rely on projected numbers, too often unrealistic, of what they anticipate their . . . earnings and liabilities will be.

The Financial Accounting Standards Board (FASB) will reportedly soon address this issue -- and it cannot do so quickly enough. . . . [A]ssets and obligations are real assets and liabilities and should be reflected as such on the balance sheet. They should be valued accurately to give a realistic and transparent picture of what pension obligations are; what assets have been accumulated to meet them; and what the overall financial situation of a pension plan's sponsor is.

Arthur Levitt, Jr., former Chairman of the SEC, November 10, 2005

The current standard that allows for smoothing is confusing and obscures valuable economic information about earnings and the value of assets and obligations of the defined benefit plan. Some argue that the accounting treatment gives firms an incentive to invest more heavily in equities than would be consistent with the structure of the liabilities. The accounting of defined benefit plans needs to be changed to increase transparency and to reflect the economic reality . . . .

Nellie Liang, Assistant Director, Division of Research & Statistics, Federal Reserve Board, October 2005 (FASAC Member)

Under FAS 87 and FAS 106, the current accounting guidance for pensions and retiree health care, respectively,

the balance sheet representation of these plans can, and often does, differ greatly from economic reality.

Michael A. Moran and Abby Joseph Cohen, Goldman Sachs, April 12, 2006

Current standards do not reflect economics.

Edward E. Nusbaum, Executive Partner & Chief Executive Officer, Grant Thornton LLP, October 2005 (FASAC and the FASB Small Business Advisory Committee ("SBAC) Member)

The Staff also believes that the complex series of smoothing mechanisms, and the disclosures to explain them, render financial statements more difficult to understand and reduce transparency. . . . While the disclosures are quite detailed, the Staff notes that it has long been accepted that "good disclosure doesn't cure bad accounting." The combination of the accounting and disclosure provisions contribute to the length and complexity of financial statements, a common complaint among users and preparers alike. Revisions to the guidance that eliminate optional smoothing mechanisms would allow significant reduction in disclosures without a loss of important information.

Office of the Chief Accountant, Office of Economic Analysis, and Division of Corporation Finance, the SEC, June 2005

A good time to dump the smoothing and provide more meaningful results.

Janet L. Pegg, Senior Managing Director Accounting & Taxation Research, Bear Stearns & Co., Inc., October 2005 (FASAC and UAC Member)

Eliminate the smoothing rules. Issue a principles-based standard: recognize and measure actuarial gains and losses exactly as changes in estimates of other obligations. Value assets in retirement plans the same way as other investments are valued.

E. Anson Thrower, Chief Financial Officer, SSP Industrial Group, October 2005 (FASAC and SBAC Member)

> . . . [T]he amounts that are currently on the balance sheet for these plans are in many cases meaningless and misleading.
>
> *David Zion, Bill Carcache, and Amit Varshney, Research Analysts, Credit Suisse, May 6, 2006*

In light of the Board's discussions in connection with the development of Statement 87, as well as requests from users, auditors, and preparers of financial statements, including some of those referenced, the Board concluded that the accounting for postretirement plans should be reconsidered. Although the trend of sponsoring defined benefit postretirement plans, particularly defined benefit pension plans, has declined in recent years, the long-term nature and the magnitude of existing arrangements are such that the perceived deficiencies in the accounting for postretirement benefits would continue for a long time unless addressed by the Board.[22]

What Are the Board's Current Plans for the Project?

During a public meeting in November 2005, the Board concluded that a comprehensive project conducted in two phases would be the most effective way to address the issues raised by users, auditors, and preparers of financial reports about the accounting for postretirement benefits.[23] The Board decided that the first phase of the project should focus on recognizing the overfunded or underfunded status of an enterprise's postretirement benefit plans, including pensions, on the balance sheet.

The Board also decided that the second broader phase of the project would comprehensively address remaining issues, including:

- How best to recognize and display in earnings or other comprehensive income the various elements that affect the cost of providing postretirement benefits
- How best to measure the obligations, in particular the obligations under plans with lump-sum settlement benefits and cash balance plans
- Whether more or different guidance should be provided regarding measurement assumptions
- Whether postretirement benefit trusts should be consolidated by the plan sponsor.

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[22] Id. at paragraph B13.

[23] The phased approach to the project was supported by many users, auditors, and preparers of financial reports, including many members of the FASAC. FASAC, Minutes of Meeting (December 1, 2005), page 9. (See also http://www.fasb.org/fasac_mtg_minutes.shtml.)

Furthermore, consistent with the FASB's efforts toward international convergence of high-quality principles-based accounting standards, the Board plans to conduct the second phase of the project collaboratively with the International Accounting Standards Board ("IASB").[24]

Since the November 2005 public meeting, the Board has held three additional public meetings to discuss the project. Preparations for those meetings included thousands of hours of staff research.

The Board has also discussed the project at public and private meetings with members of the FASAC,[25] the SBAC,[26] government officials and policy makers, and other groups and organizations representing a broad range of users, auditors, and preparers of financial reports. Moreover, individual Board members and staff have discussed the project at over two dozen venues across the country. Those speaking engagements, in the aggregate, were attended by over 10,000 participants.

After more than four months of public due process, in March 2006, at a public meeting, the Board unanimously agreed to the issuance of a proposal for public comment. That proposal, FASB Exposure Draft of a Proposed Statement, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* ("Phase 1 Proposal"), was issued on March 31, 2006.

The Phase 1 Proposal contains a detailed Notice for Recipients encouraging comments on a half-dozen specific issues. Attachment 5 includes the Notice for Recipients and the Summary of the key provisions of the Phase 1 Proposal.

What Would the Phase 1 Proposal Require and How Would It Improve Reporting?

The Phase 1 Proposal would require employers to recognize the overfunded or underfunded status of their postretirement benefit plans in their balance sheets. Thus, for defined benefit pension plans, the amount of the PBO would be compared to the value of the related plan assets. If the PBO exceeds the plan assets, the difference would be reported as a liability (underfunded) on the employer's balance sheet. Conversely, if the value of the plan assets exceeds the PBO, the difference would be reported as an asset (overfunded) on the employer's balance sheet.

Similarly, for retiree healthcare and other employer-sponsored postretirement benefits other than pensions, the amount of the accumulated postretirement benefit obligation ("APBO")[27] would be compared to the value of any related plan assets. The

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[24] The FASB and the IASB recently reaffirmed their commitment to international convergence of high-quality principles-based accounting standards. FASB and IASB News Release, "FASB and IASB Reaffirm Commitment to Enhance Consistency, Comparability and Efficiency in Global Capital Markets" (February 27, 2006).

[25] FASAC, Minutes of Meeting (December 1, 2005), page 9 (summarizing Council members general support for the phased approach to the project and expressing other views about the project). See also http://www.fasb.org/fasac_mtg_minutes.shtml

[26] SBAC, Minutes of meeting (November 30, 2005), pages 9-10 (summarizing miscellaneous Committee member comments on the project). (See also http://www.fasb.org/small_business_advisory_committee/sbac_minutes.shtml.)

[27] The accumulated postretirement benefit obligation, or APBO, is defined as the actuarial present value of benefits attributed to employee service rendered to a particular date. Prior to an employee's full eligibility

difference would be reported as an asset (overfunded) or a liability (underfunded) on the employer's balance sheet. The PBO, the APBO, and the value of the related plan assets are all presently required to be captured and disclosed in the employers' financial statement footnotes under existing accounting guidance.[28]

The additional assets and liabilities that the Phase 1 Proposal would require to be added to the employer's balance sheet would not directly affect the employer's earnings. Rather, the net increase in the employer's assets or liabilities would affect the employer's other comprehensive income resulting in either an increase or a decrease in the employer's reported equity in the balance sheet.

