April 14, 2016

Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

File Reference No. 2016-200

Dear Ms. Cosper:

This letter is in response to your invitation for comments for the proposed ASU for *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*.

I am Manager, Special Projects with ArcelorMittal USA. ArcelorMittal USA is the US subsidiary of ArcelorMittal S.A., the world's largest steel company. As a subsidiary of a European company, we report under both IFRS and US GAAP. ArcelorMittal USA is the successor to several notable US steel companies including Bethlehem Steel, LTV Steel, and Inland Steel. It has annual sales of over $9 billion and more importantly postretirement benefit liabilities of over $5 billion. I am responsible for overseeing the accounting for this area and have many years of experience related to this topic. The views in this letter are my own and may not necessarily represent those of others in my company.

I do not agree with the proposed ASU for the presentation of net periodic pension and postretirement benefit cost. <u>The underlying problem is a recognition issue and not a presentation issue.</u> By issuing the proposed ASU, the FASB is fixing the symptom and not the cause. Instead the Board should tackle the issue of when to recognize actuarial gains or losses. I know that the Board is considering adding a project to reconsider postretirement benefit accounting. Some might question how long such a project would take or whether it is worth the effort to update accounting that is become increasingly less common. However, I think a project to immediately recognize actuarial gains and losses could be achieved simply and quickly.

Whether these amounts are recognized immediately or amortized in the future, users do make adjustments to earnings to try and understand current costs versus remeasurements that are not indicative of ongoing income or cash flows. Additionally the best information about the future cash flows for postretirement benefits is to use actuarially determined amounts instead current expense or funding. This information and the components of expense are already readily available in the footnotes (including interim periods). The Board should not mandate the presentation on the face of the income statement or exclude from operating income what is ultimately is a cash compensation cost for the payment of retirement benefits.

Current recognition rules result in significant timing differences from the underlying economic events

Although SFAS No. 158 addressed the concerns over not reflecting postretirement benefit obligations timely on the balance sheet, the problem still exists in the income statement. According to a 2015 PwC study of Fortune 100 and other large companies, many companies have large cumulative actuarial losses that have not recycled through earning. Median deferred losses of companies in the survey were 30% of the projected benefit obligation. Very few companies in the survey had deferred gains and those that did were much smaller in size. Deferred losses can be very large relative to total obligation, with one company having a deferred loss equal to 151% of the total obligation. The rules for recognition of deferred losses are made in reference to the liability and can be substantial in absolute terms. For example, at the end of 2015, my own company had unrecognized losses that were about 25% of projected benefit obligation and equal to $2.2 billion – a large number for any company. Our unrecognized loss related to pensions of $1.1 billion is greater than the unfunded obligation. Additionally for companies in the PwC survey, the median unrecognized amount has grown over the last seven years from a median loss of 12% of the projected obligation in 2007. This has been due to decreasing discount rates and other factors such as updated mortality assumptions. But deferred actuarial losses have existed for years. Although future gains or losses could take place in either direction, these persistent unrecognized losses highlights that the recognition of gains and losses in the income statement has occurred much more slowly than new gains or losses have arisen. Given that only amounts outside the corridor are recycled and the relatively long amortization periods, it means that material gains or losses are often ignored in calculating expense and can take years to recognize.

But more importantly the resulting amortizations don't match the underlying economic events. Current losses reflect the decline in long-term interest rates and the dip in the stock market that took almost a decade ago, yet these impacts are still running through current income statements. Actuarial losses will not be recognized in income statement until years elapsed since the underlying events that caused the gain or loss. As a result, many companies have chosen immediate recognition to stop having to explain the impact of events that took years earlier.

The corridor was established as "guard rails" to keep a company on the gradual path to reach its destination of matching postretirement benefit costs with the ultimate cash it would expend to provide those benefits. The idea was to keep from jerking the wheel from side to side as a company encountered potholes in its path. Instead companies have been careening down the road, with their vehicle jammed against the guard rail, never returning to the center line. SFAS No. 87 and SFAS No. 106 were meant to smooth expenses to represent a normalized cost over several reporting periods. Instead the reported amortizations are a significant component of expense, unrepresentative of current changes in the liability, that can continue for years.

