MINUTES

Financial Accounting Standards Board

To: Board Members

From: FASB Staff Position No. FAS 106-b Team
(Hamilton, ext. 330)

Subject: Minutes of the February 25, 2004 Board Meeting **Date:** March 8, 2004

cc: FASB: Bielstein, Smith, Petrone, Cassel, Durbin, Rohrkemper, Hamilton, Vernuccio, FASB Intranet

Topics: Effective date and transition for applying the proposed accounting guidance for the federal subsidy under the Medicare Prescription Drug, Improvement and Modernization Act of 2003 , including situations in which a plan's status as to actuarial equivalency is unclear as of the date of enactment, and disclosure requirements

Basis for Discussion: Board memorandum dated February 23, 2004 and Board handout dated February 25, 2004

Length of Discussion: 10:45 a.m. to 12:00 p.m.

Attendance:

Board members present: Herz, Batavick, Schieneman, Schipper, Seidman, Trott, Leisenring (IASB)

Board members absent: Crooch

Staff in charge of topic: Durbin

Other staff at Board table: Smith, Cassel

Outside Participants: None

Summary of Decisions Reached:

The Board discussed the disclosure, transition, and effective date provisions of the proposed guidance on the accounting for the federal subsidy provided by the Medicare Prescription Drug, Improvement and Modernization Act of 2003. The Board decided:

1. The option to defer any accounting for the effects of the Act expires upon the issuance of the proposed guidance as a final FASB Staff Position (FSP).
2. Plan sponsors should evaluate, as of the date of enactment, a plan's actuarial equivalency status (excluding nonpublic companies that sponsor no plan with more than 100 participants). The Board noted that that determination may be inconclusive until regulations clarifying actuarial equivalence are issued.
3. If a plan is determined to be actuarially equivalent as of December 8, 2003, remeasurement of the plan's assets and obligations, including the effects of the subsidy, is required as of the earlier of (a) the plan's first scheduled measurement date following the date of enactment or (b) the end of the first interim or annual period of the plan ending after the date of enactment. The effects of that remeasurement, based upon the proposed guidance, should be reflected in financial statements for interim or annual periods beginning after June 15, 2004, with early application permitted. To the extent that financial statements for an interim period or periods subsequent to the date of remeasurement have been issued, current guidance should be followed.
4. Nonpublic companies that sponsor no plan with more than 100 participants are required to remeasure plan assets and obligations at the next scheduled measurement date for years ending on or after September 15, 2004. Amortization in periods following the date of the remeasurement upon adoption of this guidance should be adjusted accordingly.
5. If an entity is unable to determine whether a plan is actuarially equivalent as of December 8, 2003, it should not account for the effects of the federal subsidy until a determination of actuarial equivalence can be made. Once a determination of actuarial equivalence is made, that determination would constitute a significant event warranting remeasurement of plan assets and

obligations as of that date. The effect of the subsidy should be treated as an actuarial gain and amortized prospectively from the remeasurement date.

6. If an entity did not elect the deferral option provided by FSP Statement No. 106-1, *Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (FSP FAS 106-1)*, and that entity's accounting for the subsidy is inconsistent with proposed guidance, the cumulative effect of adoption of this guidance should be recorded in financial statements for periods beginning after June 15, 2004, pursuant to the guidance in APB Opinion No. 20, *Accounting Changes*, and Statement 3.
7. For an entity that elected deferral but the deferral expired due to its own actions (for example, due to a plan amendment) and the accounting for the subsidy is inconsistent with the proposed guidance, the transition provisions for an entity that did not elect deferral would apply.
8. For plans with significant prescription drug costs for which the status as to actuarial equivalency is uncertain, the following disclosures should be made in each period following the issuance of the guidance until a definitive determination of actuarial equivalency is established:
   (a) The existence of the Act
   (b) The fact that the accumulated postretirement benefit obligation (APBO) and net periodic postretirement benefit cost do not reflect any reduction arising from the federal subsidy because the sponsor is unable to conclude that the plan is actuarially equivalent.
9. For financial statements for the first interim and annual period in which the effects of the subsidy are reflected in the APBO and net periodic postretirement benefit cost, the following disclosures should be made:
   (a) The amount of subsidy related to benefits attributed to past service (gross actuarial gain).
   (b) The effect on net periodic postretirement benefit cost arising from amortization of the actuarial gain arising from the subsidy and the subsidy-related reduction in current period service cost

(c) Any other relevant disclosures pursuant to the requirements of paragraph 5(r) of FASB Statement No. 132(R), *Employers' Disclosures about Pensions and Other Postretirement Benefits*.