The Phase 1 Proposal also would require that employers measure the plan assets and obligations as of the date of their financial statements. In contrast, current accounting standards permit them to be measured at dates up to three months earlier.

As a result of the Phase 1 Proposal, reported financial information would be improved by being more complete and more representationally faithful, by measuring plan assets and benefit obligations as of the same date as the employers' other assets and liabilities, and by including, as recognized items, all changes in a plan's overfunded or underfunded status as they arise. Thus, the proposed changes would make it easier for investors, employees, and others to understand and assess a company's financial position, as well as its ability to carry out the obligations of its postretirement benefit plans, including pensions.

The Phase 1 Proposal applies to all plan sponsors, whether a public company, a private company, or a not-for-profit organization. The proposed changes, other than the requirement to measure plan assets and obligations as of the balance sheet date, would be effective for fiscal years ending after December 15, 2006.

Public companies would be required to apply the proposed changes to the measurement date for fiscal years beginning after December 15, 2006. Nonpublic entities, including not-for-profit organizations, would become subject to that requirement in fiscal years beginning after December 15, 2007.

Some of the reported reactions to the Phase 1 Proposal include the following:

> The proposed standards would require companies to recognize on their balance sheets the overfunded or underfunded positions of their defined benefit pension plans—and any other employee benefit obligations—as of the balance sheet.
>
> It is about time. . . .

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date, the accumulated postretirement benefit obligation as of a particular date for an employee is the portion of the expected postretirement benefit obligation attributed to that employee's service rendered to that date; on and after the full eligibility date, the accumulated and expected postretirement benefit obligations for an employee are the same. Statement 106, paragraph 518.

[28] Statement 132(R), paragraph 5.

The result will be better, more accurate reporting of corporate-employee-benefit obligations and more-accurate financial reporting.

"Shining a Light on Pension Set-Asides," Investment News, April 10, 2006

At the very least, it will force managers to assume full responsibility for the elephantine assets and liabilities that they have pretended are not in the room. . . .

The proposal will eliminate today's spurious balance sheet presentation of a prepaid or accrued cost equal to the cumulative difference between past costs and contributions, while also getting rid of the always-baffling practices involving minimum liability.

Another key feature will abolish the off-the-books treatment of prior service costs, deferred gains and losses for unexpected asset returns, and actuarial gains and losses on the liability. Instead of being hidden away in memo accounts, these items will be included in "other comprehensive income" in the equity section.

Paul B.W. Miller and Paul R. Bahnson, "FASB Addresses Pensions: One Small Step for. . .,"Accounting Today, April 3, 2006

Howard Silverblatt, analyst at Standard & Poor's, called yesterday's proposal "the first wake-up call for investors, retirees and workers." . . . .

In addition, the reforms would help the convergence of US accounting standards and international rules. . . .

Andrei Postelnicu, "FASB Pensions Rule is a 'Wake-Up Call,' " Financial Times, April 1, 2006

Accounting rule-makers are about to take the first real step toward overhauling the way U.S. companies account for pensions and other post-retirement benefits such as health care….

. . . investors, accountants, academics and regulators have long clamored for change, saying current accounting rules for pensions and other post-retirement benefits don't reflect reality. In many cases, companies are able to "smooth" out over a period of years the impact on earnings from changes in their pension plans. In addition, key assumptions underpinning future obligations and returns

are often subjectively decided by management, while plan assets and liabilities are kept off the balance sheet.

David Reilly, "FASB to Move Pension Accounting From Footnotes to Balance Sheets," The Wall Street Journal, March 31, 2006

What Has Been the Input Received in Response to the Phase 1 Proposal?

Following the issuance of the Phase 1 Proposal for public comment on March 31, 2006, the Board has been actively meeting with and soliciting input from users, auditors, and preparers of financial reports on issues raised by the proposal. For example, on April 11, 2006, the Board discussed the Phase 1 Proposal with its UAC. In addition, individual Board members and staff have discussed the Phase 1 Proposal at over 15 venues across the country, including New York City; Kent, Ohio; and Pasadena, California. Those speaking engagements, in the aggregate, were attended by over 2,000 participants.

The comment period for the Phase 1 Proposal ended on May 31, 2006. To date, the Board has received over 200 comment letters in response to the proposal. Those letters are from a broad range of enterprises, accounting firms, investors, valuation experts, compensation consultants, trade and professional associations, and academics.

The FASB staff is currently in the process of reading, analyzing, and summarizing the comment letters received for Board consideration at future public meetings. In addition, each of the individual Board members, as is required by the FASB's Rules of Procedure, is in the process of reading each of the letters received. Some of the key issues and concerns raised by the respondents focus on measurement of the underfunded or overfunded status, the proposed effective dates, and the proposed requirement to measure plan assets and liabilities as of the employer's fiscal year end. All comment letters received are publicly available free of charge on the FASB's website at www.fasb.org.

What Is the Current Status of, and the FASB's Plans Relating to, the Phase 1 Proposal?

The Board plans to hold one or more public roundtable meetings on the proposal on June 27, 2006, in Norwalk, Connecticut. The purpose of roundtable meetings are to listen to the views of, and obtain information from, interested constituents about the Phase 1 Proposal. The Board plans to seek participants that represent a wide variety of constituents ensuring that the Board receives broad input.

Beginning in July, the Board plans to begin its public redeliberations of the Phase 1 Proposal. The public redeliberations, consistent with the FASB's Rules of Procedure, will address key issues raised by constituents. Those issues will include consideration of (1) potential implementation costs, (2) the appropriate measurement date for the employer's assets and benefit obligations, (3) the appropriate effective date and transition, and (4) the appropriate guidance for not-for-profit organizations. For each of

those and other issues, the public redeliberations will include careful consideration of the comment letters and other input received from all parties.

The redeliberations also will benefit from the FASB staff and Board's ongoing discussion of the key issues with interested parties from a broad range of perspectives, including representatives of small businesses, not-for-profit organizations, and actuarial and compensation experts that the FASB will continue to consult with throughout the entire process. As with virtually all FASB projects, the redeliberations may result in changes that improve the Phase 1 Proposal.

Only after carefully evaluating all of the key issues and carefully considering the input received in response to the Phase 1 Proposal will the Board consider whether to issue a final standard. No final Statement may be issued without approval of a majority vote of the Board.

The Board's current plans are to issue a final Statement in the third quarter of this year. The Board, however, has no fixed deadline for issuing a final Statement and will continue its public redeliberations as long as is necessary to develop a high-quality and cost-effective accounting standard that will best serve the needs of investors, creditors, and other consumers of financial reports.

Once the final Statement is issued, the FASB will begin planning for public deliberations in connection with developing a proposal for public comment on Phase 2 of the project. As with all of the FASB's activities, the FAF and the SEC staff will monitor and oversee the Board's due process on this important and ongoing project.

Conclusion

In conclusion, current accounting standards do not provide complete and transparent information about postretirement benefits. The FASB's proposed changes in the first phase of our two-phased project will require employers to recognize the overfunded or underfunded status of their defined benefit plans. That change will increase the transparency, completeness, and usefulness of financial statements for shareholders, creditors, employees, retirees, donors, and other users.

