STANDARD
&POOR'S
Setting the Standard

October 24, 2002

STANDARD & POOR'S CORE EARNINGS TECHNICAL BULLETIN

Standard & Poor's Core Earnings Committee

Client Support
800-523-4534

David M. Blitzer, Ph.D.
(212) 438-3907
David_Blitzer@
standardandpoors.com

Robert Friedman, CPA
(212) 438-9515
Robert_Friedman@
standardandpoors.com

Kenneth Shea
(212) 438-9546
Kenneth_Shea@
standardandpoors.com

Howard Silverblatt
(212) 438-3916
Howard_Silverblatt@
standardandpoors.com

Anuj Bahal, ACA
(646)-471-4747
Anuj_Bahal@
standardandpoors.com

Charles Brinson
(303) 721-4301
Charles_Brinson@
standardandpoors.com

The Standard & Poor's Core Earnings Committee has made refinements to the Standard & Poor's Core Earnings definition as originally noted in the "Measures of Corporate Earnings" White Paper, dated May 14, 2002.[1]

Unrealized Gains/Losses from SFAS 133 Hedging Activities

Protecting the future value of operating assets and liabilities through hedging activities constitutes a core business activity. In addition, management aims to secure certain revenues and costs that are subject to market price variability or are denominated in foreign currency utilizing hedging activities. Therefore, any unrealized hedging gains or losses represent the success or failure of the company's ability to manage its core business exposures. As a result, Standard & Poor's has determined that unrealized SFAS 133[2] gains or losses should be included in the calculation of Standard & Poor's Core Earnings, and no adjustment is required.

Calculation of Pension and Other Post-Employment Benefit (OPEB) Plan Income/Expense

Standard & Poor's is making a change in the treatment of interest cost in the calculation of pension and other post-employment benefit plan income/expense. Since interest cost represents the increase in value of the benefit obligation as time passes and benefit payment time gets closer, interest cost will be included in the calculation of net pension and OPEB income expense. To the extent that interest cost is covered by the actual returns generated by the pension fund, interest costs will not be considered a charge against Standard & Poor's Core Earnings.

The use of actual market returns may add to the volatility of the pension components and the overall Standard & Poor's Core Earnings figures. Standard & Poor's Core Earnings are designed to measure the actual results of a company's core business. This differs from some of the considerations that may

---

[1] www.standardandpoors.com

[2] *Statement of Financial Accounting Standards No. 133: Accounting for Derivative Instruments and Hedging Activities,* Financial Accounting Standards Board, June 1998

have been involved in the preparation of the rules under SFAS 87[3] covering pension expense, which used an expected return on plan assets.

Please see the attached Exhibit 1 for a sample calculation of the Standard & Poor’s Core Earnings pension adjustment.

Reversals of Prior-Year Charges and Provisions

Occasionally, companies will reverse into income portions of restructuring charges and other provisions booked in prior periods. These reversals distort income in the period in which they are recognized because they relate to activities and the expenses of those activities in prior periods. Therefore, Standard & Poor's will not credit the reversal of provisions generated from prior period charges in calculating Standard & Poor's Core Earnings.

Although reversal of prior-year charges should be excluded in the calculation of Standard & Poor’s Core Earnings, these reversals should be netted against the original charge. However, because companies’ filings and reports typically do not provide sufficient information to completely identify the timing of the earlier charges, or allow one to associate each reversal with a specific prior charge, there is often insufficient data to accurately restate earlier periods. Further, any decision about restating earlier years must make a tradeoff between maintaining data that reflect the way the markets perceived companies at the time and imposing adjustments on prior years’ data that were unknown until long after the fact. Consequently, no adjustment will be made to the original charges that led to an excess provision being reversed in a subsequent period.

As Standard & Poor's develops further experience with the data, the issue of netting reversals with prior-period charges may be revisited.

Merger- & Acquisition-Related Fees

M&A activities are normally undertaken to support a company’s core business activity. Therefore, any investment banking, legal and accounting fees arising from M&A activities, as reflected in GAAP earnings, should be included in calculating Standard & Poor's Core Earnings, and no adjustment is required.