Matters Discussed:

Background

The staff reviewed the decisions reached at the February 18 Board meeting:

- The proposed FSP only would apply to situations in which the subsidy from the Act offsets the employer's costs for prescription drug coverage. Although it is unclear whether situations could exist in which the subsidy from the Act exceeds the employer's costs, the guidance in the FSP would not apply in those situations.
- The treatment of retroactive effects of the subsidy from the Act related to benefits attributable to prior service would be treated as an actuarial gain.
- The prospective effects of the subsidy from the Act would reduce the measurement of service costs.
- If a plan is determined not to be actuarially equivalent under the Act, and is amended so as to become actuarially equivalent, the effect of the plan amendment together with the effect of the subsidy should be measured on a combined basis. If the combined effect is a reduction in the APBO, that amount should be considered an actuarial gain. If the combined effect is an increase in the APBO, that amount should be accounted for as a plan amendment.
- If a plan that is determined to be actuarially equivalent under the Act as of the date of enactment is subsequently amended so as to cease actuarial equivalency, the effects of the subsidy based on the plan's status as actuarially equivalent prior to the amendment would be measured and accounted for as an actuarial gain as of the date of enactment. The subsequent plan amendment would be accounted for as a (negative) plan amendment.

- For purposes of determining the temporary difference under FASB Statement No. Statement 109, *Accounting for Income Taxes,* related to the accrued postretirement benefit cost—the recognized balance sheet liability—the temporary difference would be based on the accrued postretirement benefit cost excluding (adding back) any reduction in that amount related to the subsidy (either as a result of amortization of an actuarial gain or reduction in service and interest cost).

Overview of Staff Proposals

At the February 18 Board meeting, the staff had proposed two effective date and transition alternatives. The first alternative was to reflect the decisions reached by the Board as of the next regularly scheduled plan measurement date. The second alternative was to reflect the subsidy using a cumulative effect approach retroactive to the date of enactment of the Act (December 8, 2003).

During the course of the discussions at the February 18 meeting, a member of the FASB staff recommended using December 31, 2003 as a proxy for the enactment date as a practical expedient. The staff noted that December 31 may be a convenient date for those companies with a calendar year-end, but that for "noncalendar" year-ends (for example, January, February, April, May, and so on), that date may not be convenient.

The staff identified three possible transition scenarios and outlined the staff's proposed approach.

1. A plan is actuarially equivalent as of the date of enactment and the employer elected the deferral option provided by FSP FAS 106-1: standard transition guidance should apply.
2. A plan is not actuarially equivalent as of the date of enactment but is subsequently amended and, as a result of that amendment, is determined to be actuarially equivalent: guidance on plan amendments should apply.

3. A plan's status as to actuarial equivalence is uncertain as of the date of enactment, but subsequently, and not as the result of any plan amendment, the plan is determined to be actuarially equivalent: the plan should be remeasured on the date on which actuarial equivalency is determined and the related adjustments to amortization and service cost should be accounted for prospectively.

In the context of that third scenario, the staff identified two questions for the Board.

1. Should the proposed guidance require plan sponsors to evaluate, as of the date of enactment, a plan's actuarial equivalency status?

To the extent that a plan provides a significant prescription drug benefit, the staff noted that Statement 106 presently requires evaluation. Therefore, the staff recommended that plan sponsors should attempt to determine if a plan is actuarially equivalent as of the date of enactment of the Act, recognizing that because of ambiguities in the Act and complexities of the underlying calculations, that determination may be inconclusive for an extended period of time. The staff also recommended temporary relief from the requirement to determine a plan's actuarial equivalence for nonpublic enterprises that sponsor no plan with more than 100 participants.

Mr. Herz asked if there were any objections to the staff's proposal. There were no objections.

2. In cases for which actuarial equivalency cannot be determined for some period of time following the issuance of the final FSP and, subsequently, actuarial equivalence is determined at some later date, as of what date should the effects of the subsidy be measured:

The staff recommended that if determination of a plan's actuarial equivalence cannot be determined for a period of time subsequent to issuance of final guidance, once actuarial equivalence of a plan is determined that the effect on the APBO should be measured at that time and accounted for prospectively as

an actuarial gain. The staff stated that this treatment is consistent with the fundamental conclusion that a subsidy should be treated as a change in actuarial assumptions about health care costs.