The FASB's second phase of the project, to begin after completing the first phase, will comprehensively address a broad range of financial accounting and reporting issues in the area of postretirement benefits. Both phases will involve solicitation of input from preparers, auditors, and users of financial reports. Input received will be carefully considered in an open, thorough, and objective manner.

Our ultimate goal is to develop, with oversight by the FAF and the SEC staff, and in cooperation with the IASB, a high-quality, principles-based, global standard for the accounting for postretirement benefits that will faithfully report the underlying economic effects of those plans, thus, significantly improving the transparency and integrity of financial reporting in the US. As indicated above, the Phase 1 Proposal is a very important first step toward achieving that goal.

Thank you again, Chairman Shelby. I would welcome the opportunity to respond to any questions.

PREPARED STATEMENT OF SIR DAVID TWEEDIE

CHAIRMAN, INTERNATIONAL ACCOUNTING STANDARDS BOARD

JUNE 14, 2006

Mr Chairman, Ranking Member Sarbanes, and Members of the Committee:

I greatly appreciate the opportunity to discuss a topic about which I care deeply—the accounting for pensions and more broadly post-retirement benefits. My interest in this topic may subconsciously stem from the fact that I am reaching an age when pensions seem to matter more, but I believe there is more to my interest than that. The area of post-retirement benefits is one topic where the public interest is great. Together, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) could make progress in improving existing accounting practices that are deficient, distort behaviour, have inter-generational consequences, and could lead to great cost to taxpayers.

This hearing is particularly timely, because the International Accounting Standards Board (IASB) is now in the process of adding a project onto its active work programme on post-retirement benefits. The IASB plans to work closely with the FASB on this project, and I am delighted that Robert Herz, the chairman of the FASB, is here with me today on this panel. Bob has been one of the leading advocates of the development of high-quality international accounting standards, known as International Financial Reporting Standards (IFRSs), and has provided essential leadership in the international convergence process between the FASB and the IASB.

The IASB and progress on international convergence

Before turning to the specific topic of this hearing, I would like to put the work on post-retirement benefits into the context of the IASB's current strategy and our joint efforts with the FASB.

As you know, the IASB is a private-sector, independent accounting standard-setter, based in London and comprised of 14 members. The IASB's objective is to develop a single set of international accounting standards that are used worldwide and are consistent, comprehensive, and based on clear principles to enable financial reports to reflect underlying economic reality.

Since my first appearance before this Committee in February 2002 (less than a year after the IASB began its work), we have made progress toward the objective of a single set of accounting standards used worldwide has been steady. Nearly 100 countries now require, permit, or have adopted a formal policy of convergence with standards developed by the IASB. Significantly, beginning in 2005, all publicly traded companies in the European Union are producing their consolidated accounts according to IFRSs. Australia, South Africa, and New Zealand, countries with a strong history of independent standard-setting, have followed the EU's lead in requiring IFRSs.

The other major developed and developing economies are making similar commitments to IFRSs. The IASB is undertaking a convergence project with the Accounting Standards Board of Japan. In February this year, China introduced an entirely new system of accounting that brings Chinese accounting into substantial convergence with IFRSs with the exception of two topics (related party transactions and impairment) —and these are being re-examined. This policy marked a major step forward for the quality of Chinese accounting and its convergence efforts. In addition, the Indian standard-setter is proposing an initiative aimed at converging differences of existing Indian standards with IFRSs.

At the same time, cooperation with the FASB is now an integral part of IASB's work programme. It is clear that no system would be truly international without the participation of the United States, and convergence between US GAAP and IFRSs remains a leading priority. It is the promise of improving access to US and European markets, which convergence work makes possible, that has encouraged many countries to opt for convergence with IFRSs.

The FASB and the IASB have worked together on a formal convergence program to eliminate differences between US GAAP and IFRSs since the autumn of 2002 following the issuance of the Norwalk Agreement. As you know, our goal from the outset has been not just to eliminate differences in existing standards, but to improve the consistency and quality of financial reporting worldwide by developing new solutions to accounting issues when standards failed to provide sufficient transparency to make informed economic judgements. This strategy has yielded results, and both boards have made changes in their standards, bringing them closer in line. The IASB's work on business combinations, financial instrument accounting, and assets held for sale brought IFRSs closer in line with US GAAP. The FASB has made changes in its standards on inventory cost, asset exchanges, and accounting changes and error correction to adopt internationally accepted approaches. The boards' work on share-based payments, or stock option accounting, is an example of how both boards could raise the quality of financial reporting by building on each other's work.

For the IASB, it is important to ensure convergence proceeds to such a point that companies using IFRSs are able to access US capital markets directly without reconciliation to US GAAP. For many companies throughout the world, the objective is to make IFRSs a passport to all of the world's capital markets, and the continuing need to reconcile to US GAAP to access US investors has been a source of frustration for many. My conversations with major business groups in Europe and elsewhere indicate that support for convergence is contingent on the eventual removal of the reconciliation requirement.

The US Securities and Exchange Commission has recognised that the FASB and the IASB are eliminating differences between US GAAP and IFRSs, IFRSs have the confidence of a growing number of jurisdictions, and the pool of non-US companies registered with the SEC will grow to nearly 1,000 by the end of the decade. In this context, the SEC staff has laid out a "roadmap" which sets out steps required to eliminate the need for companies using IFRSs to reconcile to US GAAP by no later than 2009. This roadmap was particularly helpful to the FASB and the IASB, because it provided a clear demonstration of support for the two boards' efforts on convergence.

From the standard-setting standpoint the SEC roadmap was significant. The IASB and the FASB would no longer need to concentrate on a possibly endless series of changes to

get the reconciliation removed. In consultation with the SEC and the European Commission, the IASB and the FASB agreed that trying to eliminate existing differences between two standards that are in need of significant improvement is not the best use of the FASB's and the IASB's resources—instead a new common standard should be developed that improves the financial information reported to investors. Topics, including post-retirement benefits identified as part of SEC report on off-balance sheet items and as part of a recent study by Committee of European Securities Regulators, could receive priority.

It was in this context that in February 2006, the FASB and the IASB issued a new Memorandum of Understanding that described their joint work programme for the coming years. (The Memorandum of Understanding is attached as an appendix.) The FASB and the IASB agreed that convergence work should proceed on the following two tracks:

- First, the boards will reach a conclusion about whether major differences in focused areas should be eliminated through one or more short-term standard-setting projects, and, if so, the goal is to complete or substantially complete work in those areas by 2008.

- Second, the FASB and the IASB will seek to make continued progress in other areas identified by both boards where accounting practices under US GAAP and IFRSs are regarded as candidates for improvement, culminating in common standards.

The project on post-retirement benefits falls into the second category.

The public's interest and an example from the UK

Accounting standard-setters often hear that accounting should not change behaviour, but there is a case, I fear, that poor accounting has led to neglect or mismanagement of pension resources. The numbers are staggering, and the emergence of large pension deficits are not confined to the United States. The overall deficit for the European companies in the Dow Jones STOXX 50 was €116 billion at 31 December 2004 and for the UK FTSE 100 was £37 billion at July 2005.[1] The SEC staff estimated in June 2005 that the overall deficit for active US filers might be $201 billion.[2]

For a long time, companies and investors failed to give proper attention to a growing problem of increasingly unhealthy pension programmes, and the accounting shares some of the blame. The international standard, IAS 19 *Employee Benefits*, and US GAAP obscure reality by permitting gains and losses to be smoothed over time with the result that

- income and expense may be under or overstated.

