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FINANCIAL ACCOUNTING STANDARDS BOARD (FASB), DISCLOSURE, ACCOUNTING, AND REPORTING FOR PENSION PLANS

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Panelists: ROBERT J. MARZEC, GEORGE L. BERISH, E. ROBERT HOFFMAN***

1. Review of new standards

2. Relationship to "Employee Retirement Income Security Act" (ERISA) reporting standards

3. Impact on actuarial practice

4. Expectations of future change

MR. ROBIN G. HOLLOWAY: Our topic for this morning is FINANCIAL ACCOUNTING STANDARDS BOARD (FASB) DISCLOSURE, ACCOUNTING AND REPORTING FOR PENSION PLANS. This is an important and timely topic, and we have an interesting panel to discuss it -- an accountant, an actuary and a corporate pension officer.

The accountant is Robert J. Marzec, a Partner with Price Waterhouse & Co. here in Minneapolis. Bob will speak first and will address the topic from the accountant's point of view. He will outline the FASB requirements and describe why the accounting profession felt changes in the practices used by plan sponsors to disclose, account for and report on pension plans were necessary. Our second speaker is George L. Berish, an Assistant Vice President with the Edward H. Friend Company in Washington. George will describe the problems which the new accounting standards present to the actuary. But while the accountants may have issued the standards and actuaries must interpret them, it is the plan sponsor who bears the burden of complying with them. Our final speaker, E. Robert Hoffman, the Director of Benefit Finance for General Mills, will address the topic from the point of view of the plan sponsor. Bob is responsible for all financial aspects of pension plans at General Mills, where he has worked for 41 years.

Before I turn the program over to our panelists, I would like to give you a little background. We will be talking about two FASB Standards this morning. The first, issued in March of this year, is the Statement of Financial Accounting Standards No. 35, subtitled Accounting and Reporting by Defined Benefit Pension Plans. The second, issued a couple of weeks ago, is the Statement of Financial Accounting Standards No. 36, subtitled Disclosure of Pension Information.

FAS 35 sets forth generally accepted accounting principles for preparing the financial statements of a defined benefit pension plan. It does not require that such financial statements be prepared, but provides that if they are prepared, they follow the guidelines set forth in this Standard. In the view

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of the FASB, the primary purpose of a plan's financial statement is to enable plan participants to assess the plan's present and future ability to pay benefits when due. They believe that FAS 35 will accomplish this objective.

FAS 36 is an interim amendment to APB Opinion No. 8. It deals with the disclosure of information about defined benefit pension plans in the employer's financial statements, and must be followed by any plan sponsor who is required to prepare a financial statement for his business. Its primary purpose is to enable current and potential creditors and investors to evaluate the financial condition of a publicly-held company.

The accounting profession's concern about defined benefit pension plans began about fifteen years ago. Prior to that time, there were no generally accepted accounting principles for such plans, and the common practice was to expense the amount contributed. Because the contribution could vary widely from year to year, the pension expense also varied widely. Furthermore, if a company chose not to fund a pension plan, no expense provision was required until benefits were actually disbursed. Even worse, a company with a funded pension plan could use the plan to juggle its earnings -- increasing the contribution (and, therefore, the expense) in good years and reducing it in bad.

The result was Accounting Principles Board Opinion No. 8, issued in 1966, which states that if a company has a pension plan, it has an annual expense. It goes on to require that this expense be determined in accordance with a stated policy which is consistently applied, that the expense recognize the long-range cost of the plan, and that it not fluctuate widely from year to year. This meant that the expense and the amount actually contributed to the plan could differ. APB No. 8 also sets forth minimal required disclosure in a company's financial statements.

The situation did not change until 1974 when ERISA was passed. In the eyes of the accounting profession, ERISA gave them a mandate to audit the operations of pension plans. As they saw it, this required that they review a plan's financial statement and also suggested to many accountants that such a financial statement should be a miniature of the financial statement of the plan sponsor. This would require that the statement include liabilities as well as assets, thus leading the accountants into the realm of the actuary.

After a discussion memorandum designed to highlight the issues (released in 1973), public hearings (held in 1976), two exposure drafts (issued in 1977 and 1979), and a 4 to 3 vote among the Board, the FASB issued FAS No. 35 which requires that a plan's financial statement include not only the plan's assets, but also its liabilities, exhibits showing how and why the assets and liabilities changed during the year, and a number of footnotes which describe, among other things, the benefits provided by the plan.

But the FASB was not done yet. Prior to ERISA, a plan sponsor was generally not liable for any benefits provided by a pension plan except to the extent assets had been set aside in trust. ERISA changed all that -- a plan sponsor suddenly became liable for benefits not yet funded or even expensed. This change alarmed the financial community and led the FASB to decide that a reevaluation of APB No. 8 was in order. Accordingly, in March of this year, the FASB issued an exposure draft of an amendment to APB No. 8 and a "background paper" on Accounting for Pensions by Employers.

The FASB then surprised us by moving more quickly than it usually does. It issued FAS 36 only two months after the exposure draft had been released, but made it clear that FAS 36 is only a stopgap measure pending a complete review of accounting for pension plans. That review will begin with a discussion memorandum which outlines the issues, and will almost certainly be followed by public hearings and one or more exposure drafts. A final revision of APB No. 8 would appear to be several years away.

But that's enough background. Now I would like to turn to our first speaker, Bob Marzec, who will give you the accountant's point of view on the Statements.

