Testimony of
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Chairman
Financial Accounting Standards Board
before the
Committee on Banking, Housing, and Urban Affairs
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FASB's Proposed Standard on "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans"

Full Text of Testimony

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,

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

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.

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

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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.

> 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 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

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[5] Policy Statement, page 5 of 8.
[6] See Attachment 1 for information about the Financial Accounting Foundation.
[7] See Attachment 1 for information about the FASB's due process.

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

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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.

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.

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

[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).

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

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[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.)

[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.

- 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:

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[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.

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

[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.)

- 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.

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.

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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.)

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 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

[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 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.

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. . . .
>
> 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.
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> *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.