FASB should consider either (1) go to immediate recognition of actuarial gains and losses, (2) use a much shorter recycling period or narrow the corridor, or (3) have no recognition of gains or losses in earnings. This would be consistent with the basis for conclusions in SFAS No. 87 that stated that the Board believed that eventually "that it would be conceptually appropriate and preferable to recognize a net pension liability or asset measured at the difference between the projected benefit obligation and plan assets, either with no delay in recognition of gains and losses, or perhaps with gains and losses reported currently in comprehensive income but not in earnings." Given that 30 years have elapsed since this statement was issued, perhaps it is now time to consider changes in practice that were considered too radical for the mid-1980s.

Since the current standards permit companies to recognized losses over a shorter period, companies could elect to make this change on their own, and many have over the last few years. Since 2010 over 30 companies in the S&P 500 have adopted immediate recognition of actuarial gains and losses. But giving such an option creates diversity in practice. Additionally companies may be reluctant to accelerate recognition of expenses in the financial statements, even if it conceptually more sound. Finally some companies don't like the volatility and difficulty in forecasting that such a change would bring. But smoothing earnings is not a good justification for not making such a change.

Although the Board should change the timing of expense recognition; this is not what is being proposed in this ASU. The FASB may not believe it is appropriate to make such change or it needs more time to consider such a proposal. Additionally whether actuarial gains or losses are recognized immediately or deferred, there is the question of where to present these amounts. In the remainder of this letter I address what has been proposed. Other than the conclusion that the amortization of actuarial gains or losses should be excluded from the valuation of inventory or other capitalized costs, I disagree with the proposed presentation changes in the ASU. Responses to the specific questions asked of respondents are included as an appendix.

Classification of actuarial gains and losses

The amortization of actuarial gains and losses is an adjustment to prior recorded amounts. I support the recycling of such gains or losses through the income statement. I believe such recycling means preparers are more accountable to report all costs. Whether a preparer was able or unable to accurately forecast future cash costs should not change the classification of those costs. Ultimately what will be a cash cost, the payment of retiree benefits, should be reflected in the same place in the income statement. This is consistent with general practice that any adjustments, corrections, or re-measurements to amounts recorded in prior periods are recognized in the same caption in the financial statements as the original amounts. Reclassifying these remeasurements outside of operating income and compensation expense contradicts this concept. Given the long time horizon of these cash flows and the impact that changes in assumptions can have on the measurement of the liability, it can be difficult to estimate these cash flows. But the mere difficulty in making estimates should not preclude recognizing costs in a single place. Although I disagree with the requirement to present this information separately on the face of the income statement, doing so within operating income would be preferable to showing it outside.

I do however agree with the guidance to exclude the amortization of actuarial gains or losses from inventory cost and other capitalized costs. I believe the original intent of the current rules was to have periodic benefit cost represent a normalized cost. As such, including such amortizations would result in similar expenses from period to period. This not what has been occurring, but rather actuarial amortization can be a significant component of the total expense and can be volatile as cumulative losses are in or out of the corridor, even for companies that don't apply immediate recognition. Accordingly, I believe since such costs should not be included in inventory cost. This would be consistent with the general practice where out of period adjustments and unusual costs are not included in inventory values.

Classification of prior service

The reason prior service cost is amortized is because such modifications are usually made in exchange for future service. As basis for conclusion to SFAS No. 87 states "a plan initiation or amendment is invariable made with a view to benefiting the employer's operations in future periods rather than in the past or only in the period of change." If further goes on to state that "The Board concluded that the increase in the projected benefit obligation should be recognized as a component of net periodic pension cost over a number of future periods as the anticipated benefit to the employer is expected to be realized." Excluding this amortization from compensation expense and operating income ignores the reason why prior service cost is deferred. Accordingly, it would not be appropriate to classify the amortization of prior service separate from current service cost. Additionally doing so would be inconsistent with IFRS. Although the timing of recognition of past service is different under IFRS, it is included in operating cost.