MR. ROBERT J. MARZEC: I would like to preface all my remarks by saying that I'm not really here to defend or criticize FAS 35 or FAS 36. FAS 36 is relatively short and simple, and I think will be easy to apply. FAS 35 is very lengthy, complex and technical. Accordingly it will probably create a very lengthy, complex and technical financial statement. Since they've been issued so recently, we accountants really have no experience at this point in time in their applications and the practical problems we might encounter. So I'll try to simply review what's in FAS 35 and FAS 36.

FAS 35 - Accounting and Reporting by Defined Benefit Plans - Introduction

The statement establishes standards of financial accounting and reporting for the annual financial statements of a defined benefit pension plan. This is addressed to the Plan's participants, not to the employer or the company. It applies to all defined benefit plans in both the private and governmental sectors. The statement indicates that the primary objective of a plan's financial statements is to provide financial information about its ability to pay benefits when due. To accomplish this, FAS 35 prescribes the following information to be included in the financial statements:

a) statement of net assets available for benefits at the end of the year;

b) information regarding changes in net assets during the year;

c) the actuarial present value of accumulated plan benefits (beginning or end of year);

d) the significant effects of factors affecting the year-to-year change in the actuarial present value of accumulated plan benefits.

The primary objective of the statement is very controversial as evidenced by the fact that it was passed only by a four to three margin. Some of the dissenting points of view or comments were:

-Unattainable objectives were set by the plan financial statements (i.e., can a plan's ability to pay benefits when due at some remote future date be determined now on a spot comparison?). Such a determination may be subject to many other considerations not present in the financial statement. In other words, it really doesn't address the ability of the company to continue to fund the plan.

-What may be considered actuarial statements (present value of accumulated plan benefits) are included in all the basic financial statements and covered by the auditor's report, even though the

auditor is not an expert in actuarial matters. The dissenting members also stated that such information is subject to many uncertainties and is in essence "... less reliable than financial statement measurements in general". It should be noted that legislation is currently pending in Congress which would explicitly exclude actuarial information from the scope of an audit.

-The dissenters also stated that the disclosures were too detailed and voluminous to be reasonably useful to any plan participants.

FAS 35 - History

Prior to FAS 35, there were no authoratative accounting pronouncements addressing financial accounting and reporting for defined benefit plans. The project was placed on the FASB technical agenda in 1974. An exposure draft was issued in 1977, and there were 700 responses. Due to the need to analyze the responses and the complexity of the issues involved, the project was delayed. The FASB did work with the Department of Labor and actuaries to avoid any complex duplication and confusion. The revised exposure draft was issued in 1979, and 300 responses were received. FAS 35 was issued in March 1980.

FAS 35 - Significant Changes from the Exposure Draft of 1979

The use of averages or reasonable approximations (paragraph 29) for developing accumulated benefits is emphasized more in the final statement. The definition of contributions receivable is unchanged, but a footnote was added indicating that the existence of accrued pension costs is not itself adequate support for recording receivables. In other words, just because a company shows a payable to a pension plan, it doesn't necessarily mean that the plan has a receivable. A sentence was also added to paragraph 7 indicating that year-end benefit information is preferrable to beginning of the year information.

A minor change in the requirements for disclosing changes in accumulated benefits was made to the effect that if a statement or reconciliation form is used, other factors affecting the year-to-year change such as interest need not be separately identified but may be grouped in an "other" category. The minimum disclosures were the plan amendments, the plan changes, and changes in actuarial assumptions. The biggest change was a deferral for one year of the effective implementation date to plan years beginning after December 15, 1980.

FAS 35 - Accounting

Generally speaking, the accounting rules are very similar to the current practices. Normal GAAP and accrual basis accounting should be used. FAS 35 does not alter the options available under ERISA nor our current reporting practices with respect to modified cash accounting. Clients or companies may still choose to elect this option,and as accountants, we would recognize the inconsistency with GAAP in our opinion.

Contributions receivable are defined as the amounts due a plan at the reporting date pursuant to formal commitments as well as any legal or contractual requirements. A formal commitment may include:

-a resolution by the Board of Directors approving a specified contribution.

-a consistent pattern of making payments after the plan year and attributing such payments to the preceding year pursuant to an established funding policy.

-a deduction of a contribution for Federal Income Tax purposes on or before the reporting date.

-the employer's recognition of a contribution payable to the plan on his books.

Investments will be recorded at fair value at the reporting date. Since this is generally market value, there is really no change from the present requirements or no changes from ERISA. Insurance contracts are also presented in accordance with ERISA requirements. Information should be presented in detail to identify the types of investments. It should identify those without a ready market and should also identify the net appreciation or depreciation in fair value for each significant class of investment. By class of investment, I mean those that have a quoted market or those that have no quoted market when you try to calculate a fair value.

Another point is that there is no required separation of realized from unrealized gains or losses. Significant real estate transactions in which the plan sponsor, employer, or employee organizations are jointly involved should be disclosed. It's important to note that disclosures in supplemental schedules do not eliminate the need for disclosures in the basic financial statements. If it is just included through supplemental statements, it's not in compliance with FAS 35 (although FAS 35 has no effect on ERISA or Form 5500). FAS 35 really doesn't address the reporting of plan investments in master trusts. And as accountants, I think that we continue to believe that the unit of participation reporting is probably appropriate.

