



Ernst & Young LLP
5 Times Square
New York, NY 10036

Tel: +1 212 773 3000
ey.com

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

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Proposed Accounting Standards Update, Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost (File Reference No. 2016-200)

Dear Ms. Cospers:

We appreciate the opportunity to comment on the Proposed Accounting Standards Update, *Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost* (the Proposal), issued by the Financial Accounting Standards Board (FASB or Board).

We support the FASB's objective to improve the reporting of net periodic pension cost and net periodic postretirement benefit cost (net benefit cost) in the financial statements. We agree that only the service cost component of net benefit cost should be eligible for capitalization in assets because this component is directly attributable to employee services rendered in the current period. We generally believe that all forms of compensation for employee services should be presented in the same manner within operating income in the income statement, if operating income is presented. For this reason, we also support presenting the service cost component in the same financial statement line item (or items) as other compensation costs. Further, we recommend that the FASB reconsider presenting prior service cost or credit in the same financial statement line item as the service cost component because the sum of both components reflects the total cost for the period of providing retirement benefits in exchange for employee services.

We have significant concerns about the proposed amendment that would require reporting entities to present the other components of net benefit cost outside a measure of operations. We encourage the FASB to address presentation of items within or outside of operating income holistically within US GAAP before finalizing this part of the Proposal. Please refer to our response to Question 2 in the appendix to this letter. Our responses to certain other questions raised in the Proposal are also set out in the appendix.

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We would be pleased to discuss our comments with the Board or its staff at your convenience.

Very truly yours,

Appendix – Responses to questions raised in the Proposed Accounting Standards Update, Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost

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?

We generally believe that all forms of compensation for employee services should be presented in the same manner within operating income, if one is presented, in the income statement. For this reason, we support presenting the service cost component in the same financial statement line item (or items) as other compensation costs because this component is directly attributable to employee services. However, as further discussed in Question 2, we believe that in order to reflect the total cost for the period of providing retirement benefits in exchange for employee services, the prior service cost or credit component should be presented in the same financial statement line item as the service cost component.

We agree that only the service cost component should be eligible for capitalization because it represents the portion of the net benefit cost that is attributable to employee services rendered in the current period. We note that the other components of net benefit cost are not exclusively related to services rendered in the current period in the production of assets, are related to financing or investing activities or are costs that are recycled from prior periods out of other comprehensive income.

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 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?

As discussed in our response to Question 1, we believe that both the service cost component and the prior service cost or credit component should be presented in the same financial statement line item (or items) as other compensation costs. This presentation would be consistent with how other compensation costs are presented in the income statement under US GAAP. For example, when an entity modifies a performance condition at the end of the requisite service period to make vesting of a share-based payment award probable rather than improbable, the cumulative effect of the change is accounted for in the period of change, as required by Accounting Standards Codification (ASC) 718, *Compensation – Stock Compensation*, by recording the incremental cost of the modification as compensation cost. The cumulative effect includes the compensation cost for employee services rendered since the grant date of the award, which is similar to the prior service cost component that represents retroactive benefits granted in a plan amendment (or initiation) that increases benefits based on services rendered in prior periods. In both cases (i.e., changes in the estimate of the outcome of a performance condition for a share-based payment award or a plan amendment that results in a prior service cost), the adjustments pertain to employee service performed in prior periods and therefore should be consistently presented as compensation cost.

Although paragraph BC8 of the Proposal notes that the Board decided not to pursue this alternative because the prior service cost or credit component is not exclusively related to the current period's employee services, we observe that ASC 715-30-35-10 and ASC 715-60-35-15 state that the

accounting basis for not recognizing the entire amount of prior service cost or credit in the year of an amendment is that the employer is expected to realize economic benefits from employee services in future periods. As a result, we believe that both the service cost component and prior service cost or credit component should be reported in compensation cost because this provides the most complete information about the cost of retirement benefits in a reporting period.

Additionally, we have significant concerns about the proposed amendment that would require reporting entities to present the other components of net benefit cost outside a measure of operations because these components are related to the measurement of the service cost and the related benefit obligation and, with the possible exception of the return on plan assets (see Question 3 below), are not all exclusively related to an entity's financing or investing activities. For example, the prior service cost or credit component relates to the cost of benefits provided for employee services, and the net gain or loss component includes the effect of revised assumptions for mortality, employee turnover, discount rates and expected returns on plan assets. Because the net benefit cost is currently reported in operating income, we believe that the proposed amendments would materially change operating income or loss (if one is presented) for some entities.

We also observe that there is no existing conceptual framework to help the Board address the consistent presentation of items with similar measurement attributes within or outside of operating income. We believe that presenting certain components of net benefit cost outside a measure of operations would not be consistent with how other items with similar measurement attributes (e.g., items initially recognized at present value with subsequent accretion) are currently presented. For example, the accrued expense related to asset retirement obligations resulting from the passage of time and the accretion of discounts on other deferred compensation arrangements are classified as operating items in the income statement.

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?