Mr. Trott stated that he agreed with the staff's recommendation

Ms. Seidman clarified that the Act was enacted December 8, 2003, and that she was concerned about staggered implementation of the Act based on when a company decides to apply the Act. She expressed concern that an entity that determines actuarial equivalency as of the date of enactment will account for the subsidy differently than an entity that determines actuarial equivalence later. Mr. Durbin responded by stating that because the retroactive effect of the subsidy is treated as an actuarial gain the staff does not believe that the staggered implementation will cause substantially negative impact on financial statement comparability because the gain or loss is deferred and amortized and subjected to the corridor amortization approach for all unrecognized gains and losses.

Mr. Cassel stated that a more problematic scenario could result if, when proposed regulations are issued, they fail to support a company's assertion of actuarial equivalence. He stated that the FSP should contain guidance defining what is considered a significant event, and, specifically, whether the issuance of *proposed* regulations (as opposed to final regulations) constitutes a significant event.

Mr. Trott asked whether a proposed regulation or an approved regulation constituted a type II subsequent event. Mr. Cassel stated that this is a question that has not been answered. Mr. Herz recommended that this question not be addressed at this point in time.

Ms. Schipper stated that she supported the staff's recommendation, with the proviso that the date the actuarial equivalence is determined is deemed to be a significant event warranting a remeasurement of plan assets and obligations.

Mr. Herz asked if the Board had any objections to accounting for the effects of a subsidy prospectively in cases when actuarial equivalence of a plan is not determinable after related guidance is issued by the FASB and determined to be actuarially equivalent some time later. There were no objections.

Ms. Seidman, although not objecting, expressed concern that the proposed guidance is very powerful relative to the proposed form of that guidance—as an FSP.

Staff Recommendation on Transition

Ms. Schipper asked for clarification between entities that elect deferral and entities that elected deferral, but deferral expired. Mr. Durbin clarified that if a plan was amended after January 31, 2004, but before guidance was issued by the FASB, pursuant to the guidance in FSP FAS 106-1, the deferral option expired because of that plan amendment.

Ms. Schipper asked whether the staff believed that nonpublic companies with small plans should be exempt from remeasurement until a later date. She asked if the intent of the staff recommendation is to provide remeasurement relief for a class of entities that would be unduly burdened by implementation. Mr. Durbin responded that Ms. Schipper was correct in her assessment as to the staff's intent.

Ms. Seidman asked the staff why deferral for remeasurement for small, nonpublic companies expires September 15, 2004. Mr. Cassel responded that this date was the latest date for which the date of enactment would still be within the current fiscal year.

The staff recommended that for entities not electing deferral, the cumulative effect of adoption of the guidance in the FSP should be reported as the cumulative effect of a change in accounting principle in the period following issuance of the final FSP. Mr. Durbin stated that this could be problematic for companies depending on issuance date of the FSP and a company's financial reporting cycle. He suggested that it might be better to require implementation of the FSP as of a specific date. He proposed implementation of the FSP for companies for the interim or annual period ending after June 15, 2004.

Ms. Seidman asked if a company would still be permitted to book the effects of the subsidy in the first quarter even if the FSP guidance was not issued in the first quarter.

Mr. Batavick stated that a company would have cumulative catch-up for statements issued after the first quarter and that the next time a company produces financial statements for the first quarter they would be restated to reflect the implementation of the Act.

Ms. Schipper clarified that if the FSP was required to be implemented in the period beginning after June 15, 2004, that a company would have to implement the FASB staff position for the quarter ending September 30, 2004 (assuming it was a company with a calendar year-end).

Ms. Seidman observed that a company that determined that its plan is actuarially equivalent as of the date of adoption of the proposed guidance would apply the guidance retroactive to the date of enactment, which may also entail restatement of previously issued interim financial information when subsequently presented for comparative purposes. She also noted that a company that did not determined that its plan was actuarially equivalent until October 1, 2004, that

company would account for the effects of the subsidy prospectively based on the proposed guidance.

Mr. Herz stated that he believed that it would be beneficial for the FSP to require that every company has to make the determination as to whether its plan is actuarially equivalent by a certain date. He specified that if a company can conclude actuarial equivalence as of the date of enactment of the Act, then it will be required to account for the effects of the subsidy retroactively as of the date of issuance of the FSP. If a company cannot determine that its plan is actuarially equivalent by the issuance date of the FSP, it cannot record the effects of a subsidy until actuarial equivalence of the plan is determined and those adjustments will be recorded prospectively.