The liability area would be the same as it has always been. Probably the most key area to all of you would be the accumulated plan benefit. Based on discussion in FAS 35, it appears that the American Academy of Actuaries has generally accepted the method of measuring plan obligations detailed in FAS 35. The resulting amount should be suitable for inclusion in the DOL reporting on Schedule B, Form 5500. A problem with accumulated plan benefits is that such information was not contemplated in ERISA as an essential part of the financial statements. Accordingly, our involvement may cause a resurfacing of communication problems. As I mentioned earlier, there is legislation currently pending in Congress which would explicitly exclude the actuarial information from the scope of the audit. Armed with these facts, many plan administrators may really agree with the actuaries that the accountants probably have gone a little too far.

FAS 35 - Reporting

Prior to FAS 35, pension plan financial reporting was unstructured and, typically, reports followed the Form 5500 format. I think FAS 35 will undoubtedly improve the consistency of classifications and footnote disclosures. A more significant change from the current practice involves the level of detailed reporting of investment gains and losses. As I mentioned, you do not have to segregate the unrealized and realized gains and losses. Some clients may still elect to continue disclosure at original cost and separate realized from unrealized gains and losses. This would make a very confusing statement.

The basic statements include a statement of net assets available That's a straight-forward balance sheet similar to the Form 5500.

You would also have a statement of changes in net assets available for benefits. I look at this as being very similar to an income statement or P & L. This statement must include enough detail to identify significant changes during the year. Some of the minimum disclosures in this statement would be: net appreciation (depreciation) for each class of investment; other investment income such as interest, dividends and rent; employer and employee contributions; benefits paid directly to participants; payments to insurance companies; and administrative expenses.

The next statement would include the actuarial present value of accumulated plan benefits. The plan provisions should be used to measure these accumulated benefits. If there is a specified amount earned for each year of service, that would be used in the calculation. If not, you may use a ratio method (years of service to required years) to measure accumulated benefits. Other specific measurement criteria included in paragraph 18 would be: use of the history of pay and service; increased benefits for specific years of service; early retirement; death benefits; disability benefits; mortality rates; and automatic cost of living adjustments that are expected to occur in the future. There is no recognition of future inflation in calculating the liability associated with this present value of accumulated benefits. There is an attempt here to make it a liability at a point in time. If you anticipate wage increases in the future, they should not be built into this calculation until the point in time when that future increase in compensation is actually earned. I draw the parallel to price increases -- you don't record the price increase this year, you increase it in the year that the price increase occurs.

Other assumptions used in computing the value of accumulated benefits include assuming its an ongoing plan and using some realistic rate of return (an expected rate to be earned over the period the benefits are deferred). Inflation shouldn't be built into this factor unless you have a contractual obligation. That's why I believe they made the exception for cost of living adjustments that are already contracted. You would make assumptions regarding administrative expenses and any other assumptions that reflect the best estimate of the plan's future experience. The presentation of this statement would be to include the liability for those who are vested and receiving benefits currently, to disclose the liability for those who are vested and not receiving benefits currently, and to disclose the liability for the non-vested portion. This may be a separate statement. However, I think the preferrable method would be to include this with the statement of assets available. I think it ties the two together. It gives the assets available to the participants, and it would show the liablities against those assets.

The last statement that's required would show changes in the actuarial present value of accumulated plan benefits. This could be a separate statement or it could be combined with the changes in net assets. Any changes in actuarial assumptions to reflect changes in experience are considered changes in estimates and are accounted for in the current year. There would be no restatement of pro forma.

At a minimum you would disclose any amendments to the plan, the effect of the amendments to the plan, the effect of changes in the nature of the plan (such as a spin-off or a merger), and the effect of any changes in actuarial assumptions. Those will be identified separately. You would also segregate

benefits accumulated during the year (including actuarial gains and losses). You would identify any increase in benefits during the current year possibly due to a change in the discount period. You would also identify the benefits that have to be paid during the year. These benefits would exclude payments by an insurance company but would include payments to an insurance company.

Other disclosures in the financial statements would be very similar to existing disclosures. Through the footnotes you would have a plan description, you would discuss plan amendments, priority order, PBGC benefit guarantees, funding policies, tax status, and you would identify any transactions over 5% of the assets.

FAS 35 - Comments

FAS 35 does allow the use of beginning of the year accumulated plan benefits. However, it also indicates that if you use beginning of the year accumulated plan benefits, you then must compare these to beginning of the year assets. Then the beginning of the year assets must tie into changes in assets from the prior year. So what you're really doing is backing up the entire balance sheet by one year -- from the end of the year to the beginning of the year -- while not necessarily changing the income statement or the earnings of the current year. I think to use beginning of the year accumulated benefit information would be a totally confusing statement. Hopefully everyone will attempt to apply paragraph 29 which allows for the use of averages and a reasonable approximation. If only the beginning of the year information is available, it is possible to use approximations and averages to bring that information forward to end of the year information. Then you could complete your financial statement all based upon one point in time.

FAS 35 is directed toward participants and the assets available to satisfy their claims or their future benefits. I really don't think that these financial statements would be presented to the plan participants. I think it would be much more complex than the statements that now exist, which are already complex. I would anticipate that most plans would just continue to distribute financial information through some type of a plan summary. I might point out that the ERISA requirements are still the same. This plan does not change the way insurance contracts are carried in Schedule A (which isn't necessarily at market value). The actuarial present value of accumulated benefits that we've talked about calculating through FAS 35 should now become part of Schedule B. It doesn't change the ERISA reporting. However, I think FAS 35 is attempting to dictate how you will compute that -- with the result hopefully being some uniformity.