Classification of net financing component

The original pronouncements (SFAS No. 87 and SFAS No. 106) concluded that all of net periodic cost is compensation cost. I agree with those conclusions. The reason companies offer pension and retiree healthcare benefits is obtain employment services from individuals. They offer these benefits as a way to attract and retain qualified employees. No one offers to pay somebody's medical bills in retirement as a way to raise capital. The fact that some of the cash will not be expended until years in the future does not change the nature of the expenditure. By characterizing the costs as a financing item, it excludes part of what is ultimately a cash cost outside of operating income; making operating income a less relevant measure.

Classifying the net interest cost as financing cost is inconsistent with guidance elsewhere in US GAAP. In particular the guidance for asset retirement obligations, where the Board concluded that accretion of these obligations should be included as part of operating income. Additionally the newly issued guidance for operating leases, although it recognizes the obligation on the balance sheet, still includes rental costs in operating income. I think financing cost is more meaningful to users when it includes only the costs associated with more traditional financings such as debt and capital lease obligations. That way a user can understand what a company is paying to obtain that financing.

Some view pension and OPEB obligations as a debt-like obligation. Although this view is somewhat inconsistent, as some view only pensions and not OPEB as debt and most reporting services add only debt and not postretirement benefit liabilities when reporting a company's enterprise value. There is some merit to viewing postretirement benefit obligations similar to debt. I believe a preferable way to value a company is use an earnings measure of a company excluding all postretirement expense except current service. (Current service is deducted because the obligations associated with these amounts have not yet been recognized on the balance sheet.) Once that value is established, the actuarially determined postretirement benefit liabilities are deducted to arrive at an overall value. Using the postretirement liability calculated by actuaries using expected cash flows and a disclosed discount rate is much more accurate than trying than to impute a value from the reported expense. Doing so would be the equivalent of trying to establish the value of a company's debt by taking its interest expense times a multiple based on the estimated interest rate and debt maturity. I still believe that reporting all postretirement benefit costs as compensation costs is preferable, but acknowledge there is some conceptual merit to excluding the net financing component from operating income.

The Board has justified the change in presentation of financing cost to achieve more consistency with IFRS. However, I do not believe it achieves alignment. IFRS does not specifically state how costs should be classified. Diversity in practice exists within IFRS. Some companies classify the net interest components as a financing item and some as an operating item. The proposed change will make US companies more comparable to some IFRS companies and less comparable to others. Yet it will make US GAAP more internally inconsistent with asset retirement obligations and other operating costs.

Paul Hubling

Paul Hubling
Manager, Special Projects
ArcelorMittal USA
1 S. Dearborn St.
Chicago, IL 60603

Appendix – Responses to Specific Questions

Question 1: Should the service cost component be reported in the income statement apart from the other components of net benefit cost as defined in paragraphs 715-30-35-4 and 715-60-35-9 and be the only component eligible to be capitalized in assets? Why or why not?

> *No. I agree with conclusions contained in the original pronouncements that all components of net benefit costs are compensation expense. The reason companies pay pensions, healthcare benefits, and other benefits in retirement is to obtain employment services from individuals and as such all of those costs should be classified as compensation expense and be included in operating income.*
>
> *Prior service and net interest cost should continue to be eligible to be capitalized in assets as those costs were part of compensation to employees to construct those assets. I do agree that because the amortization of actuarial gains or losses represents an out of period revision to amounts previously recorded that it should not be included as a part of the cost used to bring capitalized assets to their present condition.*

Question 2: Would it be useful to require presentation of the prior service cost or credit component separately from the other components? Should all of the components of net benefit cost other than the service cost component (for example, the prior service cost or credit component) be presented outside a subtotal of income from operations, if one is presented? Why or why not?

> *No. Prior service cost or credit should continue to be shown with other components of net benefit costs. Classifying prior service cost separately from current service ignores the reason prior service is amortized and not recognized immediately. The increase or decrease in the projected benefit obligation is recognized as a component of net periodic cost over a number of future periods as the anticipated benefit to the employer is expected to be realized. As this cost is being incurred in exchange for employment services, just as current service is, it should be classified on the same line in the financial statements.*

Question 3: Would it be useful to require presentation of the net amount of the interest cost component and expected return on plan assets separately from the other components of net benefit cost to improve convergence with International Financial Reporting Standards (IFRS) or for other purposes? Why or why not?