- the asset or liability in the balance sheet may be under or over stated

To give you an example, suppose a pension fund is in equilibrium having liabilities of $40 million matched by assets of a similar amount. If the value of the assets was to fall to $30 million and liabilities remained the same, the fund would have a deficit of $10 million.

[1] Source: Lane, Clark and Peacock 'Accounting for Pensions Survey' 2005
[2] Source: SEC Report under the Sarbanes Oxley Act into off-balance-sheet arrangements June 2005

Under what I expect will be the most commonly used option of IAS 19, the deficit is reduced:

a) by a reduction of 10 percent of whatever is the higher of assets or liabilities—in this case liabilities, leading to a reduction of $4 million

b) by 'spreading' the remaining deficit of $6 million ($10 million minus the $4 million) over the expected working lives of the employees—say 10 years for this example.

The result is that deficit shown in the financial statements becomes $600,000. The incomplete nature of such an amount recognised in income and expense and the balance sheet obscures the impact of the cost on the entity. While information about the total deficit is shown in the notes, standard-setters know that disclosure is no substitute for good accounting. Moreover, there is a growing body of academic research indicating that market participants do not incorporate the disclosures in decision making.

Eliminating the smoothing mechanisms can have a profound, positive impact. In one of the last actions before I joined the IASB, the UK Accounting Standards Board (ASB) took an important first step in improving accounting for pensions—a step that foreshadows, in my opinion, the direction that the FASB and IASB are likely to head. The UK standard, known as FRS 17, eliminates the smoothing mechanism by requiring companies to value their assets and liabilities of their pension funds at year end. Surpluses and deficits are shown on the balance sheet, and changes are shown, not in net income, but in a display similar to what in the United States is termed 'other comprehensive income'.

When the ASB published its proposals for FRS 17, some criticised the standard as providing a snapshot that was inappropriate considering assets and liabilities in pension funds are long-term. For that reason, FRS 17 requires disclosure of the position of the pension fund at balance sheet date over a five-year period, so investors and pensioners can see the trends and determine whether a deterioration of the pension fund's position is an anomaly or an indication that attention is needed.

The introduction of FRS 17 in the United Kingdom has led to an important national discussion on the future of pensions and the state of private and public programmes. When first published, the business community was split on whether the standard would improve financial reporting. When the press reported the deficits of the pension funds for the first time, the ASB was accused of destroying pensions. However, the attitude in the United Kingdom has changed. UK finance directors have informed me that pensions are now a topic of discussion in boardrooms for the first time and companies are taking action to address deficits.

Furthermore, FRS 17 has given additional important information to investors, because companies are beginning to explain to investors how they plan to address these deficits. HBOS, a major UK bank, provided a good example of the type of statements that are becoming more commonplace in the UK's equivalent of the Management's Discussion and Analysis (MD&A) is:

> As announced in late 2005, we intend to eliminate the IFRS deficit of our defined benefit pension schemes within ten years. At 31 December 2005, the

> IFRS deficit was £1.8bn (2004 £1.8bn) and £1.3bn (2004 £1.2bn) net of tax. As the first steps in meeting this goal, we have signalled our intention to contribute an additional £1bn to the schemes over the next five years, £800m having been earmarked as the up-front payment before the end of 2006. Our Tier 1 capital ratio of 8.1% at 31 December 2005 makes full allowance for these intended payments.[3]

This sentiment in favour of the UK FRS 17 approach was evident when UK publicly traded companies were potentially faced with a requirement to abandon FRS 17 accounting for the smoothing mechanism of IAS 19 in order to comply with European Union's requirement to use IFRSs beginning in 2005. When the IASB asked whether companies should be allowed to continue using the FRS 17 methodology, 15 UK companies and two major business groups responded, without any UK opposition, that they should. The IASB therefore introduced an option into IAS 19 to permit the use of FRS 17 accounting.

Critics of the approach taken under FRS 17 will point out that companies are withdrawing from defined benefit plans and moving to defined contribution plans, shifting the risk from employers to employees. That has been the trend for some time, and it is possibly true that some companies have opted to end their pension plans after the health and cost of the programmes were clear. This does not, however, constitute an argument against improved accounting.

Would it be better if employees planned for a retirement on the basis of benefits that a company is unable to keep? If companies are unable to fulfil their obligations, will that burden be shifted to the taxpayers?

While some accounting issues may seem arcane, here is an issue where the public policy consequences are significant. Improved accounting will enable companies, investors, and public officials to make informed judgements regarding the future of post-retirement plans, the sharing of risk in society, and questions of intergenerational consequence. This should be the beginning of an informed debate on the future of pensions, not the end.

The proposed path for the FASB and the IASB

The introduction of the FRS 17 option to IAS 19, the IASB's post-retirement benefits standard, did mark an improvement in IFRSs, but was not intended as a long-term solution. FRS 17 itself was an incremental change, addressing one deficiency of pension accounting, but leaving other important questions for later. For example, FRS 17, like US GAAP, allows a company to recognise an assumed return on assets, rather than actual returns, in net income.

There is a need now to address the issue of post-retirement benefits in a comprehensive matter. In addition to the SEC report, the IASB has received support for a comprehensive look at post-retirement benefits and will be discussing this topic with its advisory council at the end of this month. (Examples of the support are included as Appendix B.) Assuming continued support, the IASB intends to add the project to its formal agenda at its July 2006 meeting.

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[3] Source: HBOS plc Annual Report and Accounts 2005, Financial Review

The IASB recognises that the FASB has already initiated work on a first phase project on its own. It is our intention over the coming months to join efforts together in order to ensure the quality of both sets of standards is improved by drawing on the shared resources and expertise of both boards. The February 2006 Memorandum of Understanding anticipates the publication of one due process document by 2008.

In an effort to define the scope the potential project, the IASB instructed the staff to develop an agenda proposal for a comprehensive long-term project that would involve a fundamental rethink of all aspects of pension accounting. The Board also instructed the staff to identify issues within the project that could be resolved relatively quickly, with a view to issuing an interim standard that significantly improved pension accounting within four years. The items discussed as possibilities for this first phase were:

- Definitions of defined contribution and defined benefit plans;
- Accounting for cash-balance plans, including for cash-balance features incorporated in existing defined benefit plans. Cash-balance plans challenge the IAS 19/FAS 87 accounting model. In many ways, these plans are more similar to financial instruments or insurance contracts with embedded guarantees than to old style defined benefit plans;
- Elimination of the smoothing options;
- Elimination of the assumed rate of return on plan assets;
- Guidance on pension settlements and curtailments, in particular whether additional guidance is necessary after giving effect to the elimination of the smoothing mechanism. It is likely that pension settlements and curtailments will increase, as employers grapple with the financial burden of defined benefit pension obligations. The International Financial Reporting Interpretations Committee (IFRIC), our equivalent to the US Emerging Issues Task Force has already received one request for interpretation, and it may well be the first of many;
- Revisions to disclosures occasioned by changes in recognition and measurement; and,
- Presentation in the statement of recognised income and expense, in particular:
    - Whether some components of annual pension expense should be reported as other recognised income and expense rather than directly in net profit, and;
    - Whether those amounts should be recycled to profit or loss over time.

The FASB is intending to issue a standard removing the smoothing mechanisms from the balance sheet, but not from net income, towards end of the year. I would hope that the IASB will follow suit by dealing with the matters mentioned above. Our work will be of assistance to the FASB in the same way that their forthcoming deliberations on issues, such as the appropriate interest rate to discount pension liabilities will assist the IASB. This will enable both boards to work towards a soundly-based common standard on post-retirement benefits.