One last comment on FAS 35 is that it does not require an audit. You still can have the limited scope recording with regard to assets, or you can have the modified cash approach. The only thing FAS 35 says is that if you prepare financial statements, you must follow this format. It tells you how the present values of benefits should be calculated, but there is no requirement to have the audit.

FAS 36 - Disclosure of Pension Information - Introduction

As mentioned earlier, the Financial Accounting Standards Board is currently addressing the entire area of employer's accounting for pensions and retirement benefits. However, as an interim measure - becuase there is a lack of comparable disclosures - FAS 36 was issued. FAS 36 addresses the employer or the company and not the plan or the participants.

FAS 36 Requirements

The disclosures which are required under FAS 36 are almost identical to the present disclosures required under APB No. 8. The required disclosures include: a statement that a pension plan exists, identifying or describing the employee groups covered; a statement of the company's accounting and funding policies; a disclosure of the provision for pension expense for the period; and a disclosure of the nature and effect of significant matters affecting comparability for all periods presented, such as changes in accounting methods (actuarial cost methods, amortization of past and prior service costs), changes in assumptions, and adoptions or amendments to the plan.

For a defined benefit pension plan, the employer will disclose the following (in accordance with FAS 35): the actuarial present value of vested accumulated plan benefits; the actuarial present value of non-vested accumulated plan benefits; the plan net assets available for these benefits; the assumed rate of return used in determining the actuarial present value of vested and non-vested accumulated plan benefits; and the date at which the benefit information was determined. The data may be presented in total for all plans, separately, or in some sub-aggregations that would be considered most meaningful. In some instances regarding multi-employer plans, the information may not be determinable and the requirements are waived with regard to that plan.

FAS 36 - Effective Date

This information is required for annual financial statements for fiscal years beginning after December 15, 1979, or for any complete set of interim financial statements issued after June 30, 1980. The information is not required in statements for years beginning before the effective date. I believe the interpretation would be to not require this information for prior years. If you're disclosing this information for December 31, 1980 companies, you should have comparative numbers for 1979, but the disclosures are not required for 1979. However, if you do disclose the numbers for 1979, they should be comparable. The effective date for FAS 35 was years beginning after December 15, 1980. This means that the same calculation of the present value of accumulated benefits is really going to have to be prepared by the end of 1980. Many companies may have to use beginning of the year rather than end of the year information.

FAS 36 - Changes from Exposure Draft

Originally the exposure draft required a description of significant actuarial assumptions, which was changed to requiring only the assumed rates of return. Comments indicated that the actuarial assumptions can be highly technical and complex, so they decided to disclose only the assumed interest rates. It also dropped requirements to disclose only information regarding "other post-retirement benefits" because the topic is included within the scope of their current project and it would be premature to require certain disclosures. Further the "Exposure Draft" required that employers with more than one defined benefit plan group those plans as to (a) those with accumulated plan benefits exceeding assets and (b) those plans with assets exceeding the benefits. The final statement permits but does not require such a presentation.

FAS 36 - Comments

As I mentioned, FAS 36 is considered temporary, and they haven't yet addressed the matter of symmetry between FAS 35 and FAS 36. I would assume that the way you calculate your present value for disclosure on FAS 36 would be the same as for FAS 35. But there is not necessarily a symmetry with what's used and your funding policies. This should all be adjusted at a future date. I would say that FAS 36 should bring some consistency to disclosure in financial statements. We also understand that the SEC would be dropping their required disclosures of unfunded prior service costs whenever FAS 36 disclosure is followed.

One other comment would be that I think because FAS 36 was considered temporary, an attempt was made to keep it simple. For defined benefit plans, the actuarial present value of accumulated benefits and net assets available come directly from FAS 35. Lastly, if you are not under ERISA (for example, pension plans in foreign countries), or the information is not otherwise determined already, you don't have to follow FAS 36. You can return to applying APB No. 8 disclosures. It doesn't spell that out but I think that the example shows that's what they've done.

MR. GEORGE L. BERISH: Let me begin by restating that there are two issues before us: Standard 35 and 36. Standard 35 applies to "the Plan" which is an animal that has been around some time but until recently had successfully kept hidden those attributes that qualify it as an entity requiring its own complete set of financial statements. Standard 36 applies to the method of reporting the financial impact of "the Plan" within the financial reports of the sponsor.

Since we have only a limited amount of time available today and since Standard 36 is only an interim measure, I would like to limit my remarks to Standard 35.

What then about Standard 35?

I'd like to address this on two levels.

First, as a professional actuary I see a requirement for calculating a number that I believe is complex, time consuming and, therefore, expensive to calculate. I believe there are other simpler numbers that might have served equally well. Since my profession, through Academy Opinions 1 and 2, has already embraced this approach, however, there is little left to be said on the matter.

Second, as an actuary who considers himself a member of a profession and who believes that we as professionals carry with us an obligation to serve the public as well as our clients, I am troubled by Standard 35. Simply stated, I don't believe the public is well served by this endeavor and I am disappointed in the actuarial and accounting professions for not providing a better product.

In support of this statement I would like to offer the reasons for my dissatisfaction and what I believe is a better approach.

