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PERCEPTIONS OF PENSION LIABILITIES

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Perceptions by actuaries, investors, regulators and accountants of the various pension plan liabilities which are reported. Comments will focus on how current disclosures are interpreted and how liabilities might better be determined.

1. Past service liabilities
2. Accrued benefit liabilities
3. Vested benefit liabilities
4. FASB liabilities

MR. DAVID A. DANIELS: As actuaries, we develop a funding basis for pension plans relying on a composite of our understanding of the plans' provisions, employee data, financial reports and actuarial assumptions. Our work should lead to a systematic provision for prefunding plan benefits. We are often asked in this connection to disclose various items relative to the funding of the plan. We find that these disclosure items are oftentimes interpreted erroneously or differently by different interested parties. Such seemingly diverse groups as accountants through Accounting Principles Board Opinion No. 8, the SEC through the 10K, the IRS and members of the financial community are expressing increasing interest in pension plan liabilities, required funding and even standardized bases for disclosure.

*Our panel represents a broad range of interested groups: Charles L. Trowbridge, a Fellow and Past President of the Society of Actuaries, is the author of many papers and books on pension funding, including the very recent book co-authored with Mr. Farr, entitled "The Theory and Practice of Pension Funding". He is a Senior Vice President and Chief Actuary of Bankers' Life in Des Moines. Mr. David Landsittel, not a member of the Society, is a partner with Arthur Andersen and Company in Chicago and has participated in his firm's accounting principles and standards group, and is co-author of "A New Look at Accounting for Pension Costs', a book recently published by the Pension Research Council. Mr. Ernest Ten Eyck, not a member of the Society, is the assistant chief accountant of the Securities and Exchange Commission. He has worked with the Department of Labor in coordinating their responses on ERISA and also helped write a review of the accounting and pension plan problems of the New York City pension plan. Mr. Patrick Regan, not a member of the Society, is a vice president and a director of pension planning for BEA Associates, an investment counseling firm. Mr. Regan is the author of "Financial Reality of Pension Funding under ERISA", an extract of which has been published in the Financial Analysts' Journal and which was widely quoted in recent Business Week articles. In addition, he has been the New York Society of Security Analysts' representative on the Pension Benefit Guaranty Committee and worked on the Contingency Employer Liability Insurance provisions.

MR. CHARLES L. TROWBRIDGE: This concurrent session is on perception of pension liabilities. Since this is an actuarial meeting and since none of my three co-panelists are actuaries, it may be appropriate to put the actuarial viewpoint first and I think we will see very shortly that the perceptions of these three other individuals from nonactuarial circles are really quite different. Let me start out by pointing out the extreme confusion that surrounds this entire subject. Possibly the program committee scheduled this panel in an attempt to dissipate some of this confusion, thereby bringing actuaries, investors, regulators and accountants closer together, certainly a worthwhile objective if it can be accomplished. Much of the confusion can be traced to semantics. Early pension actuaries used the noun "liability" together with a variety of modifying adjectives to express a rather subtle pension funding concept. They did not intend the word "liability" to have its usual accounting meaning and they probably did not suspect that their terminology would be so construed. A paper I wrote back in 1952 may have much to do with ingraining the word "liability" in pension literature. In retrospect, I wish it were otherwise, and I am sincerely sorry. Pension actuaries of a more recent vintage have done what they could to set the matter right. The Society of Actuaries' Committee on Pensions has proposed that the word "liability" and its variety of modifying adjectives be entirely dropped from pension literature, to be replaced by the term "supplemental present value". As recently as October 1st of this year, the Interprofessional Pension Actuarial Advisory Group, a group which incidentally has very little authority, but which does have wide representation from interested groups, has issued an exposure draft which replaces the use of the word "liability" by "supplemental actuarial value". Hopefully, such attempts to clean up pension terminology have not come too late. Note the billing for this concurrent session F in your program booklet. The word "liability" or "liabilities" appears no less than seven times.

For the purpose of this discussion, I will use the words "accrued liability" to represent the special pension funding concept that the early pension actuaries had in mind. Past service liabilities, which is the first term expressed in your booklet, or accrued benefit liabilities, which is the second one, were probably intended to have this same general meaning, although I cannot be at all sure. The third and fourth of the liability terms in the program booklet have, to me, different connotations. I don't think quite the same thing is meant.

The accrued liability in the sense we use it exists, if it exists at all, in connection with a specific actuarial valuation method. Some actuarial valuation methods do not employ the concept. Formulas that determine an accrued liability are unique to that method. Thus, the term "accrued liability" becomes defined only if the actuarial valuation method is specified. The best statement that I have been able to devise as to what the accrued liability is or, perhaps more to the point what it is not, appears in a book which Chuck Farr and I recently co-authored:
"There is no liability in the usual accounting sense. Neither the pension fund nor the sponsoring employer has any liability of this particular magnitude. Although there may be a valid view that the employer assumes certain obligations, legal or moral, when the defined benefit pension plan is entered upon, only by accident would the accrued liability be a measure of these obligations. Actually, the accrued liability is more closely related to the asset side of the balance sheet. It can be viewed as the theoretical level of assets which would have been reached had certain

conditions prevailed in the past." Having expressed what I believe is the prevailing actuarial view, let me now shift to the accountant's viewpoint. It is only natural that the use by actuaries of liability terminology has resulted in the word "liabilites" appearing in ERISA and other governmental requirements. The accountants must at least consider whether there is a liability that should appear on the balance sheet. Until recently, the accounting profession has said no to this important question but there are growing indications of a contrary view: First, APB8, the pre-ERISA opinion of the accounting profession had long called for a footnote disclosure of the present value of unfunded vested benefits. Second, with the passage of ERISA, it has been clear that some employers may have, with respect to a defined benefit pension plan, a contingent liability equal to the lesser of the present value of unfunded PBGC insured benefits or 30 percent of the employer's net worth. This liability comes into effect only upon plan termination, but nonetheless, it is of some concern. So far, the accounting profession has not really decided quite what to do with it. Third, the accounting profession is trying to rethink its position with respect to pension plan accounting, and FASB's discussion draft for plan accounting (as opposed to employer accounting) proposed the calculation of what they called "accrued benefits". It is my impression that this FASB action on its own discussion draft has been somewhat delayed and actuaries, frankly, hope that this draft will be modified if it is not actually withdrawn. Finally, there is the appearance of a new book published by the Pension Research Council entitled "A New Look at Accounting for Pension Costs". Mr. Landsittel, a co-author of this book, appears on our panel today. Perhaps he will tell us how he and Mr. Hall, his co-author, define a pension liability and why they believe it should appear on the employer's balance sheet.

