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

*Moderator: ROBERT L. BEIN. Panelists: WARREN D. ORLOFF, JULES M. CASSEL\**

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. JULES M. CASSEL: Good morning. I'm very pleased to be here today to talk with you about the Financial Accounting Standards Board's (FASB) recently issued Statement No. 35 on accounting and reporting by defined benefit pension plans. For several years, the Financial Accounting Standards Board has been engaged in examining financial accounting and reporting standards related to pensions, including those applicable to reporting by plans and those applicable to reporting by employers. During that time, the Board and its staff have on many occasions worked closely with members of the actuarial profession. Having personally devoted a major portion of my service at the Board to the area of pensions, my knowledge of a few of the rudiments of actuarial science has significantly improved, and my respect for your profession has grown as well.

For many years before the issuance of FASB Statement 35, the accountants' standards for pensions seldom practiced what they preached. The pronouncements that preceded Accounting Principles Board Opinion No. 8, and No. 8 itself, preached that accounting by the employer for pension expense and liabilities related to its sponsored pension plans was separate and distinct from actuarial costing for funding purposes. In practice, however, the accountants' standards have utilized the funding methodologies for expense measurement and for certain disclosures related to the status of plans. In Statement 35 we have broken that mold. The status of plans for financial reporting purposes is to be determined by an actuarial methodology designed not for funding purposes but rather designed for financial reporting purposes.

The cooperative efforts of the Department of Labor (DOL), the American Academy of Actuaries, and the FASB in the development of Form 5500 of the DOL, Interpretation 2 of the Academy, and Statement 35 of the FASB are just the beginning of a needed

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\*Mr. Cassel, not a member of the Society, is Project Manager, Financial Accounting Standards Board.

long-term cooperative effort. An important point that should not be lost sight of is the fact that after years of accountants and actuaries talking at each other, they are finally talking to each other. At least at the standard-setting level, each is better understanding the other's language and methodology. The educational process is next. Not only must the involved professionals--be they actuaries, auditors, or regulators--become knowledgeable about the new requirements, we must educate the reporters and users of this information as to what it means and what it does not mean.

### General Background of Pension Plan Project

The Board's efforts to establish accounting and reporting standards for defined benefit pension plans began with the passage of ERISA which requires annual reporting for plans, including (for plans with 100 or more participants) financial statements in conformity with generally accepted accounting principles.

ERISA does not apply to plans of state and local governments, but Statement 35 does apply to those plans. It applies to small as well as to large plans.

Until now, neither the Board nor any of its predecessors had issued authoritative accounting standards applicable specifically to pension plans. As a result, the bases and formats of financial reporting by those plans varied widely. In some cases, financial reports included no information about participants' benefits. In other cases, information was extracted from the actuary's report and included in the financial report, often without understanding as to its meaning and, therefore, without explanation to the user of the financial report.

FASB Statement 35 establishes accounting and reporting standards designed to correct those shortcomings. It is important to note, however, that Statement 35 does not require the preparation, distribution, or attestation of financial statements for any plan. It does establish standards for those plans that do wish, or are required, to issue financial statements in accordance with generally accepted accounting principles.

### Overview of Statement No. 35

Before discussing the reasoning that underlies Statement 35, I think it may be useful to highlight briefly the Statement's basic requirements.

The Board began its consideration of plan financial reporting by identifying the primary objective of plan financial statements.

We decided that the primary objective should be to provide financial information that is useful in assessing the plan's present and future ability to pay benefits when due. We believe that providing such information is responsive to the information needs of participants and should also be useful to those who advise or represent participants, to investors and creditors of the employer(s), and to those responsible for funding the plan, among others.

The Board recognizes, however, that plan financial statements cannot provide all the information needed in assessing the plan's present and future ability to pay benefits when due. Plan financial statements should be used along with other pertinent information, including information about the financial condition of the plan sponsor and, for private plans, the guaranty of the PBGC.