Mr. Trott stated that the cumulative catch-up adjustment from date of enactment to the beginning of the current fiscal year is not likely to be material. Mr. Durbin clarified that the "cumulative catch-up" adjustment that the staff was referring to was the amortization of the actuarial gain during the elapsed interim periods of the current fiscal year prior to issuance of the guidance (for example, the first two quarters of 2004). Mr. Cassel further stated that the more substantial effect of the subsidy is likely to be the reduction in service cost during future periods during those ensuing interim periods.

Mr. Herz stated that entities should assess actuarial equivalence as of a specified date. Mr. Herz asked if a company would have to restate its first two quarters if it determined actuarial equivalence as of the issuance of the FSP. Mr. Herz expressed concern that two entities with similar plans could account for adjustments related to the Act differently depending on when actuarial equivalence was determined.

Ms. Herz proposed that if a company concluded that its plan is actuarially equivalent as of the enactment date by the beginning of the fiscal period

beginning after June 15, 2004, then it must apply the guidance in the FSP retroactive to the enactment date of the Act. Mr. Herz asked if there were any objections from the Board members. There were no objections from the Board.

Mr. Durbin clarified that the effective date of the FSP would be for the interim or annual period beginning after June 15, 2004. He further clarified that a company does not have to determine whether it is actuarially equivalent as of the effective date, only that it must attempt to do so (excluding small nonpublic companies). He stated that early application of the FSP would be permitted. He further stated that to the extent that interim periods have elapsed that would have had amortization and other effects of the subsidy, those periods would be restated when presented subsequently for comparative purposes or for other reasons (for example, summary quarterly information in annual reports).

Mr. Batavick shared Ms. Seidman's concern that two companies with similar plans could arrive at different conclusions when assessing whether their plan is actuarially equivalent because no guidance has been issued to assist a company in determining whether it should account for the subsidy associated with the Act. In this scenario, one company could potentially account for its adjustments prospectively and one company could account for its adjustments retroactively depending on when actuarial equivalence is determined.

Mr. Schieneman stated that he would have favored prospective adoption for all companies, but because retroactive application has been recommended for one segment of companies (those that determine actuarial equivalence by September 30, 2004) he recommends that retroactive application be applied to all companies. He stated that treatment of the Act should be the same for all plans that are determined to be actuarially equivalent regardless of when actuarial equivalence is determined (excluding plan amendments).

Mr. Herz asked if any Board member objected to the requirement that the effects of the subsidy be calculated retroactive to the date of enactment (or the measurement as of the end of the fiscal period containing the date of enactment) if a company determines that its plan is actuarially equivalent as of the enactment date by the time financial statements for the period beginning after June 15, 2004 are issued. There were no objections.

The staff proposed that entities that did not elect deferral of the FSP but accounted for the subsidy in a manner inconsistent with the proposed guidance, should record the effects of adopting the guidance as the cumulative effect of a change in accounting principle. The staff recommended an exception to this guidance when the original treatment was a negative plan amendment rather than actuarial gain. In that case the staff recommended that no cumulative effect adjustment or separate disclosure of reclassification from unrecognized prior service credit to unrecognized net gain or net loss should be required.

Ms. Seidman proposed that in order to simplify the FSP that the negative plan amendment exception be removed. Mr. Batavick agreed with Ms. Seidman's proposal.

Mr. Herz asked if the Board agreed that the negative plan amendment exception should be removed. The Board unanimously agreed.

The staff recommended that if deferral expired because of a voluntary significant event (for example, a plan amendment) a company would be subject to the same provisions as companies that never elected the deferral.

Mr. Herz asked if the Board agreed with this recommendation. All Board members agreed.

Mr. Herz proposed that the Board clarify its position on nonpublic entities with only small plans. He asked the Board to affirm the staff's proposed exception that allows nonpublic companies that sponsor no plan with more than 100 participants to account for the effects of the Act, including the subsidy if applicable, prospectively from the regularly scheduled measurement date for years ending on or after September 15, 2004. The Board affirmed this exception.

Proposed Disclosures

The staff proposed that plans that have significant prescription drug costs with uncertain status as to actuarial equivalency that the following disclosures be made:

(a) The existence of the Act
(b) The fact that the APBO and net periodic postretirement benefit cost do not reflect any reduction arising from the federal subsidy.