In summary of my own view of this confusing topic and claiming that at least partially this is the actuarial view, I put forth the following: One, pension liabilities, with possibly certain minor exceptions, have no accounting significance. They should go under another name as has been suggested by the Interprofessional Advisory Group. If this group can carry the day, the whole issue may slowly fade away. Two, the accounting profession is reviewing its position. Presumably, whatever position is finally adopted will have influence on investors and regulators. Three, probably the most important of all, actuaries must learn to communicate clearly in this important area. Until now, we have not done so.

MR. DAVID L. LANDSITTEL: I am both pleased and honored to have this opportunity to speak to a group of individuals for whom I have a great deal of respect. I would like to state at the outset of my presentation that I am neither an actuary nor an individual who has any significant extent of expertise about actuarial matters. As an independent public accountant, however, I do have a great deal of interest in something that is closely associated with your profession -- that is, pensions. My interest arises from a concern that present accounting principles surrounding pension plans and pension costs are woefully deficient.

One of my partners at Arthur Anderson & Co., Bill Hall, and I were delighted to have the opportunity to undertake a project in 1976 to co-author a monograph for the Pension Research Council based on a fresh, conceptual look at accounting for pension costs. We recognized early in our project that some of our conclusions were controversial and would provoke comments advocating contrary views. Although we would have liked

to be sufficiently persuasive to carry others along toward the conclusions that we reached, we knew that we could not expect this in all cases. We did strive, however, to present our conclusions in a logical and fair manner and hoped that our positions would provoke the thoughts and views of others. In my presentation today, I will attempt to highlight for you some of the conclusions expressed by Bill Hall and me in our monograph.

As we all recognize, long-term changes in social and economic conditions have resulted in a continuing change in the nature of pension benefits and an increase in their significance to business enterprises in the United States.

The evolution of accounting standards that properly communicate the economic substance of pension-related transactions has not kept pace with these changing conditions. Although _Accounting Principles Board Opinion No. 8_, "Accounting for the Cost of Pension Plans", was indeed a significant forward step when it was issued ten years ago, the accounting rules provided by the _Opinion_ are no longer adequate.

We have identified four specific deficiencies that we believe are significant in presently existing generally accepted accounting principles governing pension costs. These deficiencies are as follows:

1. Equally acceptable actuarial cost methods result in widely differing patterns of cost recognition allowable as a means of accounting for similar economic circumstances. Differing methods available for the amortization of unfunded past service costs compound this problem.

2. The unfunded obligation for accrued pension benefits is not recognized as a liability.

3. Varying spreading and amortization techniques result in the artificial leveling of pension expense even in cases where the economic facts are to the contrary.

4. There is too great a latitude in the application of actuarial assumptions.

Time will not permit me to elaborate on each of these weaknesses, but I do want to elaborate on the first one I cited. I will touch upon the others later when I discuss our proposed accounting solutions.

One of the most significant deficiencies in today's pension accounting under _APB Opinion No. 8_ is the variety of widely different patterns of cost recognition that can result when, under identical circumstances, an employer can apply any of a number of accepted actuarial cost methods. These various methods differ in essential respects, such as whether future compensation levels are considered in determining current costs. They also differ in whether past service costs are separately identified and, even more importantly, in the year-by-year relationship of resulting costs to employees' compensation.

While most accountants and investment analysts recognize that various alternative actuarial cost methods are available under _APB Opinion No. 8_ to account for similar pension transactions, few recognize the magnitude of the differences that these equally acceptable alternatives yield.

Presentation of value-based information concerning economic resources in financial statements should be of primary relevance to (a) investors (b) creditors and (c) others who use financial statements. This information indicates the economic strength of a business enterprise and, together with the historical record of its accomplishments, provides an important basis upon which to judge the capacity of the enterprise to produce and enhance its economic resources.

The interests of various parties in existing economic resources may be those, for example, of employees for unpaid wages; of suppliers for goods, services or facilities delivered; of lenders for money provided; of various governmental units for taxes of one kind or another; and finally, the equity of the owners in the economic resources that remain once the interests of the creditors (i.e., the liabilities attributable to the enterprise) have been recognized and accounted for.

In general, traditional accounting has relied too heavily on legal concepts to guide accounting practices for recognition of liabilities. While legal concepts should be considered, financial statements best serve the users when principal emphasis is placed on economic concepts. The recognition of a liability should be based on legal claims or substantive (even though not necessarily legally binding) claims for services, money, property, goods or facilities received by a reporting entity. For most types of obligations, the substantive approach results in the recognition of a liability at the time performance by the other party to the transaction occurs. Conversely, obligations or contracts that are contingent upon services to be rendered or goods or property to be furnished in the future by another party should not be recorded as liabilities because the obligations are contingent upon performance and do not need to be discharged until such performance has taken place.

If earnings are to be considered as a result of the measurement of economic resources, the periodic earnings will be determined by the change in the owners' equity as shown by comparative balance sheets. In other words, the income or loss of an enterprise should be based upon the changes in value of that entity's net economic resources occurring during the period.

In the absence of evidence to the contrary, generally accepted accounting principles for financial reporting by business enterprises normally presume that the enterprise will continue to exist and function. Unless supported by the particular facts and circumstances, accounting should not communicate values of economic resources and interest of creditors under the assumption that an immediate termination of the enterprise will result.

Such a view, however, should not be interpreted to allow for an arbitrary "spreading" of costs or a "smoothing" of income. Changes from one date to another in the value of economic resources (exclusive of capital changes) represent an entity's earnings for the intervening period. Stability of earnings should not be communicated when there is, in fact, no such stability on the basis of the economic facts. It is not the function of accounting to ascertain and maintain an earnings trend -- to "average out" unusual income or expense. Economic events or transactions should be accounted for in the period in which they occur in order to ensure that the economic resources as of a particular point in time are properly stated, and the interests of creditors and owners in these economic resources are properly reflected. The changes in the value of such resources will then be reflected in the period in which such changes actually occur.

In developing the accounting principles that most accurately communicate the economic substance of pension-related transactions, it is important that the objectives of financial statements be differentiated from the objectives of pension funding. Much confusion has arisen in previous attempts to formulate accounting principles in this area because these differing objectives have not properly been recognized.

When developing a plan for funding pension benefits, it is, of course, important to estimate the requirements for funds ultimately to be needed to meet the related pension obligations. A strategy for discharging this obligation is a form of budgeting of the future use of resources. The long-term nature of pension costs should be considered. Stability in the year-to-year requirements for funds to meet the obligation may be a proper goal. In order to protect against unanticipated future cash shortages, a conservative policy that results in accelerated funding in earlier years may be prudent. Any one of several actuarial methods may be considered to meet this funding objective.