First, however I'd like to note that to avoid overlap I will avoid many of the excellent points I believe Mr. Hoffman will be raising, including the dissenting opinion.

Returning to the reasons for my dissatisfaction with the outcome, I'd like to note there are many but I will cover only four which I find most important.

First, I am troubled by the muddling of motives that occurred between the drafts and the final. Originally, the objective was to provide participants with the ability to assess their benefit security -- certainly this is a goal worthy of all our support.

At the risk of being accused of Monday morning quarterbacking, it was clear to me from the start that simply creating a new, complex and duplicative financial report would not meet the stated objective. Obviously many respondents and finally the Board agreed.

If at that point the Board had retained the original objective and sought a better approach they would have retained my support.

They did not. Instead they retained the approach and changed the objective. In the final version, "participants" have been displaced by anyone "having an existing or potential relationship to the employer" and the "assessment of benefit security" has been displaced by the "assessment of the ability of the Plan to pay present and future benefits." These changes are not minor.

As a result, I am prompted to ask if we have not seen a change in perspective from a problem in need of a solution to a solution in need of a problem?

This brings me to my second troubling point. I have grown up professionally post-ERISA and if there is one thing I believe ERISA has made absolutely clear it is that "the Plan" belongs to the participants. Therefore, if a separate complete financial statement can be justified for "the Plan," it should respond solely to the needs of the participant -- the interest of all other parties consist only of the financial effect of "the Plan" on the employer. Their needs will be met by Standard 36 when it is completed.

In giving up the interests of the participants as the primary justification for the new statement I believe the Board has given up the only justification.

The third item troubling me is the order in which the issues were addressed. If the problem at hand is given a little thought it should be apparent that the primary question is "can this employer maintain this plan on an ongoing basis?" This is the primary question raised in adopting a plan, amending it, or accepting employment because of it. "Ongoing" is also stressed throughout Standard 35.

The question of what happens at termination, which is the only time "the Plan's" ability to pay present and future benefits is more important than the employer's ability to support the plan on an on-going basis, is an important contingency that should be examined, but it is still a secondary consideration. In today's high rates of inflation even a fully funded accrued benefit which would be frozen at termination is not much of a substitute for an ongoing plan supported by a financially strong employer.

If the employer's ability to maintain "the Plan" on an ongoing basis is the primary question, and the Board apparently didn't have sufficient resources to complete Standards 35 and 36 simultaneously, why then wasn't 36 (which addresses the most important question) tackled first? Perhaps if they had, they would have found the need for expanding the reporting requirements for "the Plan" unnecessary.

Finally, since when has "because the Board considered the matter and thinks it's right" become a sufficient reason for taking an action as disruptive, potentially expensive and important -- important in the sense of pre-empting any better approach -- as Standard 35? Where is the empirical data? This is especially true where there was considerable question raised as to whether the approach accomplished its stated objective. Why for example wouldn't it have been more reasonable to reconstruct the required reports for Studebaker, Chrysler, a random selection of terminated plans, and a random selection of plans that have operated without problems or any threat of future problems. I'd like to think that had it been given the opportunity, the Academy would have enthusiastically cooperated in such an endeavor.

Then it would have been possible to assess whether any clear correlation between the information in the reporting rquirements of Standard 35 and the ability to pay present and future benefits could be demonstrated. And more importantly, whether other existing information would have served equally well or better.

Obviously I believe there is a better solution. Actually, I believe there are several but I would like to present one course of action for your consideration. It consists of three immediate steps and one long term goal.

First, the Academy should review the requirements for reporting under ERISA, Standard 35 and soon under PERISA to determine if the methods stated in Academy Opinions 1 and 2 meet all three requirements. I believe they do, but I believe it is the actuarial profession's responsibility, as the only profession qualified to do so, to answer that question conclusively.

Second, I believe the discussion contained in Standard 35 raises expectations among the general public that are not met by the information required by the Standard. I believe the Academy should review this problem and express its opinion publicly. Either the discussion and the expectations it raises are appropriate or they are not. If they are, they should be endorsed. If they are not, the Academy should prepare a statement to that effect and require that its members not allow any values they calculate to be used without such a statement being included as a footnote. This is fully consistent with current professional guidelines that prohibit us from allowing our work to be used for purposes for which it was not intended or is not well suited.

And third, the Academy should offer every assistance and encouragement to its task force on pension terminology to complete its work and issue its report. It should then enforce consistent usage of the agreed upon terminology by its members and vigorously pursue its consistent usage in ERISA, PERISA, Standard 35 and 36, etc. As a minimum, the public deserves that the same values, whatever purpose they may or may not serve, should be identified by the same terminology wherever encountered.

As for the long term solution. I'd like to speak for the participant who somehow never gets invited to these discussions. I believe the participants would be well served and well satisfied if we could find a way to provide an annual statement showing:

a. the total accrued benefit
b. the vested accrued benefit

    1. covered by current assets
    2. covered by PBGC guarantees, if any
    3. contingent on continued future employer contributions.

This together with Standard 36 (or the annual actuarial report) to allow assessment of the risk associated with the last item above would better inform an interested employee than all of the information they are now receiving. Obviously, this is a simple solution which is impossible for current implementation at anywhere near reasonable expense. The current asset allocation rules, for example, are a nearly impossible hurdle.