In addressing these issues of critical public importance, the FASB and the IASB are aware of the need to consult the wide range of interested parties. This will include the use of

experts to provide guidance on a range of issues, full transparency in the FASB's and the IASB's deliberations, an opportunity for interested parties to comment on proposals, and meetings and visits with leading national and international associations.

The soundness of retirement systems of most countries throughout the world depend on the three-legged stool of government-provided pensions, pensions accrued from employment and private savings. If the financial health of public or private-sector pensions is brought into question, the ability to provide a financially secure retirement for the population is brought into doubt. For too long, accounting has concealed the health of employer-provided plans. As the populations of developed economies age and public systems, including social security programmes, are strained, we cannot afford to let private sector pensions fail. Good accounting will not solve the problem, but it will enable businesses, employees, investors, and public officials to address an issue of growing concern. It is in this light, the IASB is committed to working with the FASB to develop a high-quality, principles-based, global standard for the accounting for postretirement benefit obligations that will faithfully report the underlying economic effects of those plans. In doing so, we will listen to all views, but our first responsibility is to good accounting.

Appendix A

A Roadmap for Convergence between IFRSs and US GAAP—2006-2008

Memorandum of Understanding between the FASB and the IASB

27 February 2006

After their joint meeting in September 2002, the US Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) issued their Norwalk Agreement in which they 'each acknowledged their commitment to the development of high quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting. At that meeting, the FASB and the IASB pledged to use their best efforts (a) to make their existing financial reporting standards fully compatible as soon as is practicable and (b) to co-ordinate their future work programmes to ensure that once achieved, compatibility is maintained.'

At their meetings in April and October 2005, the FASB and the IASB reaffirmed their commitment to the convergence of US generally accepted accounting principles (US GAAP) and International Financial Reporting Standards (IFRSs). A common set of high quality global standards remains the long-term strategic priority of both the FASB and the IASB.

The FASB and the IASB recognise the relevance of the roadmap for the removal of the need for the reconciliation requirement for non-US companies that use IFRSs and are registered in the United States. It has been noted that the removal of this reconciliation requirement would depend on, among other things, the effective implementation of IFRSs in financial statements across companies and jurisdictions, and measurable progress in addressing priority issues on the IASB-FASB convergence programme. Therefore, the ability to meet the objective set out by the roadmap depends upon the efforts and actions of many parties—including companies, auditors, investors, standard-setters and regulators.

The FASB and the IASB recognise that their contribution to achieving the objective regarding reconciliation requirements is continued and measurable progress on the FASB-IASB convergence programme. Both boards have affirmed their commitment to making such progress. Recent discussions by the FASB and the IASB regarding their approach to the convergence programme indicated agreement on the following guidelines:

- Convergence of accounting standards can best be achieved through the development of high quality, common standards over time.
- Trying to eliminate differences between two standards that are in need of significant improvement is not the best use of the FASB's and the IASB's resources—instead, a new common standard should be developed that improves the financial information reported to investors.
- Serving the needs of investors means that the boards should seek to converge by replacing weaker standards with stronger standards.

Consistently with those guidelines, and after discussions with representatives of the European Commission and the SEC staff, the FASB and the IASB have agreed to work towards the following goals for the IASB-FASB convergence programme by 2008:

Short-term convergence

The goal by 2008 is to reach a conclusion about whether major differences in the following few focused areas should be eliminated through one or more short-term standard-setting projects and, if so, complete or substantially complete work in those areas.

Topics for **short-term convergence** include:

To be examined by the FASB	To be examined by the IASB
Fair value option*	Borrowing costs
Impairment (jointly with the IASB)	Impairment (jointly with the FASB)
Income tax (jointly with the IASB)	Income tax (jointly with the FASB)
Investment properties**	Government grants
Research and development	Joint ventures
Subsequent events	Segment reporting
FASB Note: *On the active agenda at 1 July 2005 ** To be considered by the FASB as part of the fair value option project	*IASB Note:* Topics are part of or to be added to the IASB's short-term convergence project, which is already on the agenda.

Limiting the number of short-term convergence projects enables the boards to focus on major areas for which the current accounting practices of US GAAP and IFRSs are regarded as candidates for improvement.

Other joint projects

The goal by 2008 is to have made significant progress on joint projects in areas identified by both boards where current accounting practices of US GAAP and IFRSs are regarded as candidates for improvement.

The FASB and the IASB also note that it is impractical, when factoring in the need for research, deliberation, consultation and due process, to complete many of the other **joint projects** by 2008. The two boards understand that during this time frame measurable progress on such projects, rather than their completion, would fulfil their contribution to meeting the objective set forth in the roadmap.

Furthermore, it is noted that the strategy regarding other joint projects and the goals described below should be consistent with one of the IASB's objectives of providing stability of its standards for users and preparers in the near term.

After consultations with representatives of the European Commission and the SEC staff and consistently with existing priorities and resources, the FASB and the IASB have expressed the progress they expect to achieve on their convergence project in the form of a list of 11 areas of focus. It is noted that these projects will occur in the context of the ongoing joint work of the FASB and the IASB on their respective Conceptual Frameworks. As part of their Conceptual Framework project, the FASB and the IASB will be addressing issues relating to the range of measurement attributes (including cost and fair value) to enable a public discussion on these topics to begin in 2006.

After considering the complexity of those topics and consultation requirements, the boards set the following goals for 2008 for convergence topics already on either their active agendas or the research programmes:

Topics already on an Active Agenda			
Convergence topic	**Current status on the FASB Agenda**	**Current status on the IASB Agenda**	**Progress expected to be achieved by 2008**
1. Business combinations	On agenda – deliberations in process	On agenda – deliberations in process	To have issued converged standards (projected for 2007), the contents and effective dates of which to be determined after taking full account of comments received in response to the Exposure Drafts.
2. Consolidations	On agenda – currently inactive	On agenda – no publication yet	To implement work aimed at the completed development of converged standards as a matter of high priority.
3. Fair value measurement guidance	Completed standard expected in the first half of 2006	On agenda – deliberations in process	To have issued converged guidance aimed at providing consistency in the application of existing fair value requirements.[4]
4. Liabilities and equity distinctions	On agenda – no publication yet	On agenda (will follow FASB's lead)	To have issued one or more due process documents relating to a proposed standard.
5. Performance reporting	On agenda – no publication yet	Exposure draft on a first phase	To have issued one or more due process documents on the full range of topics in this project.
6. Post-retirement benefits (including pensions)	On agenda – deliberations underway on the first phase of multi-phase project	Not yet on the agenda	To have issued one or more due process documents relating to a proposed standard.
7. Revenue recognition	On agenda – no publication yet	On agenda – no publication yet	To have issued one or more due process documents relating to a proposed comprehensive standard.

The objective of the goals set out above is to provide a time frame for convergence efforts in the context of both the objective of removing the need for IFRS reconciliation requirements by 2009 and the existing agendas of the FASB and the IASB. The FASB and the IASB will follow their normal due process when adding items to the agenda. Items designated as convergence topics among the existing research programmes of the boards include:

Topics already being researched, but not yet on an Active Agenda			
Convergence topic	**Current status on the FASB Agenda**	**Current status on the IASB Agenda**	**Progress expected to be achieved by 2008**
1. Derecognition	Currently in the pre-agenda research phase	On research agenda	To have issued a due process document relating to the results of staff research efforts.
2. Financial instruments (replacement of existing standards)	On research agenda and working group established	On research agenda and working group established	To have issued one or more due process documents relating to the accounting for financial instruments.