The objectives of financial statements, however, differ from those of funding. Financial statements purport to communicate the financial position as of a specified date, and the results of operations from period to period. The long-term nature of pension costs is not a relevant characteristic that should be considered in communicating the value of economic resources and the interest of creditors and equity owners in such resources at a specified date. Although accounting principles should assume the continuing existence of the business enterprise in the absence of evidence to the contrary, and although the cost of providing pension benefits is a continuing one, investors need to know the financial status of a business enterprise as of a particular point in time. They need to make economic decisions periodically and require information regarding the currently existing values and obligations of the business enterprise in order to make such economic decisions effectively.

The standards we advocate for adoption with respect to the accounting for pension plans as separate reporting entities are consistent with our financial statement objectives.

The various classes of assets of a plan should be accounted for using current value as a measurement basis. Information about the value of the plan's economic resources is consistent with the needs of the financial statement users -- that is, such information is relevant to (a) an evaluation of the extent to which employees' rights to pension benefits are secure, (b) an evaluation of earnings performance of the plan's assets and (c) an evaluation by the employer of the adequacy of funding. Historical asset cost has no particular relationship to a plan's ability to meet its obligations for present and future benefits, nor to any evaluation of earnings performance or plan security. Consequently, use of the current-value basis better accomplishes the objectives described previously relating to both financial position and periodic changes in financial position.

Similarly, our objectives are best met by recording in the plan's financial statements some measure of the obligation for pension benefits. Information with respect to this obligation is meaningful to financial statement users in their evaluations set forth in the preceding paragraph. This obligation for plan benefits should be recorded in employee benefit plan

financial statements as such benefits are earned by the employees -- that is, as the employees' performance, measured by service rendered to date, has been completed. Stated briefly, our view is that the recording of such pension obligation should be correlated with direct compensation cost, using an actuarial present-value approach.

A liability does not exist for aggregate total future benefits estimated ultimately to be payable to present employees to the extent that such benefits have not yet been earned. Unearned estimated future benefits are simply a commitment of the plan -- a commitment that is executory in nature and dependent on future performance by the employees. The translation of this commitment into a fixed obligation that should be recorded does not occur until performance occurs -- that is, until the employees' service results in the benefits being earned.

Although the obligation to be recorded should not reflect an anticipation of any service not yet performed by employees, estimated future compensation levels (including increases resulting from inflation) should be considered in measuring the obligation. This, we believe, is true in all cases but is most readily apparent where the amount of the benefit ultimately payable is dependent on some future consideration -- for example, an average earnings during the last five years prior to retirement. Such a consideration of expected future salary increases simply represents another factor to be considered in an estimate of the amount of the benefits ultimately expected to be payable, just as estimated inflation implicit in the discount rate and estimated mortality, disability and employee turnover must be considered.

If our views on the accounting for pension plans are accepted, we believe that symmetry between the accounting for pension benefits followed by the plan as a separate reporting entity and that followed by the employer in recognizing the costs of the related pension obligation is essential. Looking through the form to the economic substance of pension plan arrangements, the obligation for pension benefits must logically be considered a liability of the sponsoring employer as well as a liability of the plan. The plan is merely a vehicle for discharging the responsibilities an employer has undertaken to provide pension benefits to its employees. It is the employees' service to the employer that provide the basis for recognizing and measuring the plan's liability for pension benefits.

Stated otherwise, the employer has assumed an obligation for pension benefits and will be required to pay amounts in satisfaction of that obligation during some future periods. To the extent that the obligation to make future payments relates to services already rendered by the employees, a liability has been incurred and should be recorded in the financial statements of the employer.

Some have relied upon legal concepts in contending that the liability for pension benefits need not be recognized by the employer until the liability is funded through contributions to the pension trust. They argue that the trust serves to insulate the employer from the legal liability. We do not believe that such an argument is valid from an economic point of view, and evolutionary changes in the pension environment support our contention. The enactment of ERISA serves as a recent illustration of such changes. Although ERISA may not have resulted in the addition of any legal responsi-

bility for business enterprises to provide benefits for their retired employees, its provisions do serve to add weight to the economic, as opposed to the legal, view of the pension liability. Minimum funding and vesting requirements, as well as termination guarantee provisions contained in ERISA, serve to reduce this insulation. Because the employer is now required ultimately to fund those benefits defined in the plan, its obligation to provide the promised retirement benefits becomes more direct. Future payments required by the employer with respect to benefits earned to date represent a present liability.

If our proposal for the accounting by the employer for the costs of pension plans were to be adopted, we believe that investors and other financial statement users would benefit. Equally accepted alternatives now existing under current generally accepted accounting principles that can be applied under identical circumstances would be eliminated. The substantive liability of the employer covering the obligation for unfunded pension benefits earned to date by the employees would be recorded. The measurement of that liability would be defined in a manner that would result in elimination of alternative actuarial methods currently allowable as a basis for financial reporting (although such actuarial methods could, of course, continue to be utilized in the development of prudent funding policies). The cost of benefits attributable to the prior service of employees at the time of adoption or amendment of a pension plan would no longer implicitly (and erroneously) be deferred; and the alternative methods of amortization of such costs could therefore be eliminated. The economic resources of an enterprise and the interests of creditors and equity owners in such resources as of a specified date would be properly reflected. The changes in these interests and resources would be recorded in the period in which they actually occur.

MR. DANIELS: Mr. Trowbridge has indicated where we think we are in terms of measurement of liabilities and Mr. Landsittel discussed where he thinks we ought to be. I think we should now turn to what is often called the real world, which is how these liabilities are being interpreted and how they are being used.

MR. ERNEST TEN EYCK: The Commission and the chief accountant's office take no responsibility for the musings of their missionaries. Whatever I may say is an expression of my opinion and does not necessarily reflect theirs. I should also tell you that the history of symmetry between my opinion and that of the Commission is less than one to one.

There are four areas I will focus on: (1) Whether or not there exists a liability, (2) the widespread lack of understanding among users of financial information about so-called actuarial liabilities, (3) the lack of disclosure that perhaps contributes to that lack of understanding, and (4) the Commission's views on the recent Second Circuit decision in Daniel versus the Brotherhood of Teamsters.

The concept generally adhered to by actuaries, that there is no liability in the accounting sense created for a plan sponsor where his pension plan is less than fully funded in the actuarial sense, is contratuitive to accountants. The argument that is often made in support of the "no liability" concept is that the actuarial computations are designed to provide for full funding at some time in the future. This, combined with

what in most cases is lack of legal liability, actuaries often argue, does not create a liability in the accounting sense requiring a balance sheet entry. To an accountant, however, if the sponsor or the corporation has an obligation to pay money out in the future in order to meet his commitments to his employees, there is the implication of a liability, which theoretically should be put on the balance sheet of the plan sponsor. Recent activities of the Financial Accounting Standards Board points to the likelihood of a requirement that pension liabilities, however they are ultimately measured, should be shown as a liability on the balance sheet of the sponsoring organization. But for Accounting Principle Number 8, most accountants would argue that an existing standard, Financial Accounting Standards Board Opinion Number 5, regarding contingent liabilities, when they are contingent and when they are recordable, would lead you to recording the liability for unfunded pension costs under existing accounting principles. Other FASB opinions adhere to this conservative historical concept of measuring things as they happen. Probably the most notable one is FASB Opinion Number 8 regarding foreign currency translation. The gain or loss that arises from translating from one currency to another is recognized in the current period whether or not a transaction occurred. I would suggest to you that the concept of gains or losses in foreign currency translation is not very different than the concept of actuarial gains and losses. The board might in the final analysis treat them the same way, recognizing them when the economic event takes place. I do not have any strong personal view about whether there is any benefit in booking the liability and I am not yet convinced that the perceptual framework, as it develops, should take the view that all obligations of a corporation should be recorded on the balance sheet.