That is no reason not to correct the situation. For once we should start with the participants' needs and adjust practices, procedures and legislation to meet them. Therefore, I'd like to see the Academy, in cooperation with the accounting and legal professions, as well as public interest groups representing participants, design a solution to this problem and prepare and sell whatever legislation may be required to allow its implementation at an affordable cost to the employer.

MR. E. ROBERT HOFFMAN: Since this is a three-pronged panel talking about the FASB standards, I would like to approach the subject from the point of view of the corporate pension plan sponsor. I hope this approach will give somewhat of a different perspective to the subject; that is, compared to the way it is perceived by either public accountants or actuaries.

I believe many people in corporate pension financial administration will view the standards as a case of overkill. By that I mean, the new rules try to accomplish too much and thus defeat their primary objective. As a matter of fact, three of the members of the Financial Accounting Standards Board seem to hold this very view. The minority report accompanying the report includes the following statements:

"...it establishes an unattainable objective for the plan's financial statements, it improperly includes what (the minority) consider to be actuarial statements within the financial statements rather than as supplementary information...and it prescribes detailed reporting beyond reasonable usefulness to plan participants.

"(The minority) believe that the stated primary objective of a pension plan's financial statements...'to provide financial information that is useful in assessing the plan's present and future ability to pay benefits when due,' promises more than can be achieved and will foster unreasonable expectations. In most cases the plan's ability to pay benefits will depend primarily on the continuing support and financial health of the plan sponsor far into the future. In (the minority's) view, users are not well served by an objective and a presentation that suggest a spot comparison of the estimated present value of benefits to the current market valuation of assets held is a relevant or reliable indicator of a plan's ability to pay benefits when due."

I think it is well to note that the final standards were adopted within the Board by a vote of only 4-3.

In brief, it appears that most corporate sponsors are going to feel that the reporting requirements and the related footnotes give an impression of reality that does not exist. In addition, they seem unduly complex, and probably of little practical use to the average participant.

In the discussion section of the report a footnote reference is made to the Harris survey which indicated that most plan participants would like to have more information about the financial aspects of their pension plans. I feel

reasonably convinced that, if the people responding affirmatively to that question had been given a set of the statements and related footnotes as prepared under FASB #35, most participants would have considered they had received much more than they could really digest.

It would seem that even the writers of the rules recognize this problem, since in paragraphs 50 and 158 they mention the need to educate "some" users of the proposed material. They do not explain the educational forum that is to be used to accomplish this purpose. (I hope plan sponsors do not have to start seminars for participants!)

In general, therefore, it appears that the complexity of the footnotes, the unfamiliar and technical terms used, the use of the statement form of presentation, the cross references and complexity of the footnotes, including the long and involved sentences used, the qualifications of most of the statements - all these severely limit the use of this type of reporting to the plan participants. Frankly, General Mills would not distribute this report to our participants. Yet, oddly enough, its the participants who are supposed to be served and to whom the statements are tailored according to the Financial Accounting Standards themselves.

The background paragraphs suggest that additional information is really needed: for example, information on the pension plan's financial status over a period of years, information on the plan sponsor's financial position and funding patterns. However, it is questionable whether the average participant could accumulate such data and it is unlikely even if accumulated by the sponsor the participant would be able or be inclined to use it.

However, having said all of these things of a somewhat unfavorable nature about the standards, we feel that there are some good things in the new rules, particularly when compared to the earlier exposure draft issued by the Board.

One of these is the use of market valuation of assets with the total exclusion of cost data. Plan sponsors using active investment managers realize that the comparison of cost and market and the segregation of realized versus unrealized gains or losses has little meaning. In fact, it tends to complicate the preparation of financial statements and casts implications on the meaning of the data which is often quite misleading.

A second factor that is desirable is the tie-in with the ERISA reporting requirements. As we understand it, the actuarial present value of accumulated plan benefits as computed under the accounting standards will be the same number that is reported on the Form 5500 to the Department of Labor. Obviously the use of identical computations will improve the comparability of the data as well as reducing some of the costs of accumulating the information.

A third area which appears favorable to the pension plan sponsor is the flexibility of presenting benefit information either in statement form or by means of a narrative, as well as the relaxation of some of the rigid rules which were in the exposure draft. For example, it is possible to use estimates; flexibility is permitted in the realm of the accrual accounting particularly in the use of trade date versus settlement date accounting; and in other areas.

Accordingly, in comparison with previous exposure drafts, it appears that improvements in the reporting of information have been sought after and do appear in the final set of rules.

Nevertheless, there are a number of bothersome areas which we feel are going to affect the corporate pension plan's sponsor.

The first of these areas is in the use of interest rates in discounting the actuarial present value of accumulated plan benefits. The rules specifically require the use of an explicit rate rather than the rate used in the computation of contributions - which may be an implicit rate taken in conjunction with the other actuarial assumptions. In fact, the language of the standards seems to encourage the use of different rates for these two purposes.

However, it is not so much the use of the explicit interest rate that is bothersome, as is the fact that this rate will change from year-to-year. For example, the sample footnote shows rate changes over a 3-year period from 7% to 6.75% and to 6.25%. This would seem to clearly indicate that under certain circumstances the interest rate assumption is expected to change from year-to-year. Paragraphs 187-197 of the discussion talk about the interest rate assumption. (These are not a part of the formal opinion.) These paragraphs, on the one hand, seem to say that the rate used to discount liabilities is related to the return on the securities in the portfolio; on the other hand, they seem to indicate that longer term interest rate trends should influence the rate chosen. But they also seem to prohibit any forecasting of the nature of such long-term trends. They talk about changes in the portfolio from lower yielding to higher yielding bonds, but do not mention equities. To me these paragraphs are "fuzzy". All in all, we find the matter of the interest rate to be used to be of considerable concern.