[4] The fair value guidance measurement project will not extend requirements for the use of fair value measurements, and any proposals regarding increasing the use of fair value accounting will be addressed in the context of the Conceptual Framework and other projects on the FASB's and IASB's respective agendas.

3. Intangible assets	Not yet on agenda	On research agenda (led by a national standard-setter)	To have considered the results of the IASB's research project and made a decision about the scope and timing of a potential agenda project.
4. Leases	Pre-agenda research underway	On research agenda (led by a national standard-setter)	To have considered and made a decision about the scope and timing of a potential agenda project.

In setting out the projects for both the short-term convergence topics and the major joint topics, the FASB and the IASB recognise that with respect to its foreign registrants the SEC staff will undertake an analysis of their 2005 IFRS financial statements across companies and jurisdictions. This analysis may reveal the need for additional standard-setting actions by one of the boards or both. Furthermore, the FASB and the IASB note that their work programmes are not limited to the items listed above, but remain committed to fulfilling their contribution to meeting the objectives set out by the roadmap.

The FASB and the IASB also recognise the need to undertake this work in a manner that is consistent with their established due process, including consultation with interested parties on their ongoing joint efforts before reaching conclusions.

Appendix B—Examples of Support for a Comprehensive Project

John Plender, The Financial Times, 19 December 2003

Pensions accounting is encouraging companies to delude themselves about their profitability and financial health. If this ends in tears, as well it may, the standard-setters have much to answer for.

CBI response to 2004 amendments to IAS 19

We agree a fundamental review needs to take place in order to determine the appropriate accounting treatment covering the range of circumstances and situations that need to be addressed in connection with final salary schemes.

Standard and Poor's response to 2004 amendments to IAS 19

We strongly encourage the IASB to add a project to its near-term agenda that would comprehensively look at the accounting for costs and obligations arising from defined benefit plans. We recommend that the aim of the project be to require a single model of accounting that would mandate the full recognition of assets, liabilities and costs and reduce the potential for abuse. In our view it is desirable that the project be conducted in parallel with other accounting standard setters such as the FASB to further improve international conformity of financial reporting.

Institute of Chartered Accountants of England and Wales response to 2004 amendments to IAS 19

There is an urgent need for the Board to undertake the comprehensive review of IAS 19 at the earliest opportunity.

Astra Zeneca response to 2004 amendments to IAS 19

However, we do believe that the area of pension accounting is in need of review and would urge the IASB to complete such a review as soon as practicable.

KPMG response to 2004 amendments to IAS 19

We would prefer that all of the proposed changes, other than the change in respect of participation on group plans, be considered as part of a comprehensive project on post-employment benefits covering all areas, preferably as a joint project with other standard setters, including the US FASB and the UK ASB.

PricewaterhouseCoopers response to 2004 amendments to IAS 19

We encourage the Board to progress to a more wide ranging update of IAS 19, in conjunction with the development of the single performance statement, as soon as possible.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR ENZI FROM ROBERT H. HERZ

Q.1. A recently released study of 100 large corporations with defined benefit pension plans found that 97 of those corporations would suffer a significant reduction in equity if FASB implements Phase 1 of the pension accounting project to move the footnote disclosure onto the balance sheet. Some analysts say that market researchers and analysts already take into account the footnote disclosure when making a recommendation on a company's stock. I am very concerned about this. While it appears to be a relatively minor change, the additional red ink on many companies' bottom line will be significant. Since our defined benefit system is a voluntary system, one could see where companies in the red would file bankruptcy to get rid of their pension plans.

Has FASB looked at any additional studies to see whether this might be a possibility?

A.1. The objective of Phase 1 of the FASB's project on pensions and other post-retirement benefits is to improve the completeness, transparency, and understandability of a sponsoring employer's reported obligations related to post-retirement benefits. At present, important information about the financial status of a company's post-retirement benefit plans is reported in the footnotes, and not recognized in the basic financial statements. That makes it more difficult for users of financial information to assess an employer's financial position as well as its ability to carry out the obligations of its plans. So while sophisticated investment analysts and users of financial statements may use the footnote disclosures to prepare pro forma financial information that more properly reflects the employer's obligations related to post-retirement benefits, recognizing the funded status of the plans in the sponsor's financial statements will make it easier for investors, employees, and others to understand and assess a company's financial position, as well as its ability to carry out the obligations of its post-retirement benefit plans, including pensions.

The FASB has long believed that disclosure is not an adequate substitute for recognition—a belief that is supported by studies and years of experience. Many investors focus on the primary financial statements rather than the footnotes.

During the course of our work on this project, we reviewed various studies quantifying the extent and magnitude of unrecognized liabilities for defined benefit pension and other post-retirement benefit plans. Commentators have expressed various views on possible actions of employers if and when such liabilities are recorded on the employers' balance sheets. For example, some believe that certain companies, following the already well established trend away from defined benefit pension plans, may choose to migrate to defined contribution plans. Others contend that recognizing the liability for defined benefit pension and other post-retirement benefit plans will promote greater security of the promised benefits by increasing the incentive for companies to more fully fund such obligations and, as discussed in the response to Question 2 below from Senator Bunning, to adopt more sound investment policies related to plan assets, which might also reduce the volatility of a plan's funded status.

As I noted in my testimony at the June 14, 2006, hearing, predicting such behavioral impacts is difficult at best. In any event, our mission is to establish unbiased accounting standards in order to enable the users of financial statements to better assess the financial condition and performance of enterprises. The accounting standards we establish should not be deliberately skewed or biased toward favoring particular transactions or types of arrangements or toward achieving particular social, political, or economic objectives other than sound and transparent reporting to investors and other users. In that regard, the proposed requirement to recognize the plan surplus or deficit on the employer's balance sheet does not alter the underlying economic position, but merely reflects that position in the financial statements.

Q.2. As Chairman of the HELP Committee, we have been working on pension reform since the beginning of last year. It is quite apparent that accounting for pension plans is quite unique in that accountants and auditors must rely heavily on third parties, such as actuaries, in order to put together the accounting statements. As part of Phase 2 of the FASB initiative, you will be looking at how the pension and retirement health benefits are calculated.

How will FASB include the actuaries in the process of the development of the Statement? Would FASB consider establishing a new, perhaps ad hoc, Advisory Board just to gain the expertise of the actuaries and other third parties?

You established a Small Business Advisory Committee, which I applaud you for doing. It appears quite effective. A new temporary Committee for the pension accounting initiative could prove just as productive.

A.2. The FASB establishes project resource groups to provide information and practical insights from knowledgeable parties on all our major projects. The FASB seeks information and views from project resource group members as needed throughout the life of a project, for example, to identify issues to be addressed as well as to analyze possible alternative approaches. Resource group members also perform reviews of Exposure Drafts and final Statements prior to finalization.

A typical project resource group comprises constituents from a variety of backgrounds—preparers, auditors, users of financial information, subject-matter experts, and representatives of the nonpublic, small business sectors (also mutual enterprises and not-for-profit sectors when appropriate). With regard to our pensions and other post-retirement benefits project, we intend to form a project resource group for Phase 2 of the project. Given the importance of actuarial information and calculations in this area, the project resource group will certainly include actuaries. Moreover, we have already and will continue an active dialogue with the actuarial community regarding the project. During Phase 1 of the project, we have sought and received significant input from actuaries through comment letters, at our public roundtables, and through various other discussions.