To accomplish the primary objective, the Statement requires that plan financial statements include four basic categories of information. They are information about:

1. Net assets available for benefits
2. Changes in net assets during the reporting period
3. The actuarial present value of accumulated plan benefits and
4. The significant effects of factors such as plan amendments and changes in actuarial assumptions on the year-to-year change in the actuarial present value of accumulated plan benefits.

We created and use the term "accumulated plan benefits," rather than "accrued benefits," because the latter term suggests a liability in a legal or accounting sense. Statement 35 takes no position as to whether any or all of the accumulated plan benefits constitute a liability of the plan.

Statement 35 requires that information about net assets available for plan benefits be presented as of the end of the plan year and be prepared on the accrual basis of accounting. Under the statement, plan investments, other than contracts with insurance companies, shall be measured at fair value, and contracts with insurance companies shall be measured in the same way as the DOL requires for plan annual reports under ERISA.

The Statement also sets the first accounting standards for information regarding participants' accumulated plan benefits. Accumulated plan benefits are defined as those future benefit payments attributable under the plan's provisions to employees' service rendered to date. Under Statement 35, information about accumulated benefits may be presented either as of the beginning or the end of the plan year. If a beginning-of-year

date is chosen, additional information is required regarding both net assets as of that date and changes in net assets during the preceding year. At this point, perhaps I should point out for the benefit of your 1980 work plans that although Statement 35 is not effective before plan years beginning after December 15, 1980, if the plan intends to adopt a beginning of the year benefit information date, then benefit information as of the same day in 1980 will also be required. Thus, a calendar year plan will need benefit information for both January 1, 1980 and January 1, 1981 for its 1981 annual report. Application of Statement 35 to years ending before December 16, 1980 is encouraged but not required.

Under Statement 35, accumulated plan benefits are to be measured at their actuarial present value, based primarily on employee's history of pay and service and other appropriate factors as of the measurement date. Future salary changes are not considered. Future years of service are considered only in determining employee's expected eligibility for particular types of benefits, for example, death and disability. The methodology in Statement 35, in traditional actuarial terms, is closest to the unit credit or accrued benefit cost method, without salary projection.

The calculation of the actuarial present value of accumulated plan benefits is to be based on an assumption of an ongoing plan. Every other significant assumption used in the calculation shall reflect the best estimate of the plan's future experience solely with respect to that individual assumption.

Assumed rates of return used in the calculation are to reflect the expected rates of return during the periods for which payment of benefits is deferred and should be consistent with returns realistically achievable on the types of assets held by the plan and the plan's investment policy. To the extent that assumed rates of return are based on values of existing plan assets, the values used in determining assumed rates of return should be the values presented in the plan's financial statements pursuant to the requirements of Statement 35.

In selecting certain assumptions, an acceptable alternative is to use those assumptions that are inherent in the estimated cost at the benefit information date to obtain a contract with an insurance company to provide participants with their accumulated plan benefits. Selection of other assumptions that are necessary but are not inherent in that estimated cost should be consistent with the guidelines I briefly summarized before. For plans below a certain size, the alternative approach may be preferable to selection of certain assumptions (for example, mortality rates) appropriate for the participant group because the validity of actuarial assumptions is dependent on the law of large numbers. Use of insurance company premium rates may, as some have suggested, reduce for some plans the cost of implementing the Statement. Note that this is an allowable alternative, not a requirement.

Statement 35 requires annual benefit information. Whether that information can be determined without an annual plan valuation is dependent on each plan's facts and circumstances, and also, I should note, on what the terminology "plan valuation" means to different actuaries. Some actuaries use the terminology to describe any work done for a plan that involves determining a measure of benefits. Others use it to mean calculations needed for funding purposes, including detail analysis of experience gains or losses.