Of course, the impact of changes in interest rates on the present value of accumulated benefits is substantial. Is it reasonable for a participant to believe that his benefit security has improved substantially because the discount factor has changed, say from 6% to 7%? Nevertheless, the statements required by the accounting standards would lead to this conclusion.

As a result, we feel that it is extremely likely that, at least within the present inflationary and relatively high interest rate environment, higher interest rates will be used for this comparison than have ever been used in the past.

It is important to note that Financial Accounting Standards Number 36 prescribes that the actuarial present value of accumulated plan benefits and the value of the plan's assets available for benefits be taken directly from the plan's financial statements and used without modification in the financial statements of the plan sponsor. Because of the plan sponsor's natural desire to avoid overstating the unfunded accrued and vested liabilities in the corporation's reports, it seems likely that there will be a trend toward the use of higher interest rates than are currently being used.

Peat, Marwick, Mitchell in a recent Benefits Letter, commenting on Statements 35 and 36, stated:

"The requirement that actuarial information in plan financial statements be based upon explicit assumptions will encourage many plan sponsors, the great majority of whom now use implicit assumptions to determine their accrual pension expense, to review the actuarial basis and adopt explicit assumptions that reflect more realistically the impact of inflation on each actuarial assumption that is influenced by economic forces."

In a recent survey made by Greenwich Research of a large sample of the Fortune 1000 industrials, 78% of the companies used an interest assumption of less than 7% and, in fact, 32% used an assumption under 6%. We might well anticipate changes in the interest rates used over a period of time and a reduction in reported unfunded liabilities by plan sponsors on their financial statements.

Other areas within the opinion are also troublesome to us.

We believe that the footnotes tend to cover the waterfront and try to disclose much more information than is needed or that the average reader of the statements is able or willing to soak up.

Of course, the Board has really taken a cop-out approach to the valuation of insurance contracts by indicating they should be valued at whatever method is used for reporting to the federal government.

The determination of when an account receivable should be shown as an asset on the plan's financial statements seems to us rather difficult to follow and subject to varying interpretations.

In the case of General Mills, we have some 30 or more plans for which the financial assets are administered under a master trust arrangement so that the individual plans participate in a number of pooled investment vehicles. The breakout of some of the sources of income and expense in accordance with the Accounting Standards Board's requirements is difficult if not impossible to make under such arrangement. It appears that neither the FASB nor the Department of Labor understands how a master trust arrangement for a group of pension plans is handled.

It has been already noted that the instructions go into considerable detail to prescribe actuarial methods and procedures. As a plan sponsor, we question why we hire actuaries as experts, and then must pay public accountants to second guess their work.

And finally we see a dilemma for many small plans who are interested in verification of assets and transactions without paying the public accountants the fees that I am sure will be involved in reviewing actuarial work and preparing extensive footnotes that are necessary under the regulations.

In summary, as a representative of a pension plan sponsor, I feel that FASB #35 goes far beyond what is really necessary to disclose the financial aspects of pension plans and far beyond what the non-technical user of this information can understand and assimilate.

DISCUSSION.

MR. HENRY BRIGHT: As I understand it, any employer with over 100 participants in the plan will have to follow FAS 35 because he's going to have to file a financial statement with Form 5500. On the other hand, any employer with fewer than 100 participants does not have to do that. I just want to verify that my understanding is correct.

MR. HOLLOWAY: I believe that is correct.

MR. MARZEC: I would like to comment that FAS 35 doesn't necessarily require a full audit. You can still have the limited scope examination provided for in ERISA. You can still even use the cash basis. The only things the auditor will say are -- 1) his scope has been restricted, and 2) if you're on a modified cash basis, the statements aren't in accordance with GAAP.

MR. BRIGHT: Are you saying that the statement for a plan of more than 100 participants does not necessarily have to follow FAS 35?

MR. MARZEC: I don't want to make that statement explicitly since we don't have practical experience with this yet. I don't feel the rules have changed. Currently under ERISA, you can use the limited scope approach. The auditors would look at the statement and write an opinion saying they did everything except look at the plan assets. You can continue to report in the same way. Your statement format will follow FAS 35 but the auditor may not audit the entire statement.

MR. BRIGHT: I though that ERISA said that the financial statement has to be prepared in accordance with generally accepted accounting principles.

MR. MARZEC: I think there are exceptions to that. For example, we do not require generally accepted accounting principles for plans using a modified cash basis. Because FAS 35 is so current, I would like to qualify many of my statements. I think FAS 35 will change the format of these plans. I don't think that FAS 35 requires everyone to have an audit. You cannot do that. I do not think that FAS 35 precludes you from using the limited scope method allowed by ERISA.

MR. THOMAS T. LONERGAN: I was interested in Mr. Berish's comments concerning Statement 35. It seems to me that we've already had the opportunity to comment on Statement 35 through the Committee on Actuarial Principles and Practices of the Academy. And, to my understanding, this Committee did have significant input into Statement 35. Although I disagree with the results and recommendations by this Committee and Statement 35, it seems to me that the water is over the dam and there's really not much we can do with respect to this Statement.

