

The FASB's New Pension and OPEB Standard is Effective for 2006 for Calendar Year-End Public Retail & Consumer Companies

In September 2006, the Financial Accounting Standards Board (FASB) issued its new pension and other postretirement benefits standard, FASB Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)* (SFAS 158). This standard affects all entities with defined benefit plans, including retailers and consumer products manufacturers (Retail & Consumer companies), by requiring them to recognize in their financial statements off-balance sheet amounts currently disclosed in the notes to the financial statements. While SFAS 158 may have a significant impact on some companies' balance sheets, it does not introduce new income statement accounting requirements. Calendar year-end Retail & Consumer companies that are "public" (what constitutes a public company is discussed later in this *QuickBrief*) should prepare to adopt the standard for 2006 because the balance sheet and disclosure requirements are effective as of the end of 2006 for calendar year-end public companies.

The key requirements of SFAS 158 are:

- Companies will record the funded status of their benefit plans on their balance sheets with a corresponding adjustment to equity
- Amounts recorded in equity will be amortized into the income statement as part of future net benefit expense
- Companies are required to provide additional disclosures related to their benefit plans
- Beginning no later than 2008, companies will be required to measure plan assets and obligations as of their fiscal year-end instead of up to three months prior to their fiscal year-end

This *QuickBrief* provides a high-level overview of the requirements of SFAS 158 to raise awareness of its broad implications to Retail & Consumer companies, and suggests actions companies should take to prepare for implementation. For a detailed discussion of significant changes in companies' accounting for

pensions and other postretirement benefit plans resulting from the issuance of SFAS 158, refer to PricewaterhouseCoopers LLP's (PwC's) DataLine 2006-26, *FASB Issues New Pension/OPEB Standard Effective In 2006 For Public Companies* and DataLine 2006-31, *Companies Should Recognize and Disclose their Additional Minimum (Pension) Liability Under SFAS 87 Before Applying SFAS 158*. In addition, PwC's white paper, *Rethinking Post Retirement Benefits - The FASB Accounting Project, Its Impact on Companies and Capital Markets, and the Changing Pact with the American Worker*, addresses broader pension-related issues. These publications are available on www.cfodirect.com.

Recording the Funded Status of Benefit Plans on the Balance Sheet

SFAS 158 requires that the balance sheet reflect the funded status of defined benefit plans as either a net benefit asset or net benefit liability. The funded status is the difference between the plan's assets at fair value and the

benefit obligation. When recording the funded status upon adoption of SFAS 158, companies will record all previously unrecognized items (prior service costs/credits, gains/losses, and transition asset/obligation) in the Accumulated Other Comprehensive Income (AOCI) component of equity. For companies whose plan assets are less than their benefit obligations (i.e., are in an underfunded position), the balance sheet effect would be to increase liabilities and reduce equity.

In order to put the balance sheet requirements in perspective, below is an illustration of pension-related balances before and after the application of SFAS 158.

Company A – Pre and Post SFAS 158 Pension-related Balances

	Pre-SFAS 158	Post -SFAS 158
	(in millions)	
Projected benefit obligation	\$ (1,000)	\$ (1,000)
Plan assets, at fair value	800	800
Funded/(unfunded) status	(200)	(200)
Deferred charges:		
Unrecognized prior service costs	50	-
Unrecognized net (gains)/losses	200	-
Prepaid/(accrued) pension cost	50	(200)
Accumulated other comprehensive income	-	250

In the illustration above, Company A's benefit plan has a projected benefit obligation of \$1 billion and plan assets of \$800 million, which results in a net benefit liability of \$200 million. Prior to the adoption of SFAS 158, because there were unrecognized amounts of \$50 million in prior service costs and \$200 million in net losses, Company A reported a pension asset of \$50 million. Under SFAS

158, the \$200 million net pension liability will be recorded in the balance sheet by adjusting (crediting) the prepaid/(accrued) pension cost balance by \$250 to reflect the previously unrecognized prior service costs and unrecognized net loss with a corresponding charge (debit) to AOCI.

The Income Statement Accounting Remains the Same

The net pension expense included in the income statement will continue to be determined in the same manner as it had been under FASB Statement No. 87, *Employers' Accounting for Pensions* (SFAS 87), FASB Statement No. 88, *Employers'*

Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits (SFAS 88), and FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions* (SFAS 106).

Under SFAS 158, the amounts that are recorded in AOCI at adoption will be amortized out of AOCI using the existing recognition

provisions in SFAS 87 or SFAS 106 and become a component of net benefit cost.

Presentation and Disclosure Requirements

SFAS 158 requires a portion of the net benefit liability to be reported as a current liability to the extent that benefit payments due from the plan in the ensuing twelve months exceed the fair value of plan assets. Accordingly, companies' working capital as well as noncurrent liabilities and equity balances will be affected if they have unfunded or significantly underfunded plans and they record an incremental net benefit liability upon adopting SFAS 158. We would expect to see a current portion of the liability for most postretirement healthcare plans, as those tend to be unfunded (i.e., have no plan assets).