Because ERISA permits benefit valuations for funding purposes to be performed on a triennial rather than annual basis, some actuaries did not favor requiring annual benefit valuations for financial reporting purposes. Statement 35 permits detailed service-related data for individual employees collected at an earlier date to be projected to the benefit information date. However, based on testimony by certain actuaries at the September 1978 hearings held by the Department of Labor regarding its proposed revision of Schedule B of Form 5500, projecting beginning-of-year employee data to year-end would be difficult. Therefore, it is expected that only in unusual circumstances will projecting the data collected during a triennial valuation to a benefit information date in a subsequent year satisfy the criterion of providing results that are substantially the same as those that would be obtained using data as of that latter date. An example of such unusual circumstances might be a small plan with a stable participant population.

Although the Board decided not to require end-of-year benefit information, it considers presentation of such information to be preferable to using beginning-of-the-year-information. Plans are encouraged to develop procedures to enable them to use an end-of-year benefit information date. In that regard, the Statement provides that detailed service-related data for individual employees as of a date preceding the end of the year may be projected to that latter date, provided the results obtained are substantially the same as those that would be determined using data as of the end of the year.

In applying the provisions of the Statement, it is recognized that the use of averages and other methods of approximation consistent with recommended actuarial practice may be useful, particularly when applied to plans sponsored by small employers. For example, the Statement provides that if participants' individual historical salary data for plan years before the effective date of the Statement are not available, reasonable approximations thereof are acceptable.

#### Cooperative Effort in Developing Statement No. 35

Statement No. 35 is the culmination of a long and sometimes difficult process in which many people, including many actuaries, participated. The final Statement was preceded by a discussion memorandum, a public hearing, and two exposure

drafts. The Board received and considered a total of approximately 1,100 letters of comment and position papers on the three documents that preceded the final Statement.

From the beginning of its work on financial reporting by pension plans, the Board recognized the essential role of actuaries in developing any required benefit information. It therefore undertook a cooperative effort with the American Academy of Actuaries to develop a basic method of determining benefit information that would be both meaningful and workable.

That cooperative effort included informal meetings and extensive correspondence between various actuaries and members of the FASB's staff. Members of the actuarial profession participated in some of the Board's formal meetings on the more difficult issues relating to determining the benefit information and served on our project task force.

The Board appreciates the time and resources that the actuarial profession has been willing to devote to that cooperative effort.

The Board also worked closely with the Department of Labor in an attempt to minimize unnecessary conflicts and duplication between financial reporting requirements and governmental reporting requirements.

Many of the changes made to the method of determining benefit information between the first exposure draft, issued in 1977, and the final Statement resulted from the cooperative effort with the Academy and the DOL. The basic methodology for determining employees' accumulated plan benefits required by our Statement is, we think, consistent with the views of the Academy as presented in Interpretation 2. The same benefit information that is prepared for financial reporting purposes should also be acceptable for Schedule B reporting purposes.

#### Areas of Some Continuing Disagreement

As I have just indicated, the development of accounting and reporting standards for pension plans was a long process involving decisions on many controversial issues. The Board is pleased that the outcome of that process represents substantial agreement among the parties involved. For the first time, pension plans will be reporting meaningful and comparable data--comparable in the sense that preparers of plan financial statements will all be following the same broad asset and benefit valuation guidelines.

We recognize, of course, that not everyone will be completely happy with all of the provisions of the Statement. One area of continuing concern to some, including perhaps many actuaries, is the requirement that the benefit information be presented within the financial statements. Some would have preferred that the Statement require benefit information to be

presented as supplemental information, that is, in the plan's financial report, but outside the financial statements. Reasons for that preference include (a) the view that because the benefit information is prepared by actuaries rather than accountants, it should be presented in an actuarial report rather than in financial statements, and (b) a desire to exclude the benefit information from the scope of the independent accountant's audit.

The major reason for the Board's decision that the benefit information should be included within the financial statement is that the benefit information does not supplement other information about plan assets and liabilities that appears in the plan's financial statements. It is the only information about the plan's obligation to pay benefits that is required to be presented. Because the benefit information is necessary both to present the plan's financial status and to achieve the primary objective of the financial statements, the Board concluded that it should be presented within, rather than outside, the financial statements.