Q.3. The debate has been going on for years among the banking and securities industries as to whether there should be a difference in accounting for the bottom line as to which assets should be tracked on a mark-to-market basis or whether they should be tracked based upon a long-term investment strategy.

With respect to pension accounting, some have believed that pension plan sponsors are trying to build up the portfolio for the longer term investment and that the accounting standards should reflect that.

As you move into Phase 2 of the FASB project, what criteria should be considered to determine whether mark-to-market accounting is appropriate? In addition, what additional costs will companies incur to implement mark-to-market accounting? Will FASB be doing a cost-benefit analysis on this?

A.3. The FASB decided to conduct the pensions and other post-retirement benefits project in phases so that issues such as those related to measurement of benefit obligations and mark-to-market accounting could be addressed by leveraging the FASB's projects on the conceptual framework and on financial statement presentation, which are presently ongoing. The conceptual framework establishes the foundation, principles, and definitions on which accounting standards rely. The conceptual framework, therefore, is essential in analyzing economic transactions in order to identify the assets, liabilities, gains, and losses that should be represented in the financial statements. The financial statement presentation project will establish the reporting format for reporting those gains and losses.

Phase 2 of the FASB's pensions and other post-retirement benefits project has no predetermined conclusions. The FASB will research, analyze, and carefully consider the timing of recognition of gains and losses (i.e., what some refer to as mark-to-market) but has not prejudged the outcome, which will be based on a thorough analysis of the issues. As with all FASB decisions, the Board will consider the costs of implementing accounting standards compared to the benefits to be derived by the improvement in accounting and reporting.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR BUNNING FROM ROBERT H. HERZ

Q.1. I would like to ask Mr. Herz about an issue that came up in the Finance Committee yesterday that involves FASB. Very quickly, Mr. Herz, there was discussion yesterday in the Finance Committee about the fact that international accounting standards generally do not recognize the LIFO method. I understand that FASB and the IASB are involved in discussions about the possible convergence of U.S. and international accounting standards. However, I understand that the issue of inventory accounting generally, and LIFO in particular, is NOT on any current agenda. Could you please confirm this for me?

A.1. Your understanding is correct. The issue of inventory accounting in general is not on any current agenda for the FASB. In 2002, when the IASB decided not to permit the use of LIFO internationally, we considered whether to propose eliminating its use under U.S. GAAP. We decided against this, noting that tax conformity rules would make LIFO elimination more difficult in the United States and that companies reporting using international financial reporting standards (IFRS) that file financial statements in the United States could avoid the need to report reconciling items relating to inventory accounting by using methods such as FIFO or average cost that are acceptable under both U.S. GAAP and IFRS.

Q.2. Your written testimony indicates that some feel that the current accounting treatment provides an incentive for companies to invest more aggressively than might be appropriate for their pension plans. Do you feel this is a real concern?

A.2. A number of knowledgeable commentators have expressed these concerns. Current accounting standards permit an employer that sponsors defined benefit post-retirement plans to recognize investment income based on what management assumes it will earn on dedicated plan assets over a long period of time, not what it actually earns each year. The period over which that assumed investment return is based is the period over which the plan assets will be used to pay benefits. That could span 30 or more years. Actual investment gains or losses need not be recognized as those gains or losses are incurred.

Some believe that use of this accounting method leads plan sponsors to invest in higher risk securities. They therefore contend that the present accounting has a bias toward investing in higher risk investments that has jeopardized the security of promised defined benefits. Accordingly, they advocate that the present accounting be eliminated by requiring immediate recognition of actual market gains and losses as those gains and losses are incurred; potentially causing employers to reallocate their plan portfolios away from equity securities toward more fixed income securities.

Q.3. What kind of feedback did you get during the open comment period? Are there any common concerns you have heard?

A.3. We received approximately 240 comment letters and hosted 2 public roundtable meetings. Most of the respondents agreed with the goal of making financial statements more complete, transparent, and understandable. Most auditors, investors, and many in-

vestment and credit analysts generally agreed with the Board's proposal to use the projected benefit obligation (PBO). On the other hand, actuaries and plan sponsors generally disagreed with the way pension benefit obligations are proposed to be measured. They advocated measuring those obligations as the accumulated benefit obligation (ABO) versus the PBO. The difference between the two measures is that the PBO includes the effect of assumed future salary increases on the obligation for salary-based promised benefits while the ABO does not. As with each of the major components of the proposal, the Board carefully deliberated this issue before reaching a final consensus to use the PBO.

Respondents made numerous other comments, including those related to retrospective application of the proposed changes and other features of the proposed Statement that the FASB is carefully redeliberating.

Q.4. and **Q.5.** The Projected Benefit Obligation used in the proposed standard requires accounting for assumed future salary increases even though these increases are not owed under any contract between employer and employee. Do you think it is misleading to reflect such a liability as it is not yet an obligation of the employer?

I am sure you are aware of discussions in the business community about the use of Accrued Benefit Obligation as the appropriate measure for the balance sheet instead of the Projected Benefit Obligation. Do you agree and why or why not?

A.4. and **A.5.** The determination of future cash flows used to develop measures of pension obligations makes a variety of assumptions about the future based on the existing agreement between the employer and the employee. Examples include assumptions about obligations that will vest in the future, assumptions about future growth of cash balance and other lump-sum benefits, assumptions about early retirement benefits that are not fully actuarially reduced, and assumptions about employee turnover, retirement, and life expectancy, as well as assumptions about future inflation and about increases in compensation for plans that base the pension benefit on final or career average pay.

As discussed in the response to Question 3, the difference between the PBO and the ABO is that the PBO includes the effect of assumed future salary increases in the calculation of benefits payable for service to date, while the ABO does not factor this into the determination of the obligation.

As described below, when the Board issued Statement 87, it concluded that the PBO was the most relevant measure of the pension obligation. Some have suggested that because employers have discretion to grant or not to grant increases in compensation, the measure of a company's pension obligation should ignore the effect of future salary increases on benefits earned to date.

The FASB's conceptual framework does not limit liabilities to those that are legally enforceable. Liabilities include constructive, equitable, and moral obligations. Furthermore, the definition of a liability encompasses the duty or responsibility that entails settlement by probable future transfer or use of assets and the duty or responsibility obligates a particular entity, leaving it little or no

discretion to avoid the future sacrifice. Current accounting standards, as well as the Board's proposal, require employers to assume future increases in compensation that they expect to grant as they affect the benefits promised for current or past service. This is consistent with the way many other long-term liabilities are currently recognized in financial statements.

