Oral Statement

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"

Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee:
I am Robert Herz, chairman of the Financial Accounting Standards Board. I am pleased to appear before you today on behalf of the Board. I want to thank you for the opportunity to discuss the Board's current project to improve the accounting by employers for defined benefit pension plans and other postretirement benefits.

Our ultimate goal in the postretirement benefit project is to develop, with oversight by the SEC, and in cooperation with the IASB, a high-quality, principles-based, global standard for the accounting for these obligations. I am therefore very pleased to appear here today with Sir David Tweedie of the IASB. As you probably know, we are working closely with our international colleagues on a number of key projects, including the development of a common conceptual framework, business combinations, accounting for 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 our respective standards. Sir David will elaborate further on these efforts to bring about high quality global accounting standards.

With regard to the postretirement benefit project, we have undertaken the project because current accounting standards do not provide complete and transparent information about employers' obligations and costs relating to these 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 single-employer defined benefit pension plans and other postretirement benefits. These changes will 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, donors, and other users.

The 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.

Before discussing further details about this project, I would like to provide some background on the FASB. The FASB and its parent organization, the Financial Accounting Foundation, are independent private-sector organizations. Our independence from enterprises and auditors 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 deliberative process, which contributes to the overall confidence in the capital markets.

Financial reporting is meant to tell it like it is, and not allow distortions or the skewing of information to favor particular companies or industries, particular types of transactions, or particular political, social, or economic goals. While bending the standards to favor or retain a particular outcome may seem attractive to some, in the long run a biased accounting standard can lead to mistakes in private and public investment decisions.

Because the actions of the FASB affect so many organizations, our decision-making process must be open, thorough, and objective. So our Rules of Procedure require an extensive and thorough public due process. The process involves public meetings, public roundtables, meetings with interested parties, and exposure of our proposed standards to external scrutiny and public comment. And in making our technical 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.

In November 2005, the Board unanimously decided to add a comprehensive project to our agenda to reconsider the existing accounting guidance for defined benefit pension plans and other employer-sponsored postretirement benefits. The decision responded to requests from users, preparers, and auditors of financial reports, our advisory committees, the staff of the SEC, the PBGC, and others to remedy deficient rules that have resulted in unclear and misleading financial reporting.

What are the key concerns? First, the current standards permit an employer sponsoring such plans to delay recognition of the economic events that affect the cost and obligation relating to providing postretirement benefits. Current requirements also relegate important information about postretirement benefit plans to the notes to the financial statements. Additionally, the existing reporting of benefit costs obscures the employer's reported results of operations by combining the effects of compensation, investing, and financing activities.

The project will be conducted in two phases. The first phase of the project focuses on recognizing on the balance sheet the funded or unfunded status of an enterprise's postretirement benefit plans.

The second broader phase of the project will comprehensively address other more complex issues, such as:

- 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 obligation, in particular the obligations under plans with lump-sum settlement benefits, cash balance plans and multiemployer plans

- Whether more or different guidance should be provided regarding measurement assumptions

- Whether postretirement benefit trusts should be consolidated by the plan sponsor.

Since the November 2005 decision, the Board and staff have held three public meetings to discuss the project, discussed it at meetings with our advisory committees and other interested groups. We have also discussed the project at over two dozen venues across the country where over 10,000 participants attended.

After more than four months of public due process, in March 2006, the Board unanimously agreed to issue a Phase 1 proposal for public comment, FASB Exposure Draft of a Proposed Statement, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*.

The Phase 1 Proposal would require employers to recognize the overfunded or underfunded status of their postretirement benefit plans on their balance sheets. For example, for defined benefit pension plans, the amount of 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 (underfunded), with a corresponding decrease, net of tax effects, in the employer's equity. Conversely, if the value of the plan assets exceeds the projected benefit obligation, the difference would be reported as an asset (overfunded), with a corresponding increase, net of tax effects, in the employer's 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 three months earlier.

The proposed changes that would require recognition of the overfunded or underfunded status would be effective for fiscal years ending after December 15, 2006. For public companies the change in measurement date would become effective in fiscal years beginning after December 15, 2006. For nonpublic companies including not-for-profit organizations the change in measurement date would become effective in fiscal years beginning after December 15, 2007.

The comment period for the Phase 1 Proposal ended on May 31, 2006. The Board plans to hold public roundtable meetings later this month on the proposal to ensure that we understand the views and positions of all interested parties. While our staff is currently analyzing and summarizing the over 200 comment letters we received, from my own reading of the letters 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.

After the roundtable meetings, the Board will begin public redeliberations on the Phase 1 Proposal. Our redeliberations will address the key issues raised by constituents. Only after carefully evaluating the input received in response to the Phase 1 Proposal will the Board consider whether to issue a final standard, which requires approval of a majority vote of the Board.

While our current plan is to issue a final Statement in the third quarter of this year, we will continue public redeliberations as long as is necessary to develop a final high-quality accounting standard. Once the final Statement on Phase 1 is issued, the Board will begin Phase 2 of the project.

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