A decision to exclude the benefit information from plan financial statements would have required a Board conclusion that the benefit information is not a recordable liability or even a contingent liability of the plan. The Board did not reach such a conclusion; rather, having decided that benefit information is essential, the Board concluded that it was not necessary at this time to resolve the issue of whether the benefit information or any part of it constitutes a liability of the plan.

Although the Board believes actuaries are best qualified to prepare the benefit information, we did not accept the notion that if the preparation of information does not fall within the professional qualifications of accountants, it is outside the scope of financial statements. There are many areas in which professionals other than accountants are needed to prepare financial information that presently appears in financial statements, for example, the aggregate reserves for life, accident, and health policies of life insurance companies. Whether any financial information is to be audited and, if so, by whom, are not issues that are within the Board's province to decide. The FASB is confident that the actuarial profession and the American Institute of CPAs can work out the various responsibilities in connection with an independent audit of a pension plan.

Another area of disagreement is the Board's determination that future salary changes should not be considered in measuring accumulated benefits. Among the factors that led the Board to that conclusion are:

1. Belief that benefits attributable to future salary increases should not be considered "earned" until the related compensation is earned.

2. Belief that future salary increases are not unlike certain other future price changes, the accounting effects of which are recognized in the periods in which the price changes occur.
3. Interpretation No. 2 of the American Academy of Actuaries, which opposed considering future salary increases for both conceptual and practical reasons.

As a result of not considering future salary increases, the Board's and the Academy's views on the basic methodology for determining participants' accumulated plan benefits appear to be essentially the same.

Some recent articles, including one in Forbes, criticize the FASB for not taking salary progression into account in Statement 35. I believe that criticism is misdirected. Statement 35 deals with plan reporting from the perspective of a participant in the plan. The criticisms, however, focus on understatement of pension expenses and pension obligations in the employer's (sponsor's) financial statements. The employer's accounting was not within the scope of the project that resulted in Statement 35. The FASB has a separate project that is addressing the reporting by employers.

In our preliminary discussions about the subject matter for my presentation, Bob suggested and I comment on the implications, if any, of Statement 35 having been adopted by a 4-3 vote of the Board. Whether any Statement is adopted by a 4-3 vote or a 7-0 vote has no implications as to the enforceability of the Statement as far as the public accounting profession is concerned. A 4-3 vote cannot be used to support a lesser degree of compliance, even with regard to areas that were contentious among Board members.

Although the Statement was adopted by a 4-3 vote, it is not correct to imply that the dissenting Board members totally disagree with the Statement. Under the Board's rules of procedure, there is no such thing as a qualified assent. The Accounting Principles Board of the AICPA, the predecessor body of the FASB, did allow for such a vote. That is, a Board member could indicate his disagreement with one part of a standard and still vote for the document. That is not the case with the FASB. If a Board member disagrees with one aspect of a final Statement, he must dissent from that Statement if he wishes to express that disagreement. Given the many conclusions on issues addressed in Statement 35, I believe it is fair to say that many such conclusions reflect a much higher degree of agreement among Board members than is reflected by the actual vote on the document.

### Conclusion

In closing, I would like to express the thanks of the Board for the outstanding cooperation of the actuarial profession



in the Board's pension projects to date, and I want to take this opportunity to encourage you to continue that cooperation by participating both in the education process that will be needed for successful implementation of Statement 35 and in resolution of the difficult issues to be addressed in the Board's employer pension cost project.

MR. WARREN D. ORLOFF: The statement has been developed over a six year period to set standards for the preparation and presentation of financial information furnished by defined benefit pension plans which might be useful in determining whether such plans can reasonably be expected to meet their benefit obligations.

The treatment of assets at their fair market value on the valuation date would seem to be consistent with the concept of a "snapshot" of the plan's finances at a point in time. The inclusion of a description of the change in assets over the year leading up to the valuation date does provide some conceptual "averaging" for parties interested in the plan's financial statements.