The issue is whether and, if so, how to include the effects of future increases in compensation when a defined benefit plan's formula incorporates compensation in determining the pension benefit. Some of the factors for measuring the pension obligation as the PBO include:

a. The Board concluded in Statement 87 that the PBO is the most relevant measure of the benefit obligation after extensive debate of the issue. The Board's current decision to retain that conclusion in Phase 1 of the project, therefore, is consistent with that prior conclusion.

b. Most users of financial statements believe the PBO better reflects the employer's economic obligation and the terms of the substantive plan.

c. Using a measure of the obligation other than the PBO might necessitate changing how other assumptions are determined, specifically the discount rate, which implicitly includes the impact of expected inflation. Views on that issue are described in paragraphs 140–142 of Statement 87's basis for conclusions.

d. Further, as noted in paragraph 139 of Statement 87's basis for conclusions:

> Among those respondents who argued that obligations dependent on future compensation increases are excluded by the definition of a liability, very few were prepared to accept a measure of net periodic pension cost that was based only on compensation to date. The Board notes that under the double entry accounting system, recognition of an accrued cost as a charge against operations requires recognition of a liability for that accrued cost. Thus, excluding future compensation from the liability and including it in net periodic pension cost are conflicting positions.

e. For most plans that provide post-retirement benefits other than pensions, there is no measure of the obligation that is analogous to the ABO in a pension plan. Therefore, if the Board was to require that the ABO be used to measure the pension obligation, the Board also would have to determine the equivalent measure for other post-retirement benefits. Thus, the issue is broader than pension plans alone.

f. Including assumed future increases in compensation in the benefit obligation reflects the different employer commitment and employee expectation between a flat benefit plan and a final pay or career average pay plan.

Some also have suggested that the ABO is the amount at which the obligation could be settled, assuming the employer terminates or freezes the plan. In considering this issue, we have noted that the ABO does not necessarily represent the amount at which the obligation could be settled in an arm's-length transaction with an independent third party. That settlement amount would likely be affected by factors not presently reflected, or measured differently from those included, in the ABO as presently measured. The result could be a settlement amount that could be higher or lower than

the ABO. Further, we do not believe that the accounting for a presently ongoing arrangement between the employer and the employee should assume a different arrangement than what is presently understood between the employer and the employee. Any future event or transaction that alters that arrangement should be recognized when that event or transaction takes place. Phase 2 of our project will include a comprehensive examination of alternative measurement approaches.

The Board is currently redeliberating the Phase 1 Proposal. In our redeliberations, we are addressing many key issues raised by constituents during the comment phase of the project. We expect to complete redeliberations soon and issue a final standard for Phase 1 shortly thereafter. Once the final Statement on Phase 1 is issued, the Board will begin Phase 2 of the project.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR ENZI FROM SIR DAVID TWEEDIE

Q.1. Recently, the United Kingdom has been undertaking pension reform. When we met a couple of years ago, accounting reform for pension plans was high on your list due to the trouble of companies in legacy industries.

Could you provide us with greater detail of the U.K. experience of having to deal with the accounting for old-line companies as compared to companies without legacy burdens?

A.1. By legacy industries and old-line companies we assume that you are referring to industries with substantial union labor such as steel, mining, heavy industry, and airlines. Such companies will tend to have mature pension plans that are large compared to the company itself. For example, in the United Kingdom, the 2005 Lane Clark and Peacock survey reported the following figures for 2004:

Largest FRS17 deficits compared to market capitalisation

Company	Deficit £m	Market Cap £m	Deficit/ Market Cap %
BAE Systems	4,334	7,004	62
British Airways	1,306	2,992	44
BT	5,136	15,346	33
Rolls-Royce Group	1,398	4,209	33
ICI	883	2,871	31

Under FRS 17, the United Kingdom accounting standard, the accounting for pension plans in such companies reflects the economic reality that the pension plans are large compared with the size of the company. However, to prevent the balance sheet of the entity from being overshadowed by the pension deficit, FRS 17 requires

the pension deficit to be presented separately after all other net assets. Similarly, the retained earnings of the entity are presented both before and after the impact of the pension deficit.

A further concern was expressed that the recognition of a deficit in full on the balance sheet would reduce retained earnings to a level such that it would not be possible, under company law, to pay dividends. However, under U.K. company law, the availability of retained earnings for the payment of dividends is assessed by reference to the separate financial statements of the parent, not the consolidated financial statements. FRS 17 does not require recognition of group plans in the separate financial statements of the parent or the individual financial statements of the subsidiaries in the group if the individual companies cannot identify their share of the plan assets and liabilities.

The international standard on pensions, IAS 19, permits the use of FRS 17 accounting as one of the permitted options.

Q.2. The debate has been going on for years among the banking and securities industries as to whether there should be a difference in accounting for the bottom line as to which assets should be tracked on a mark to market basis or whether they should be tracked based upon a long term investment strategy.

With respect to pension accounting, some have believed that pension plan sponsors are trying to build up the portfolio for the longer term investment and that the accounting standards should reflect that.

As you move into Phase 2 of the FASB project, what criteria should be considered to determine whether mark to market accounting is appropriate? In addition, what additional costs will companies incur to implement a mark to market accounting? Will FASB be doing a cost benefit analysis on this?

A.2. While the Senator's question is directed to the Phase 2 of the FASB project, it is applies equally to the IASB's work on pension accounting. FASB Statement 87 (issued in 1985) requires that the assets of a pension plan be measured at fair value. In 1993, revisions to IAS 19, the international standard, required plan assets to be measured at fair value. The U.K.'s most recent standard, FRS 17, continued this well-established practice. The question, then, is not whether accounting standards should change to mandate fair value in this case, they already do. The question is whether the accounting standards should include devices designed to smooth the income-statement effect of changes in plan assets. Those same devices have been widely criticized as masking economic reality. On balance, I agree with many of those criticisms.

Critics often complain that fair value is a "snapshot" and assert that they are investing pension assets "for the long term." I certainly heard those criticisms at the U.K. Accounting Standards Board. Rather than introducing arbitrary smoothing mechanisms, FRS 17 requires that companies disclose 4 years of trend information. Financial statement users can form their judgements from 4 years of real information, rather than having to untangle 4 years of smoothed information.

The Senator also asks about the costs companies will incur to implement fair value measurement of plan assets. As noted above,

there is no incremental cost, nor can I see any savings from failing to measure plan assets at fair value. Indeed, the cost of implementing and tracking the various smoothing mechanisms, and of preparing the disclosures needed to explain their effects, far outweighs the cost of measuring fair value. We should also note that financial statement users—including analysts, shareholders, lenders, regulators, unions, suppliers, and others—incur significant costs in attempting to understand the effects of the smoothing mechanisms inherent in FASB Statement 87, IAS 19, and to a lesser degree, FRS 17.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR BUNNING FROM SIR DAVID TWEEDIE

Q.1. In some cases it is appropriate for companies to close defined benefit plans when they become a potential liability for the taxpayer. In your testimony, you cite such closings in the United Kingdom as a positive occurrence under the same reasoning. Do you think that companies with otherwise viable defined benefit programs are choosing to close these programs as a result of the pension accounting standard being implemented by the U.K. Accounting Standards Board?

A.1. We have anecdotal evidence that the accounting under FRS 17 raised the profile of pension plans with Boards of directors. I would argue that FRS 17 resulted in companies becoming more aware of the liabilities arising from the pension plan and the associated risks. This, together with changes in the regulatory environment, may have led to companies to conclude that their pension plans were no longer an economically viable method of providing employee compensation. I do not think that companies that regard defined benefit plans as an economically appropriate method of providing employee compensation have closed their plans just because of the accounting required under FRS 17. FRS 17 simply provides transparent and objective information about the cost and risks of providing a defined benefit pension.

Q.2. Is there an alternative accounting standard that could provide accountability and transparency, but not unnecessarily force employers out of pension programs?

A.2. Standard setters often hear that accounting standards will change behavior. Yet, if the standard reveals information to the capital markets, and market participants find the information useful, why should accounting standards withhold that information? There may be implications. Management may change its behavior. But the role of the accounting standards, as I see it, is to provide the capital markets with the most useful and neutral information possible.