SFAS 158 also requires additional annual disclosures beyond those required by FASB Statement No. 132 (revised 2003), *Employers' Disclosures about Pensions and Other Postretirement Benefits* (SFAS 132(R)). Further details on the specific requirements can be found in PwC's DataLine 2006-26 and in paragraph 7 of SFAS 158.

Companies are required to disclose the incremental effect of adopting the standard on the balance sheet in the year of adoption. SFAS 158 also requires non-public companies to disclose certain facts related to the requirements of SFAS 158 that are similar to the requirements of SEC Staff Accounting Bulletin 74, *Disclosure of the Impact That Recently Issued Accounting Standards Will Have on the Financial Statements of the Registrant When Adopted in a Future Period* (Topic 11-M) (SAB 74), in their upcoming annual financial statements.

Effective Date and Transition of Balance Sheet Accounting and Disclosure Requirements

The balance sheet accounting and disclosure requirements are effective for public companies for years ending after December 15, 2006. A "public company," as defined in SFAS 158, is a company with publicly traded equity securities, or a company filing with a regulatory agency in preparation of selling equity securities. Non-public companies, which include those that have publicly traded debt only, have a one-year deferral; the standard is effective for these companies for fiscal years ending after June 15, 2007. Retail & Consumer companies with public debt only should be aware that although they have one additional year before they must begin recording in their balance sheets the funded status of their benefit plans, they are required to make the disclosures required by SAB 74 in their public filings until SFAS 158 is adopted.

The standard requires prospective application and explicitly prohibits retrospective application. Therefore, in the financial statements for the year of adoption, the balance sheets will not be comparable from year to year since two different reporting models for the benefit obligations will be used.

Change in Measurement Date

SFAS 158 eliminates the option companies currently have of measuring assets and obligations prior to their year-end dates and requires that the measurement date be the company's fiscal year-end date. Previously, SFAS 87 and SFAS 106 permitted the measurement date to be up to three months prior to the fiscal year-end.

The change in measurement date will compress the timeframe in which companies must finalize their actuarial computations for inclusion in their annual financial statements. This shortened timeframe will heighten the need for timely and proper communication and coordination with actuaries.

Public companies can adopt the new measurement date up to two years after adopting the balance sheet and disclosure requirements. All companies, both public and non-public, are required to adopt the new measurement date for years ending after December 15, 2008.

Implications and Other Considerations

Companies with debt covenants will need to consider the impact of SFAS 158 on defined terms and ratios and other balance sheet metrics, and may need to seek amendments of their covenant agreements to avoid violating them. Companies in a significant underfunded situation will also need to consider what steps, if any, they will take to address the impact of SFAS 158 on their balance sheets. To reduce the net benefit liability, some companies may choose to fund their benefit plans and others may choose to reduce, freeze, or eliminate benefits. If companies choose to fund their plans, they will need to address where the additional cash will come from (e.g., operating cash flows, equity or debt offerings or a shift in investment strategy). If companies choose to reduce, freeze, or eliminate benefits, they should consider whether they will provide compensating benefits to affected employees and how such benefits will affect the company's overall compensation structure. Further, they should consider how such changes will affect their reputation and their ability to

attract and retain qualified employees. Whatever solutions companies choose, they will need to communicate the rationale for their decisions to employees, investors, and analysts.

Companies should also assess the income tax effect of SFAS 158 under FASB Statement No. 109, *Accounting for Income Taxes* (SFAS 109). The additional net benefit asset or liability recorded as result of adopting SFAS 158 will lead to a difference between the book and tax basis of the benefit asset/liability -- which will in turn result in an adjustment to recorded deferred tax balances.

Future Developments in Pension Accounting

The issuance of SFAS 158 represents the culmination of Phase I of the FASB's two-phase pension project. In Phase II, the FASB is expected to undertake a fundamental reconsideration of the basic measurement model for the benefit obligation and the deferral techniques in recognizing benefit expense in the income statement. Phase II is at least three years away from being completed.

The FASB is also expected to address discrete pension-related issues separately, such as multiemployer benefit plan accounting, and could release specific guidance before the completion of Phase II. A multiemployer plan is a plan in which two or more unrelated employers contribute, typically under the terms of collective-bargaining agreements with a labor union — usually referred to as a "joint trust" or "union plan." Employers' contributions to the plan may be used to provide benefits to employees of other participating employers since contributions are not segregated in separate accounts or restricted. These plans are common for many

Retail & Consumer companies, particularly those in the grocery sector. Multiemployer plans are not under the scope of SFAS 158¹. Under current accounting, the required contribution for multiemployer plans is recognized as net benefit expense and any unpaid contributions that are due are recognized as a liability. If the FASB concludes that companies should record their proportionate share of the entire plan obligations on the balance sheet, the impact on Retail & Consumer companies with multiemployer plans could be significant, and thus an issue of interest to follow.

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¹Multiple employer plans are considered single-employer plans rather than multiemployer plans and are accounted for under SFAS 158. Multiple employer plans are aggregations of single-employer plans combined to allow two or more unrelated employers to pool their investment assets and reduce the costs of plan administration. Such plans usually do not involve collective-bargaining agreements

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