There is an increasing public concern with this whole concept of unfunded liabilities and unfunded obligations. This has received much attention in the press: articles in Business Week, the Financial Executive and other publications. Some of the stories that appeared describe a $1 trillion unfunded liability in The Social Security System. Articles such as these generate tremendous interest. They will likely provide the impetus for increased disclosure requirements and significant pressure with respect to uniform accounting for corporate pension costs including decreasing the array of alternatives that is available for measuring these costs, regardless of whether or not the liability is to be booked. Such changes should come from the Financial Accounting Standards Board, which is, after all, the body that has been designated as having primary responsibility for setting accounting standards.

The FASB put the project of accounting for pension costs on its agenda shortly after ERISA was passed in September 1974. The Board does not plan to publish a discussion memorandum until 1979. Based on the usual time frame in which the FASB deliberates and considers these things, it would appear there will not be new accounting standards until 1981. In the current environment, that is probably too long to wait. Too long because the current environment, with respect to the topic of this particular session, is one clouded by confusion and involves highly sensitive public issues. For the most part, I do not think the investing public really understands anything about actuarial liabilities and they do not know what either the accountants or the actuaries are talking about.

Everybody has dropped the ball, including the SEC, who has not addressed the problem since APB8 was passed in 1967 and Regulation SX was amended to conform most of its disclosure requirements to those of APB8. The alternatives are staggering. The number of permutations of ways to compute pension costs must run into many digits. Therefore, it is not likely that the Commission will break with its traditional posture of leaving accounting measurement problems to the private sector. On the other hand the Commission is not likely to adopt Mr. Landsittel's book as a reporting requirement for public companies.

However, the possibility is growing that we will take some steps between now and 1981. The Commission is not a collector of information as are other government agencies. The Department of Labor, for instance, gathers great rooms of data, only some of which is designed for the benefit of outsiders. The SEC's primary responsibility is to see that the information that gets into the hands of the public is reasonably informative, contrary to popular belief that the concept of the two-tier disclosure system is still alive and well at the SEC. That concept involves presenting certain information to the general reader of financial statements and more sophisticated and more detailed information for the so-called sophisticated users of financial statements, such as securities analysts. More than any other, the area of pension costs is likely to test the viability of that two-tiered disclosure concept, because there are few if any accounting areas more complex or less understood.

Disclosure of unfunded past service costs is a likely focal point in rethinking our current requirements. One of the obvious things we must ask is whether that number is meaningful. Most actuaries we have spoken to over the years tell us it is not meaningful. Certainly Mr. Trowbridge would agree. Many accountants think it is meaningful, including many of the accountants that work in the Division of Corporation Finance. These individuals are sophisticated. That they take this position with respect to the meaning of past service costs, whether rational or not, must be reckoned with.

A basic problem with current disclosure requirements is that we do not know what is disclosed. The actuaries tell us there are two methods they use in which unfunded past service cost is never developed as a separate number and we do not know whether the absence of an unfunded past service cost number means they did not feel like disclosing it or whether or not they are using one of those actuarial methods. It is also disclosed, of course, in connection with the standard accounting principle disclosure of unfunded vested benefits, but there is no requirement that the fund value portion of that calculation be the same one that is used in calculating unfunded vested benefits. The two numbers that appear side by side in an SEC footnote may not be comparable at all.

I would like to see disclosed the number that analysts seem to calculate all the time. That is, the company's pension costs expressed in terms that are understandable and comparable between companies, either as a percentage of the company's total payroll cost or as a cost per employee.

Finally, we are probably going to try to shed some light into the black box that constitutes the actuary's involvement in the calculation of plan costs and liabilities, begin looking at actuarial assumptions and try to get some handle on what can be disclosed to give the reader of the financial statement some idea of what is the risk of being wrong. What is the sensitivity of those actuarial numbers to changes in the factors which they are trying to measure? How do the particular actuarial assumptions compare with historical reality? How frequently are those actuarial assumptions reviewed and changed? What is included in each of the actuarial assumptions for purposes of making the calculations? We will probably examine other things as well, such as future commitments for funding costs over long periods of time, remaining balances and amounts to be amortized and prior services costs and actuarial gains and losses.

The Commission has never viewed the complexity of an issue to be an overwhelming argument against disclosure. I have heard actuaries present the argument that no matter what you disclose, you will omit some information important in understanding that piece of information just disclosed. So, you are always missing something and to disclose everything would be useless. I suspect that there are ways of approaching this problem. Perhaps the actuaries, themselves, could suggest possible solutions.

I have been asked to comment on Daniel versus the Brotherhood of Teamsters, which was a recent Second Circuit Court decision. This should be of some interest to the actuarial profession. While I am not a lawyer, I have done my best to gather this information from the people in our General Counsel's office who are responsible for following the Daniel case and responsible for writing the Commission's amicus brief. Nevertheless, I will add the extra disclaimer that I do not understand the whole legal significance of this decision because the case is so new. Mr. Daniel worked for several years as a teamster and because he had a 3-month involuntary break in service, some obscure provision of the Teamster's pension plan prevented him from collecting any pension benefits. Apparently no one ever told him about that provision. He sued the Brotherhood under the federal securities laws alleging fraud. The Second Circuit, addressing the narrow issue of whether an interest in a pension plan constitutes a security, said it was, on appeal, affirming the Second District Court's decision. Mr. Daniel has not as yet "been made whole". He must still appear before the U.S. District Court and prove that he, in fact, was defrauded and that there was monetary loss as well as many other elements.

The important factor for actuaries to consider is not whether Mr. Daniels wins or loses, but, that for purposes of the anti-fraud provisions of the securities laws an interest in a pension plan is a security. I emphasize "anti-fraud provisions of the federal securities laws" because the decision is fairly limited. The decision does not mean, as some have suggested, that pension plans now have to register with the SEC. It does not affect the registration or reporting provisions of either the 1933 or the 1934 act. Pension plans are still exempt by statute under those provisions. The decision does mean, however, that private parties and the Commission, if it should choose to bring an injunctive action, have a right of action under the securities laws if they believe a fraud has been committed in connection with their participation in the pension plan. The Court's reasoning in the case, interesting enough, was based on what they considered to be the absence of the kinds of protection that are provided by the securities laws, specifically section 10B of the 1934 act and 17A of the 1933 act.