> *No. Presentation of net interest cost should continue to be shown with other components of net benefit costs. Companies offer pension and retiree healthcare benefits to obtain employment services. The fact that those costs are not paid in the same period as when the services are received should not change the classification of those costs. Classifying this cost separately and outside of operating income would create inconsistencies within US GAAP with the unwinding of other discounted operating costs, namely asset retirement obligations.*
>
> *IFRS does not specify where net interest cost is classified, so although common, not all IFRS financial statements present net interest cost as a financial cost. Even if net interest costs were presented separately or excluded from the operating costs there would still be substantial*

differences between IFRS and US GAAP because of proposed differences to where prior costs would be presented and the fact that remeasurements are not recycled under IFRS.

I do acknowledge that some users view postretirement benefit obligations as a debt-like obligation and classifying this component as an interest cost is more in alignment with how they evaluate earnings.

Question 4: Would the proposed amendments improve the usefulness of financial information provided to users? Why or why not?

I understand the concerns that the timing of when net periodic benefit costs - including current service - are paid can vary significantly from when the cost is recognized in the financial statement, that those costs often contain re-measurements to previously recognized amounts, and that those amounts, particularly for companies that immediately recognize gains or losses, can be volatile. Additionally predicting future cash flows associated with these obligations is best obtained from the footnote disclosures and not the income statement. But the information to understand those components is already contained in current financial information. I think the Board would be better served by re-examining the timing of net periodic benefit expense recognition, instead of excluding what will be ultimately cash costs to receive services from employees from operating income.

Question 5: Should the proposed amendments be different for rate-regulated entities? Why or why not?

Not familiar enough with the issue to answer.

Question 6: Would the proposed amendments be operable without incurring significant incremental costs by entities (such as not-for-profit entities, entities that enter into cost-plus contracts or government contracts including but not limited to contracts under Cost Accounting Standards Board regulations, and entities that allocate cost from cost pools)? Why or why not?

Not familiar enough with the issue to answer.

Question 7: How much time would be necessary to adopt the proposed amendments? Should early adoption be permitted? Would the amount of time needed to apply the proposed amendments by entities other than public business entities be different from the amount of time needed by public business entities? Why or why not?

Since what is being proposed, other than what costs are included in inventory, are all presentation changes, minimal time would be required to adopt the proposed changes. The information needed to make these changes can already be found in current financial footnotes. Revaluing inventory would be more challenging but could be accomplished within the lead times normally provided in new pronouncements. At my own company, this change could be accomplished with a relatively modest amount of effort. Early adoption should be permitted.

Actuarial firms normally provide the components of postretirement benefit costs. Because the same actuarial firms service both private and public clients, there should be no difference in when those firms could make the information available. Factors such as a size of a company, the *nature of the business and how they are staffed has a greater impact on that entity's ability to meet its reporting obligations. Whether an entity is public or private alone should not affect the time required to apply the proposed amendments. The same time to adopt should be given to both types of entities.*

Question 8: Should the proposed amendments be applied retrospectively for the presentation of the service cost component and other components of net benefit cost in the income statement and prospectively, on and after the effective date, for the capitalization of the service cost component of net benefit cost in assets when applicable?

Yes. Comparability of current information would be improved if amounts shown on the income statement were made retrospectively. I agree that changes to presentation should be made retrospectively. However, the retrospective application for the capitalization of asset costs could be difficult as might involve the need to consider several issues such the need to re-perform lower of cost or market analysis, consider the impact on LIFO reserves, or make revisions to depreciation expense. Yet, I see little benefits to justify these costs and these impacts should be made prospectively.

Question 9: Should the disclosures of the nature of and reason for the change in accounting principle be required in the first interim and annual reporting periods of adoption? Why or why not?

I agree with the Board that specified disclosures should not be applicable given that it provides limited useful information to users.