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A legal update from Dechert's Employee Benefits and Executive Compensation Group

FASB Proposes Changes to Accounting Standards for Pensions and Postretirement Benefit Plans

The Financial Accounting Standards Board ("FASB" or the "Board") recently announced a project to reconsider the existing accounting rules related to pensions and other postretirement benefit plans. The objective of this project is to improve the reporting for pensions and other postretirement benefit plans in company financial statements by making this information more useful and transparent for investors, creditors, employees, retirees, and other users. The project will proceed in two phases.

In the first phase, the Board will reconsider the current accounting rules related to the reporting of pension and postretirement benefits on corporate balance sheets. The proposed first phase changes include the following items.

The Board proposes to require companies to recognize their pension and postretirement benefit plans as either assets or liabilities on their balance sheets. Current accounting rules permit information related to the funded status of pension and other postretirement obligations to be provided in footnotes to the financial statements, as opposed to being provided in the financial statement itself.

Under the Board's proposal, the liability or asset to be recognized on the balance sheet with respect to each pension or postretirement benefit plan will equal the difference between the fair value of plan assets and the benefit obligation (*i.e.*, projected benefit obligations ("PBO") for pensions and the accumulated postretirement benefit obligations ("APBO") for other postretirement benefits).

The Board also proposes to change the current accounting rules that permit plan assets and obligations to be measured as of a date up to three months prior to the balance sheet in favor of a rule that would require companies to report the overfunded or underfunded status measured as of the date of the financial statements.

Finally, the Board would also require recognition of an asset for overfunded plans and a separate liability for underfunded plans.

The Board hopes to implement the phase one changes as quickly as possible, and has indicated a goal of making them effective for years ending after December 15, 2006. It is expected that an Exposure Draft will be circulated in March 2006. In the second phase, which is expected to take several years, the Board plans to completely reevaluate postretirement benefit accounting. Some of the issues expected to be addressed in phase two include:

- How the various elements that affect the cost of postretirement benefits are best recognized and presented on the income statement
- How to best measure an entity's benefit obligations
- Whether postretirement benefit trusts should be consolidated by the plan sponsor

As already reported in the press, these proposed accounting changes may be the "last straw" for many employers who no longer see their pension plan as a necessary employee benefit. Recently, more and more employers have abandoned their defined benefit plans in favor of defined contribution plans (*e.g.*, 401(k) plans). It is likely that

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the prospect of recording a significant balance sheet liability for an underfunded pension plan will cause many more employers to move to the defined contribution plan only approach.

Although companies need not take any particular action at the current time, it is recommended that companies begin to consider the impact of the Board proposals on their financial statements.

Practice group contacts

If you have questions regarding the information in this legal update, please contact the Dechert attorney with whom you regularly work, or any of the attorneys listed. Visit us at www.dechert.com/employeebenefits.

Robert W. Ballenger
Philadelphia
+1 215 994 2208
robert.ballenger@dechert.com

Judith M. Bandler
New York
+1 212 698 3548
judith.bandler@dechert.com

Stanley D. Baum
New York
+1 212 891 9277
stanley.baum@dechert.com

Richard D. Belford
New York
+1 212 891 9449
richard.belford@dechert.com

Susan M. Camillo
Boston
+1 617 728 7125
susan.camillo@dechert.com

David F. Jones (Chair)
Philadelphia
+1 215 994 2822
david.jones@dechert.com

Paul S. Kimbol
Philadelphia
+1 215 994 2603
paul.kimbol@dechert.com

Ryan M. Metz
Philadelphia
+1 215 994 2821
ryan.metz@dechert.com

Melissa K. Ostrower
New York
+1 212 891 9578
melissa.ostrower@dechert.com

Abigail B. Pancoast
Philadelphia
+1 215 994 2574
abigail.pancoast@dechert.com

Drew A. Picciafoco
Boston
+1 617 728 7109
drew.picciafoco@dechert.com

Beth L. Rubin
Philadelphia
+1 215 994 2535
beth.rubin@dechert.com

Stephen W. Skonieczny
New York
+1 212 698 3524
stephen.skonieczny@dechert.com

Frank B. Tripodi
New York
+1 212 698 3871
frank.tripodi@dechert.com

Kathleen Ziga
Philadelphia
+1 215 994 2674
kathleen.ziga@dechert.com

Dechert LLP

www.dechert.com

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