I do not know what the Daniel decision may mean for most of the people sitting in this audience, but to some extent it should make actuaries aware that they are more likely now to become involved in litigation. Certainly accountants can tell you about rule 10B5 and what that means to a profession, and I think, in turn, that should give the profession, as a whole, some cause for thought as to what standards an actuary should be judged against when his performance is called into question by a lawsuit. Meeting the requirements set up under ERISA or the Department of the Labor regulations may not be enough to keep the actuary out of trouble. The accountants have found where the professional literature acknowledged that professional standards do not cover an issue, and in some cases, to their chagrin, where they do cover the issue, the courts have applied their own tests. The real danger is when there are no standards and the court has to look to its own devices to determine whether by his performance the actuary failed to do right or not.

In reviewing those areas where accountants have gotten into trouble over the years, we might conclude that the following areas might be particularly vulnerable in the case of actuaries: (1) responsibilities arising in connection with a plan description or another document distributed to participants and the actions that are taken, if any, when an actuary decides that some of that element with which the actuary is associated is false and misleading, (2) the extent to which the actuary is entitled to rely on others, including management or the auditor for providing him information which forms a basis for his calculations, and finally, (3) responsibility for the reasonableness of actuarial assumptions, whether they are used in the calculations of pension costs or in other disclosures that are made to employees.

On this last point, I would ask you to particularly focus on differentiation between the reasonableness of individual actuarial assumptions as opposed to the reasonableness of actuarial assumptions taken as a whole. This is another place where the accountants have gotten into trouble, when, having reviewed financial statements assertedly taken as a whole, the court has found that some element of those financial statements was material in and of itself and that they could, under the securities laws, reject the view that any individual element of a calculation or in the accountant's financial statements was not meaningful.

MR. DANIELS: ...Thank you. Mr. Patrick Regan will now tell us how the financial community uses pension liabilities.

MR. PATRICK J. REGAN: There are about 15,000 security analysts in the country who analyze stocks and bonds, and make recommendations for the management of pension fund portfolios as well as to individual investors. How they interpret data on unfunded pension liabilities is important in terms of which companies will be able to continue to raise capital at attractive prices. Since ERISA was designed primarily from the legal and actuarial perspectives, it is not surprising that the financial implications in the law received little attention at first. In the absence of contingent employer liability insurance though, ERISA can have a major impact on the capital structures and in the operations of companies which maintain defined benefit pension plans. With the introduction of claims and counter claims against pension beneficiaries, plan sponsors and the Pension Benefit Guarantee Corporation, ERISA has added new elements to the analysis of bonds, stocks, portfolio volatility and pension planning. Today I would like to address some of these changes and illustrate how the financial community is interpreting and using actuarial data in its decision making.

From a financial point of view, the major change wrought by ERISA was the imposition of a potential corporate liability for unfunded pension benefits. Whereas the legal claim of pension beneficiaries was formerly limited to assets in the pension fund, ERISA extended it to include up to 30 percent of the sponsoring company's net worth (in the absence of contingent employer liability insurance) in the event of a plan termination. In the event of the plan termination, unfunded guaranteed pension benefits would be assumed by the Pension Benefit Guaranty Corporation, which would then attach the equivalent of a tax lien on the assets of the sponsoring company. This would place unsecured - and that is an important differentiation for bankers - corporate creditors in a potentially subordinate position. In effect, the capital structure of the firm would be altered, as the lien would be the equivalent of a reserve appropriated from stockholder's equity.

To better reflect the total leverage of the company, some analysts and bankers are constructing augmented balance sheets. To construct an augmented balance sheet, you simply add the pension assets and liabilities to the corporate assets and liabilities. This is in violation of legal and accounting principles, since the pension fund is not an asset of the corporation and a dollar transfer from the company's cash account to the pension fund cannot be reversed. Nevertheless, it provides a framework for assessing the total financial position of the company. For example, using an augmented balance sheet, analysts can determine how a given percentage change in the market value of the fund would affect the size of the unfunded pension liability. The sensitivity of unfunded liability to fluctuations in asset value is important since such liability represents a potential claim on the stockholder's equity and through amortization affects the annual pension expense. For example, if a security analyst was considering recommending the purchase of two companies whose corporate financial statements, growth prospects and unfunded pension liabilities were identical, he would construct an augmented balance sheet and favor the company with a larger pension fund. After all, it makes a difference if a company has a $10 million unfunded obligation whether the company has $1 million in the fund or $100 million in the fund with which to support the obligations for past service.

Unfortunately, the accounting profession does not require the disclosure of the pension assets or the liabilities, merely the net amount. In annual reports to shareholders and 10K reports filed with the Securities and Exchange Commission, companies are only required to disclose their annual pension expense, unfunded vested benefits, amortization period and any actuarial changes that affected net income in a "material fashion". In their SEC filings, we have found that about 80 percent of all large corporations voluntarily disclose their unfunded past service costs, and a few even reveal pension assets, funding methods and key actuarial assumptions. Most actuaries tend to think in terms of pension costs as a percent of payroll and this is an approach that would be very useful for analysts to follow. Unfortunately, companies are not required to disclose their payroll costs, and those who do, sometimes include social security in the tax base.

Bankers and bond holders realize that unsecured debt can be subordinate to these claims in the event the corporate assets have to be attached. In some cases, they are adjusting capital structures by adding to the long-term debt the liability for unfunded vested benefits and reducing stockholders' equity by a like amount, subject to the 30 percent of net worth limitation. I have reviewed the effect of such an "adjustment" to the capital structure of 40 major corporations, which account for about 15 to 20 percent of the pension assets and the employees covered by ERISA. These represent the four largest companies in ten major industries. The median figures for this sample indicated the "typical" firm in the survey had a long-term capital structure of 26 percent long-term debt and 74 percent equity before the adjustment. After the adjustment, the capital structure is compared to 6 percent unfunded vested benefit, 26 percent long-term debt, and 68 percent stockholders' equity. In effect then, the firm with $100 of capital had a $6 unfunded vested obligation which was transferred out of stockholders' equity and $26 of long-term debt which remained unchanged.

While the 40 companies were ranked on the basis of their adjusted debt to equity ratios, they all used somewhat different sets of funding methods and actuarial assumptions. Such a variety of bases can be very confusing, particularly to analysts. Therefore, analysts tend only to look at the companies showing a dramatic change as a result of the adjustment. After the adjustments the "median" company had a debt to equity ratio of .46 which is an increase of 35 percent from the preadjustment ratio of .34. At the end of 1974, when we first took the survey, the increase was about 50 percent, but since then there has been some appreciation in the stock market which somewhat closed the gap. In seven of the 40 cases, the debt to equity ratio more than doubled as a result of the adjustment. The sharpest increases took place in the auto, steel, tire and rubber, and electrical equipment industries. These are the industries that had the highest debt to equity ratios before the adjustment as well as after.