With respect to selecting an explicit interest assumption, I think we have to break the interest assumption down into components. For instance, we can think of the interest assumption as consisting of: a real rate of return; an equity risk element; an inflation element; an element reflecting the existence of investment objectives and good communication between the fund manager, plan sponsor, and actuary; and possibly also an expense element. There may even be other elements that you might want to add. You can then come up with an explicit interest assumption that you can be comfortable with and justify. For instance, you could come up with a range for an explicit interest assumption of 9%-12%. Therefore, you could argue that your selection of the 9% assumption is reasonable and you could support that. With respect to the possible change from year-to-year, hopefully, we can avoid that by saying we are picking the interest rate for a long period (specifically over the period during which benefits are deferred). Therefore, we could be comfortable with an explicit interest assumption for purposes of Statement 35 and 36 for at lease a three year period. This would avoid the possibility of changing the interest assumption every year.

MR. BERISH: Are you aware of any formal statement from the Academy with reapect to FAS 35? Secondly, have you seen the latest issue of the Academy Newsletter where they say they were asked but they certainly have withheld endorsement?

MR. LONERGAN: It is my understanding that Interpretation 1 and Interpretation 2 were a response to the exposure drafts and had considerable input with respect to what Statement 35 is today.

MR. BERISH: I think we're just under different understandings. I think if you look in your recent Academy Newsletter you'll see that they specifically mention that they agree with the method of calculating but they don't agree with the results.

MR. JOSEPH P. McALLISTER: I was going to say essentially the same thing Mr. Berish did. Both the introductory statement when FAS 35 was introduced and a lot of the publicity concerning it have emphasized the cooperation of the actuarial profession and the Department of Labor with the accounting profession. However, this most recent publication of the Academy states that in fact the Academy's position all along has been that actuarial numbers should not be included in financial statements of this sort, but that if the accountants decided that these numbers had to be included, then here was a way according to Interpretations 1 and 2 of arriving at them. I think that the statement that the Academy agrees that this is a good thing, is a misstatement of the actual situation.

I hope that we will not take the position that this is set in stone and can't be changed. I encourage anybody here who has not done so to read the dissent---I think that it is by far the clearest thinking anywhere in the publication. It summarizes admirably, in just two or three pages, a number of points which many of us who responded to both drafts said at greater length and in some heat. The statutory underpinnings for the whole house of cards seem pretty weak. The idea that the results will be helpful to individual participants is to me just ludicrous. The information gives an appearance of substance, but it's really only of peripheral significance.

Generally, I'm philosophically opposed to any legislative involvement in restricting a profession's exercise of its professional responsibilities. I've got to say that in this particular case, I think the proposed legislation to require the accountants to accept the actuary's numbers is a reasonable response to what I see as a great over-reaching by the accounting profession of its professional responsibilities, so I encourage your support of that legislation.

Overall, it seems to me that Statement 35 is costly and provides very little benefit. We can compute all the numbers that are required, but I question the need or desirability for them. It seems to me that this statement just becomes part of the bureaucracy that we have to struggle with every day. We have enough of that from the government without contributing to it.

These requirements create an unnecessary drag on productivity, and, as Mr. Hoffman mentioned, one more problem for the private plan system. I think the private plan system is a desirable approach to the provision of retirement benefits, and we ought to be trying to maintain it. I'm not convinced that this statement does that.

MR. HOLLOWAY: Henry, weren't you involved in some of the Academy committees that reviewed these areas?

MR. BRIGHT: Yes. Firstly, I just want to clarify a point. I think it is clear that the Academy as such has all along been clearly and consistently opposed to the kind of result that we have in FAS 35 (the inclusion of the actuarial numbers in the financial statement). There was a fairly extensive and well-written brief or presentation prepared on behalf of the Academy and submitted to the FASB subsequent to the July 1979 exposure draft. The Academy Committee on Pension Principles and Practices did not make or prepare any official presentation on behalf of the Academy to the FASB. The individual members in that committee may have done so on their own, but the Committee as such did not.

The Committee, however, did develop Interpretations 1 and 2. Interpretation 1 was developed before this issue arose and related simply to the means of determining the present value of vested benefits. Really, the context of that was how to do it under the old APB Opinion #8. The principles in that Interpretation go back to 1970. Interpretation 2 was drafted in anticipation of the promulgation of a requirement for the present value of accrued benefits. It was the feeling that if this was going to be required, the actuarial profession ought to be prescribing the proper way to do it. One of the positive results of that was that it was not required to project salaries for the computation of accumulated benefits. I think without Interpretation 2 that would have been required.

MR. LONERGAN: I would like to clarify my earlier remarks. It is true that the Academy had initially taken the position, and continues to take it, that the Statement should not include the value of accrued and vested benefits. However, I think that battle with the accountants was lost very early. When we had an opportunity to describe what the valuation of accrued and vested benefits should be, we really went in the wrong direction by going into Interpretation 2. I think that it would be generally true that most actuaries have not used this ongoing plan approach in calculating the value of accrued and vested benefits, but rather an approach where you calculate the value of accrued and vested benefits on a plan termination basis and possibly use the Funding Standard Account as a measure of the ongoing ability of the plan sponsor to continue to fund the plan. So, I feel in this way the Academy really lost an opportunity and took the wrong direction as they provided input with respect to Statement 35.

MR. HOLLOWAY: Our time is up. I want to thank the panelists, especially our two guests, Bob Hoffman and Bob Marzec.