The staff proposed the following disclosures for the period in which the subsidy is first reflected:

(a) Amount of subsidy related to benefits attributed to past service (gross gain)
(b) Consider disclosure requirements of paragraph 5(r) of FASB *Statement No. 132(R), Employers' Disclosures about Pensions and Other Postretirement Benefits*
(c) Basis for concluding actuarial equivalency.

Mr. Trott asked the staff to articulate what the staff envisaged for the disclosure about the "basis for determining actuarial equivalency" of a plan. Mr. Durbin stated that there is uncertainty regarding application of the Act, specifically, how to determine actuarial equivalence. He further stated that the staff believed that it was important to users of financial statements to know how a company reached its conclusion for determining whether a plan is actuarially equivalent. Mr. Cassel stated that disclosing the basis for concluding actuarial equivalency is particularly relevant due to the diversity of views among professionals in determining whether a plan is actuarially equivalent.

Mr. Trott recommended eliminating the requirement to disclose the basis for concluding as to actuarial equivalence because the legitimacy of that conclusion is implicit in the accounting recognition of the effects of the subsidy.

Mr. Batavick stated that Congress may not issue the guidance on how to determine whether a plan is actuarially equivalent until 2005.

Mr. Durbin clarified that the Center for Medicare Services will provide additional guidance, not Congress. Mr. Durbin also clarified that the staff believes that the regulatory guidance governing actuarial equivalency needs to be in place by late 2005 because most of the provisions of the Act related to the subsidy take effect in 2006.

Mr. Batavick asked the staff if there was a consensus that certain plans will be affected by the Act regardless of additional proposed guidance; And if certain plans will not be affected regardless of additional proposed guidance. Mr. Durbin confirmed that the staff believes that certain plans will be affected and certain plans will not be affected regardless of the issuance of additional guidance.

Ms. Seidman stated that she shared Mr. Trott's concern about requirements for disclosing the basis for concluding that a plan is actuarially equivalent. She stated that she would prefer to see a company's basis for not concluding actuarial equivalence.

Mr. Herz proposed that the guidance clarify that if a plan sponsor determines that a plan is actuarially equivalent then the company must account for the subsidy; if a company cannot conclude about its plan's actuarial equivalent status, then the subsidy should not be accounted for. Mr. Cassel indicated that the staff intends that the FSP will provide that clarification.

Ms. Seidman asked whether, if two companies with similar plans come to different conclusions as to actuarial equivalence, the FASB would determine that one of those conclusions is incorrect. Mr. Cassel responded that the FASB would not. He further stated that the basis for disclosure would allow readers of financial statements to view a company's basis for determining a plan's actuarial equivalence and view potentially contentious accounting practices.

The staff proposed that companies that have not reflected the subsidy because they have not been able to determine whether their plans are actuarially equivalent should be required to disclose the existence of the Act.

The staff further recommended that companies that have been able to determine that their plan is actuarially equivalent should be required to disclose the effect of the subsidy and should consider the disclosure requirements in paragraph 5(r) of Statement 132(R), which requires disclosure of any significant item that affects the accumulated postretirement benefit obligation.

Mr. Trott stated that he supports both staff recommendations.

Mr. Batavick asked the staff to consider disclosure of the current year effect on service cost.

Ms. Seidman stated that she believes that all disclosures should go through a "significance screen". She further stated the she only supports including the disclosure requirements found in paragraph 5(r) of Statement 132(R). She asked why a company that has not been able to determine whether its plan is actuarially equivalent is not required to disclose how it attempted to determine whether its plan was actuarially equivalent and why it could not be determined.

Ms. Seidman asked if a company adopted the Act after September 30, 2004 and prospectively accounted for the adjustments, would the company's APBO be

adjusted. Mr. Cassel responded by stating that the APBO would be adjusted and information related to the adjustment would be included in a related footnote.

Mr. Herz asked if the Board had any objections to the disclosure requirements proposed by the staff for companies that have not been able to determine if their plans are actuarially equivalent. The Board had no objections.

Mr. Herz asked if the Board had any objections to the disclosure requirements proposed by the staff for companies that have determined that their plans are actuarially equivalent. He specified that the revised staff proposal no longer included disclosure of the basis for concluding actuarial equivalence and now includes the effect of adoption on current year service costs. The Board had no objections.