The increase in financial leverage is substantial, and this combined with the fact that unsecured corporate creditors are in a potentially subordinate position, could affect the decisions of some lenders and investors. For example, some banks now have loan provisions that effectively prohibit voluntary termination of a pension plan by accelerating the maturity of the loan in the event of a termination.

When ERISA first became law, many members of the financial community adopted a liberal attitude in the belief that very few plans would be terminated. Today there is a greater concern. In three years, more than 15,000 plans have been terminated, several times the original estimate of the PBGC. Companies that have shut down integrated plans or sold unprofitable divisions have found that unfunded pension obligations constitute the major part of the close down cost. This is becoming a major concern of analysts and bankers.

For companies involved in mergers or acquisitions, price now reflects unfunded pension liability. Bankers, bondholders and security analysts are paying more attention to pension costs and unfunded liabilities and portfolio managers are sometimes unwilling to invest pension fund assets in the securities of companies that they believe have pension problems. In short, more and more investment decisions require an understanding of actuarial data and this no doubt leads to a demand for greater uniformity and greater disclosure.

As an example of how security analysts consider pension liabilities in their evaluations of companies, it is interesting to look at the case of General Electric and Westinghouse. The analyst has to estimate the earnings of each company. So, the pension plan of Westinghouse concerns him more than that of GE's, since 1976 pension costs were equal to 31 percent of Westinghouse's pretax profits, but only 15 percent of GE's. Therefore, the analyst who follows Westinghouse knows that its pretax profits are more sensitive to changes in the pension expense. Also, the GE plan appears to be better funded, since its $568 million unfunded vested benefits were equal to a mere 16 percent of its $3.6 billion pension fund at the end of 1976, whereas Westinghouse's $751 million of unfunded vested benefits were equal to 65 percent of its fund value. Again, in most cases, the value of the pension fund is not disclosed, but the analyst must also consider how conservative the numbers in the liability side have been stated. This involves an examination of funding methods, actuarial assumptions, benefit formulas, asset evaluation methods, etc. Generally, the only time that an analyst would seek this additional information is when the pension costs and unfunded liability figures are quite large relative to the size of the company. Some analysts examine D2 reports and others ask company officials to comment on the pension plans of their competitors, asking them to point out where theirs is superior or inferior; in other words, are the costs and liabilities stated on a more conservative basis than in comparison to the competition.

When ERISA was passed in 1974, one institutional brokerage firm went so far as to hire a major actuarial firm to analyze the pension plans of the companies on which it was offering stock market opinions. Actuaries will probably become important consultants in the merger and acquisition area, as companies will have to adjust their bid prices when the takeover candidate has an unfunded pension liability problem.

About four percent of the large corporations have potential claims against the Pension Benefit Guaranty Corporation, since their unfunded vested benefits exceed 30 percent of their net worth. For this purpose I use "unfunded vested" as a proxy for unfunded guarantee benefits, since the PBGC has noted that unfunded guaranteed benefit liabilities have averaged about 86 percent of the unfunded vested figure. The economic value of these companies in a merger situation would be less if the merger partner was fully funded and had a great net worth. An example would be the disbanded merger last year of White Motor into White Consolidated. White Motor had an enormous unfunded vested pension liability equal to its net worth. In a merger, the potential claim against the PBGC would have been diluted, due to White Consolidated's greater net worth. For this reason, among others, the merger was called off. Instead, White Motor began selling its operating divisions, perhaps increasing the aggregate claim against the PBGC. An example of how this can happen was the sale of Scoville Manufacturing's brass business in 1976. The business had a book value of $75 million. It was sold to a private investor for a mere $35 million, which itself was composed of $7 million in equity capital, the assumption of a $10 million mortgage and $18 million unfunded pension liability. Since the new company had a very small net worth, most of the unfunded pension liability became a potential claim against the PBGC. Should there in fact be a termination, the PBGC would be left with most of that unfunded pension obligation, not the private investor.

MR. DANIELS: Thank you. Our last two speakers have touched on the subject of greater uniformity in the basis for determination of liabilities. Would the panel like to comment ?

MR. TROWBRIDGE: I want to point out that the three other speakers in varying degrees took the position that pension liabilities are liabilities. It is my view that there is no liability normally, but that the PBGC imposes a liability on the employer under certain conditions. Mr. Regan, by reducing Shareholders' Equity by the smaller of 30% of Shareholders' Equity or Unfunded Vested Liability is saying, in effect, that there is a liability and that once in a while you can throw some of it back on the PBGC. It is just entirely a different way of looking at it. He looks at liabilities as real and that sometimes you can transfer them to the PBGC. I look at them as entirely unreal and that once in a while PBGC, because of its contingent liability requirements, can affect an employer's balance sheet to the extent of 30 percent of the net worth.

MR. REGAN: Whether these liabilities are viewed as real or unreal, or whether they are on the balance sheet or not, most analysts and bankers have to be very careful particularly in the investment of pension assets. There is a similar problem with leases - Are they real or unreal? Accountants have debated this back and forth. Most analysts assume the leases are real. They are not due tomorrow. They are spread out over a period of time. Long-term debt is not due tomorrow; it is spread out over a long period of time. Similarly, the pension obligation is a current obligation of the employer. Prior to ERISA, it was possible to walk away from it. We may have had one set of rules for going concerns and one set for other concerns. However, analysts were shaken up by the recent example of Bethlehem Steel shutting down two antiquated plants, thereby incurring a write down and a speeding up of vesting for particular individuals. It will cost them a write down of about $400 million. The stock dropped 50 percent. The bonds had their rating lowered for the first time in history and it certainly shook up Wall Street. It has caused analysts to carefully look at liabilities. Are they real or are they unreal?

MR. LANDSITTEL: I would like to comment on the real versus unreal issue that Mr. Trowbridge brings up, because it is the crux of our discussion, while the measurement of what would be the liability, if real, being perhaps secondary. If you take the posture that a corporation is a going concern, the liability appears to be unreal. It is not a legal liability of the corporation. The pension trust insulates the corporation from that liability. From a substantive standpoint, however, I conclude that it is a real liability. Before ERISA was adopted, I would have come to that conclusion in any case, but there are a couple of things that ERISA did that reinforce that conclusion. ERISA set up minimum funding requirements and minimum vesting requirements that ultimately, if you assume a going concern, results in an unavoidable obligation of the corporation. For an argument supporting the substantive liability consider two corporations, A and B, exactly equal in terms of their balance sheet assets and liabilities, in terms of the business they conduct, the quality of their management, the future outlook of the corporation, and exactly equal in terms of the types of pension plans for their employees. A and B are identical except for one thing: A adopted its plan 20 years ago and has been funding cash into the trust over a 20-year period and B adopted its plan yesterday.