While we agree that presenting the net amount of the interest cost component and expected return on plan assets separately from the other components of net benefit cost would improve convergence with IFRS, we note that International Accounting Standards (IAS) 19, *Employee Benefits*, uses the discount rate used to determine the interest cost on the benefit obligation to also determine the interest income on the plan asset, while ASC 715 uses an expected return on plan assets. We agree with the view stated in BC77 of IAS 19(R), *Employee Benefits*, in which the International Accounting Standards Board (IASB) concluded that "in principle, the change in value of any asset can be divided into an amount that arises from the passage of time and amounts that arise from other changes. The interest cost on the defined benefit obligation arises from the passage of time. Consequently, the 2010 ED proposed that the net interest component of defined benefit cost should include not only the interest cost on the defined benefit obligation, but also the part of the return on plan assets that arises from the passage of time. In addition, the Board concluded that, to be consistent with the principle of separating components of defined benefit cost with different predictive implications, the net interest component should not include the part of the return on plan assets that does not arise from the passage of time."

To achieve uniform accounting results with IFRS, the Board would need to consider eliminating the concept of “expected return on plan assets” in US GAAP and instead adopt the net interest on the net defined benefit liability (asset) that represents only the effect of the passage of time. In considering this approach, the Board could retain the current deferral concept in accounting for actuarial gains and losses to mitigate volatility in the income statement. Achieving convergence with IFRS may be outside the scope of this project.

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

ASC 980, *Regulated Operations*, requires that the difference between net benefit cost calculated under ASC 715 and amounts of postretirement benefit costs included in an entity's rates billed to customers be recognized as a regulatory asset or liability. We anticipate that some entities may believe that the proposed amendment that would allow only the service cost component of net benefit cost to be eligible for capitalization in assets would change the amount of net benefit cost deferred as a regulatory asset or liability (i.e., the other components of net benefit cost, excluding service costs, would not be permitted to be deferred as a regulatory asset or liability). If this is not the Board's intent, we recommend that the Board clarify that the proposed amendment that would allow only the service cost component of net benefit cost to be eligible for capitalization in assets does not affect the determination of amounts deferred as a regulatory asset under ASC 980. Specifically, we recommend adding the following to ASC 980-715-15-1, “In addition, the provisions in paragraphs 715-30-35-7A and 715-60-35-10A shall not change the accounting for regulatory assets related to pension cost and other postretirement benefit cost for rate-regulated entities.”

As discussed in our response to Question 2, we are concerned about the proposed amendment to present the other components of net benefit cost outside a measure of operations. We believe this proposed amendment would artificially increase operating margins for rate-regulated entities and other entities that directly recover a portion of net benefit cost from their customers. These entities currently include the amount of net benefit cost directly recovered from their customers in revenue, and they include the related costs in operating expenses. If the Board proceeds with the Proposal, these entities would continue to report the amount of net benefit cost directly recovered from their customers in revenue, but they would present a portion of the related expense below operating income. We recommend that the Board remove this proposed amendment from the final Accounting Standards Update.

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?

As discussed in our response to Question 5, we believe that the Proposal would artificially increase gross margins for rate-regulated entities and other entities that directly recover a portion of net benefit cost from their customers. We anticipate that some of these entities and other entities that capitalize costs in assets from aggregated cost pools may incur significant costs to change their systems and processes to disaggregate components of net benefit cost and capitalize only the service cost component in assets.

Not-for-profit entities

We do not believe that not-for-profit entities (NFPs) would incur significant additional costs to implement the proposed requirements. However, certain proposed amendments to the guidance for NFPs may need clarification. For instance, it is not clear whether the Board intended to no longer require NFPs to present certain components of the net defined benefit obligation or asset (i.e., net gain or loss, prior service costs and transition assets or obligations) separately from expenses when an intermediate measure of operations or performance indicator is not presented. Additionally, the reason for the Board's decision to require NFPs to present the deferred items outside an intermediate measure of operations or performance indicator, if one is presented, is unclear. The Board had decided in prior standard-setting activities (i.e., in the Basis for Conclusions of Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 106, and 132(R)*), not to impose these presentation requirements for NFPs.

To resolve these concerns, we recommend that the Board retain the implementation guidance in ASC 958-715-55-7 and 55-8 and revise it to reflect the proposed changes in presentation to help NFPs understand the proposed requirements. We also believe the Board should clarify whether NFPs would report other components of net benefit cost by function. The FASB recently made a tentative decision in phase 1 of its Financial Statements of Not-for-Profit Entities project to require NFPs to report all expenses by function and nature in one location.

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?

We believe reporting entities, especially those that would need to change their systems and internal control processes to implement the proposed requirement to capitalize only the service cost component of net benefit cost, will need sufficient time to implement the proposed amendments.

We support a one-year deferral of the effective date for entities other than public business entities so that they have time to learn about the new presentation requirements.

Early adoption should be permitted for all reporting 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?

We recommend prospective application for both of the proposed amendments. We believe it would be operationally difficult for employers that capitalize costs in assets from aggregated cost pools to retrospectively disaggregate and reclassify components of the net benefit cost recognized in the income statement.

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?

We believe the disclosures of the nature of and reason for the change in accounting principle should be required in accordance with ASC 250-10-50-1 through 50-3.