Tax Rate Used in Adjustments

Where the calculation of Standard & Poor's Core Earnings requires adjustment for taxes, the tax rate used is the 35% statutory rate for U.S. corporate taxes. No adjustment is made for either state and local taxes or for an effective tax rate different from the statutory federal corporate rate.

---

[3] *Statement of Financial Accounting Standards No. 87: Employers Accounting for Pensions,* Financial Accounting Standards Board, December, 1985

Summary of Revisions

The tables below reproduce Table 2 from the May 14, 2002, White Paper and an updated version showing the impact of the changes discussed in this Bulletin.

As published May 14, 2002

Table 2: Items included in and excluded from Core Earnings

Included in Core Earnings	Excluded from Core Earnings
Employee stock option grant expense	Goodwill impairment charges
Restructuring charges from ongoing operations	Gains/losses from asset sales
Write-downs of depreciable or amortizable operating assets	Pension gains
Pension costs	Unrealized gains/losses from hedging activities
Purchased research & development expenses	Merger/acquisition related expenses
	Litigation or insurance settlements and proceeds

As revised, October 24, 2002

Items included in and excluded from Standard & Poor's Core Earnings

Included in Core Earnings	Excluded from Core Earnings
Employee stock option grant expense	Goodwill impairment charges (2)
Restructuring charges from ongoing operations (1)	Gains/losses from asset sales (2)
Write-downs of depreciable or amortizable operating assets (1)	Pension gains
Pension costs – *revised treatment of interest cost*	Litigation or insurance settlements and proceeds
Purchased research & development expenses (1)	**Reversal of prior-year charges and provisions**
Merger/acquisition related expenses (1)	
Unrealized gains/losses from hedging activities (1)	

(1) Treatment under GAAP is the same as under Standard & Poor’s Core Earnings.
(2) Treatment for Operating Earnings the same as under Standard & Poor’s Core Earnings.

Further Technical Bulletins

As questions arise regarding the treatment of new accounting standards and industry-specific income/expenses, Standard & Poor's will publish additional Technical Bulletins when deemed appropriate.

Acknowledgements

Standard & Poor's is pleased to acknowledge Warren Buffett of Berkshire Hathaway, Jack Ciesielski of the *Analysts' Accounting Observer*, Erik Eisenstein of S&P Equity Research, Liz Fisher of Dresdner RCM Global Investors, Pat McConnell of Bear Stearns, Janet Pegg of Bear Stearns, Bill Sohn of Buck Consultants, and David Zion of Credit Suisse First Boston, who graciously contributed their time and insights to this Technical Bulletin. Standard & Poor's is solely responsible for the opinions expressed in this report.

Exhibit 1

GENERIC CORPORATION
PENSION INCOME CALCULATION
(in 000's)

		Example 1		Example 2		Example 3	
		Pension Income & Expenses		**Pension Income & Expenses**		**Pension Income & Expenses**	
	GAAP	**Included in Core Earnings**	**Excluded from Core Earnings**	**Included in Core Earnings**	**Excluded from Core Earnings**	**Included in Core Earnings**	**Excluded from Core Earnings**
Expected return on plan assets	4,000		4,000		4,000		4,000
Service cost	-900	-900	---	-900	---	-900	---
Interest cost (1)	-2,000	0	-2,000	-1,500	-500	-2,000	---
Prior service cost	-200		-200		-200		-200
Net actuarial gain recognized	900		900		900		900
GAAP PRE-TAX PENSION INCOME	$1,800						
PRE-TAX CORE EARNINGS PENSION ADJUSTMENT			$2,700		$4,200		$4,700
CORE EARNINGS PENSION ADJUSTMENT (2)			**$1,755**		**$2,730**		**$3,055**

(1) Interest Cost Calculation

	Example 1	Example 2	Example 3
Interest cost	-2,000	-2,000	-2,000
Actual return on plan assets	$2,000	$500	$0 OR <$0
INTEREST COST	**$0**	**-$1,500**	**-$2,000**

(2) Core Earnings pension adjustment is an after-tax adjustment (35% statutory tax rate)