Obviously, Corporation A is in a much better position than Corporation B. I would submit to you that if both of these corporations were on the market to be sold as a going concern business, the one that had the largest unfunded balance would sell for less than the other. This represents an economic or otherwise intuitive basis to argue that there ought to be something recorded on the balance sheet of each company or on one vis-a-vis the other to reduce the one company's net worth in relation to the other.

MR. TEN EYCK: Mr. Regan is not necessarily dealing with this only from an accounting standpoint. What an analyst does with a piece of information does not necessarily reflect accounting practice, but it certainly reflects the value of the information to individuals actively involved in the market place. In point of fact the manner in which the analyst is now using the information is having a tremendous impact in some cases on a company's ability to raise capital. If Standard and Poor's, for example, decides to drop your bond rating from AA to A, such action would likely require an extra half percent on a new bond issue which could have a serious impact on the shareholders. Is there a liability or not?

MR. DANIELS: The Accounting Principles Board first issued an Opinion several years ago on how to account for pension costs. The FASB recently issued an exposure draft concerning financial reporting for pension plans. Two of our panelists have mentioned that there is a need for greater standardization. Mr. Ten Eyck suggested that the FASB was the logical body to set new standards, although somewhat discouraged by their pace since they would first start in 1979 and not have working standards until 1981. I would like to ask the panel if they feel the FASB is the best body to be setting such standards.

MR. LANDSITTEL: As a professional accountant from the private sector I would clearly endorse the FASB as the proper unit to set accounting standards, whether they are disclosure or measurement. I am, of course, sympathetic with the SEC's concern that there is a lack of disclosure in this area. I can also appreciate the SEC's concern that 1981 might be the earliest date that the private sector can accomplish some changes. The accounting profession ought to move forward more quickly than that. I do not endorse any attempts by the SEC to do our job.

MR. DANIELS: The panel is prepared to entertain questions from the floor.

MR. PRESTON BASSETT: Mr. Regan, I would like to understand what you have said. Is your concern in the liabilities of the forty companies you have surveyed the liability that they would incur in event of plan termination over that which is guaranteed by the PBGC?

MR. REGAN: Yes.

MR. BASSETT: So that the investment analysts are concerned with legal liabilities, that is, liabilities that could occur and affect stockholders and others in the event of a plan termination and only with the legal liabilities. Is that right?

MR. REGAN: One of the factors that analysts would focus on is the book value per share. You cannot compute the book value when you have some unusual claims. Nevertheless you would have to get some handle on this. I have attempted to do this by adjusting the capital structures by the unfunded termination liability. The figures published in 10K's formed the basis for my calculations.

MR. BASSETT: Is it not true then, that if it should occur that a corporation, through paying a higher premium rate, could insure their full liability in event of plan termination, you would not need any figures in connection with pension plan liabilities?

MR. REGAN: Yes.

MR. BASSETT: We have heard that Mr. Regan is only concerned with the legal liabilities, or legal obligations. Then what purpose, Mr. Landsittel or Mr. Ten Eyck, do you see in putting a liability on the balance sheet of a corporation when it has little meaning to the ones who are most vitally interested in the makeup of those balance sheets?

MR. LANDSITTEL: I would like to convince Mr. Regan to the contrary of that which he has stated. Mr. Trowbridge set forth my biggest concern and that is, we ought to reflect the concept that there is a liability to the corporation over and apart what flows through the financial statements at the time of the funding. While it is secondary how you measure it, I prefer that the liability be measured based on performance between the parties. Performance by the employee is the benefit that the employer receives. Matching this benefit with the cost of the benefit to the employee would mean that the employer reflects the liability at the same time, and that overconcern with respect to termination is contrary to facts and circumstances in most cases. There are,of course,the particular cases, such as Bethlehem Steel, where plants are shut down involving a termination concept rather than a going concern. For the average company, termination is not imminent, and therefore, I see no reason to record the liability based on termination concepts.

MR. C.V. SHALLER-KELLY: Mr. Landsittel advocates the use of a "going concern" for valuing pension liabilities. Why does he advocate market value for assets? One does not have to go as far as British actuaries, who value common stock at the discounted value of expected future dividends. However, the value of the assets to the pension plan should be the present value of future cash flow including an allowance for the probability of sale of the asset at any given time and price. Using market value assumes 100% probability of immediate liquidation.

On a going concern basis, is not the significant figure the annual pension cost figure rather than any liability figure? In the acquisition of a company or in judging the real value of a company as a going concern, it is the present value of expected future profits which should be compared to the purchase price. Is there not a danger that pension costs incorrectly enter twice into the acquisition costs if any consideration at all is given to pension liabilities?

MR. LANDSITTEL: With respect to the first question the point being made that to carry assets at market value when the assets are not going to be sold is a form of a termination concept, which of course is contrary to the going-concern concept. I do not view the valuation of assets at market as being similar to a termination concept. The best way to measure the financial position of a company at a particular date, or the expectations of the company using performance over a period of time, is based on a value based system. If I were evaluating whether or not to purchase a company that had only marketable securities in its portfolio I would like to have information that shows today's value of the marketable security and the performance in terms of changes in value over specified periods of time. That does not mean that I am forced to take a posture that I would liquidate those particular securities. Taking value based information in my view is most relevant when measuring financial position and results of operation and is consistent with the going concern concept in that sense. With respect to the second question, my example is fallacious. I was, however, attempting to construct an example holding all variables the same in two situations, except that one pension plan is funded and the other is not. Obviously, this would be a self contradiction. Nevertheless, some differentiation should be made in the financial position between the company that had a funded plan and the company that had a plan that was not yet funded.

MR. REGAN: When valuing a business, an analyst or a merger specialist will examine the amount of capital required, the return on that capital, and how quickly the capital will be returned. The focus of the analyst or merger specialist would be the pension cost, much more so than a liability, so that the problem of double accounting will not arise.

MR. DONALD S. GRUBBS, JR.: I disagree with most of the conclusions presented in Mr. Landsittel's book; particularly that the financial statement should meet the needs of users. Think of the statement which is given to the plan participant, forgetting for the moment those statements which might go to security holders or investors. Presumably the participant is concerned with whether or not he is going to get his promised benefit. If the plan is ongoing, would you agree that the financial statement of the plan is irrelevant to that concern? On the other hand, if the plan is discontinued but his benefits are fully guaranteed by PBGC, would you agree that the financial statement of the plan is irrelevant to his concern?

MR. LANDSITTEL: With respect to the second question, if the plan was discontinued and the pension benefits were fully guaranteed, the financial statements are irrelevant. With respect to the first point, my biggest concern is with the accounting to the sponsoring employer. You can take a position that the plan, apart from its sponsor, is not significant. It might be a valid position to say that we ought not to have financial statements of the plan or at least that such statements are not particularly useful. However, ERSIA says otherwise. Furthermore plan participants can get some comfort in evaluating the security of his or her benefits by looking at the financial position communicated through the plan financial statements.

MR. THOMAS A. McCROSSON: In Mr. Landsittel's second case, he said the company had a large unfunded liability because it had just started its pension plan. Why would this particular employer establish a defined benefit plan if he knew that Mr. Landsittel would require inclusion in his balance sheet of an unfunded past service liability?

MR. LANDSITTEL: Obviously, there are economic concerns that enter into play when you propose changes in accounting principles. One such concern requiring careful attention is any negative impact that would be unwarranted by adoption of one principle over another. I am not qualified to evaluate that type of concern. I am qualified to set forth what optimately ought to be the proper accounting principles. If such principles cannot be adopted because of other economic effects that would make the cost of adoption more severe than the benefits, then I would opt for no adoption.

MR. TROWBRIDGE: Mr. McCrosson's question touches on a very important point. An employer would likely not establish a defined benefit plan, if he realized he would be required to place a large liability on his books. The employer has another choice. That is, establishing a defined contribution plan rather than a defined benefit plan. Mr. Landsittel's book makes a sharp differentiation between defined benefit plans and defined contribution plans. There is a difference between a defined benefit plan and a defined contribution plan. The real question, however, is whether there is a significant enough difference between those two to require such different accounting. The promises made under a defined benefit plan and the promises made under a defined contribution plan are different in detail, but they are not that much different in principle. The sponsoring employer of a defined benefit plan does not guarantee the benefit and he certainly does not guarantee the contributions. Neither does he guarantee the contributions under a defined contribution plan and he certainly does not guarantee the benefits. The promises to an employee under the two types of plans are different in form, but not really that different in substance. The accounting recommended by Mr. Landsittel for defined benefit plans would encourage employers to abandon defined benefit plans in favor of defined contribution plans to the disadvantage of American employees and American business.

MR. LAURENCE E. COWARD: In reading Mr. Landsittel's book, I noticed how he emphasizes that market value must be used for the assets. Surely it is then logical to require market valuation for liabilities. This would imply that all the actuary has to do is to determine how the benefits accrue under a particular plan and then shop the insurance companies for the cheapest rates covering accruing benefits.

Unless I am mistaken, this, together with Mr. Landsittel's suggestions for accounting for costs and liabilities, would leave nothing to do for the pension actuarial profession.

MR. LANDSITTEL: I believe that is oversimplification. With respect to Mr. Trowbridge's point, it is clear that there are defined contribution plans that take the form, in substance, of defined benefit plans, but other than these particular plans, defined contribution and defined benefit plans are sharply differentiated. In one case it is the employer or the trust that has the risk of ownership of the assets and in the other case, the risk is totally transferred to the employee. This is a very important difference that must be recognized in the accounting.

MR. DANIELS: The other half of your comment concerning comparison shopping at the insurance companies was pointed out by the FASB as, perhaps, one-stop shopping at the PBGC.

MR. DAVID R. CASS: I am terribly concerned about the style that has been evidenced in this session, because I consider it symptomatic of the relationships between the actuarial profession on the one hand and the users of actuarial information on the other. There has been a degree of sophisticated baiting from the floor to the panel. This is attempting perhaps to point out their inadequate knowledge of the totality of the pension mechanism, which may indeed have some validity. It would be far more hospitable for us as a profession if we were to welcome you new arrivals in pensionland, recognize that you have legitimate constituencies and recognize that there are legitimate needs for different types of information for those constituencies, and then attempt to advise you that there are certain operational problems in furnishing information needed to meet those legitimate needs and then create a dialogue. In that vein, I have two comments and a question for Mr. Landsittel.

Mr. Ten Eyck made the comment that he had been told that certain actuarial figures in a particular report do not mean anything. I have been guilty of the same sort of statement to clients and others in certain situations. Really, gentlemen, it is not very good public relations for our profession if we constantly advertise that we are giving out numbers that do not mean anything. Perhaps we really should be saying that certain values do not mean what you think them to mean, because perhaps of some difficulties in nomenclature. I frequently quote Alice in Wonderland and I think back to the White Queen who points out that "a word means exactly what I say, no more and no less." Unfortunately, it's not quite that simple in the world we live in.

The accountant, by his training, reports on events that have taken place. The actuary, by his training, estimates events that will take place. Gentlemen, perhaps the balance sheet is the uncomfortable meeting place.

The question then, Sir: Assume we have an employee whose service to date is 9 years and who has an historic pay base of $1000. The actuary is asked simply to place a liability on the benefits earned to date. How would you expect an actuary to deal with the following four aspects. The fact that these benefits will not vest until some additional service is rendered, the fact that the pension benefits for this service already rendered may, under the plan provisions be based on a future pay of $2000, $3000 or some other value rather than the historic $1000. Would you take into account, or have us take into account the fact that the service already rendered has validated conditional nonretirement benefits such as death benefits, the fact that many plans include provision for such items as subsidized early retirement, which if elected, will be more valuable than equivalent normal retirement benefits? Remember, our goal in furnishing the outside world with actuarial present value figures is to compute a single figure with a single name attached to it that means what people think it means.

MR. LANDSITTEL: With respect to the single figure, I am very sympathetic with Mr. Cass. One favorite point that accountants always like to make is that you cannot take financial statements piecemeal. The only way you can read financial statements from an auditor's standpoint is taking it as a whole. Therefore, I am very sympathetic that the actuarial profession would be concerned that you cannot pinpoint one single figure as the liability. Unfortunately we do have to set forth a balance sheet which must represent our best efforts at communicating liabilities that reflect properly the financial position and the results of operations when considered with the rest of the enterprise. Our method of measuring is not predicated on when vesting occurs, but rather when performance occurs. So, with respect to the first point that dealt with vesting, I would say vesting per se is not relevant. Otherwise, I would be trapped in a position where I could have a company that recognizes no compensation cost for employees with less than 10 years of service and then suddenly a large amount of compensation cost in the tenth year. I think we should recognize the cost as performance occurs apart from the vesting that the plan sets forth. The second point dealt with the possibility that the earnings base for prior service benefits would increase with future salary increases from $1000 to $2000, for example. We would like to measure the obligation for future benefits based on performance to date. In this measure we would be concerned with the best estimate of future inflationary or other increases in salary. This should be consistent with using a discount rate containing an implicit assumption of future inflation as well as an estimate of future events such as, mortality, turnover, disability, etc.