The treatment of assets held under insurance contracts may create a problem for some actuaries. The Statement requires the exclusion of assets held under allocated contracts and the inclusion of assets held under unallocated contracts. Many plans are valued by independent actuaries using the insurance company's underlying experience fund regardless of the nature of the contractual arrangement with the insurance company. In this way the plan actuary is able to use his own assumptions as to interest, mortality, and, where applicable, turnover, disability, retirement and expenses with respect to the benefits held under allocated contracts thereby anticipating future dividends or non-vested termination refunds from the insurance company. The elimination of the benefits which have been purchased by allocated fund assets may require the submission of additional data from the insurance company and the plan sponsor to separately determine such amounts. In addition separate valuation routines may be required to identify the benefits to be so excluded. The elimination of "anticipated future dividends" from the plan assets may cause a significant increase in the plan's unfunded liability depending on the conservatism in the insurance company's rate structure for reserving for benefits attributable to allocated plan assets.

The balance of my remarks will be addressed to the subject of the calculation and presentation of the Actuarial Present Value of Accumulated Plan Benefits.

It is clear that the Statement requires explicit assumptions for all benefits for all types of defined benefit pension plans, i.e., qualified and non-qualified, big and small, those subject to ERISA and those that are not. This will probably require fairly rigorous calculations for the valuation of deferred compensation arrangements intended as supplemental pensions for company executives.

The Actuarial Value of Accumulated Plan Benefits was basically designed to agree with the values prepared for Schedule B of Form 5500. Where the instructions for the entries in Schedule B may be subject to several interpretations, the calculations described in the Statement are quite clear. Example B from Interpretation 2: Interpretation of Recommendations Concerning the Calculation of the Actuarial Present Value of Accrued Benefits under an Active Plan was reproduced and incorporated as Appendix E of the Statement. There is little question that these procedures should be followed for defined benefit pension plans subject to the disclosure requirements set forth in ERISA.

The Statement discusses the use of averages or reasonable approximations as appropriate provided the results obtained are substantially the same as the results obtainable by precise methods. The intent is to alleviate to some extent the unduly burdensome calculations and recordkeeping for plans sponsored by small employers.

Perhaps the most important single assumption affecting the liability for accumulated plan benefits is the interest assumption used for discounting the expected benefits to be paid at some future time. The Statement requires that "assumed rates of return should reflect the expected rates of return during the periods for which payment of benefits is deferred and should be consistent with returns realistically achievable on the types of assets held by the plan and the plan's investment policy." This could be interpreted to mean that plan benefits being valued at the time of depressed market conditions resulting from the availability of excessively high yielding investment opportunities might well be justified in adopting a correspondingly high interest assumption--at least to the extent that the actuarial value of the assets (probably considerably higher than market) covers a reasonable estimate of the present value of the accrued liabilities on the actuarial assumptions used for plan valuations.

A reasonable approach would be to use the same interest assumption used for APB Opinion 8 purposes for the calculation of vested benefit liabilities. As long as the assumption is not overly conservative, it should be acceptable.

Expected rates of inflation assumed in estimating automatic cost-of-living adjustments should be consistent with the interest assumption, e.g., an 8% interest expectation with a 3% c-o-l-a might lead to a 5% rate of return assumption.

Administrative expenses associated with providing plan benefits expected to be paid by the plan may be reflected either by being assigned to future periods and discounted directly or by adjusting the assumed rate of return.

The other assumptions selected for Statement 35 purposes will probably be similar to those employed in the periodic actuarial valuations. Since those represent the "best estimate" of rates

of mortality, turnover, disability, and retirement, they should be satisfactory for this purpose.

Changes in actuarial assumptions should be made to reflect changes in the plan's expected experience. As is certainly true in reviewing valuation assumptions with respect to their continued appropriateness, a similar degree of care should be exercised for Statement 35.

The Statement suggests the use of "those assumptions that are inherent in the estimated cost at the benefit information date to obtain a contract with an insurance company to provide participants with their accumulated plan benefits." In our opinion this approach would seem to be most appropriate for valuing a block of retired lives or benefits for vested terminees.

Presentation of changes in the Actuarial Present Value of Accumulated Plan Benefits should identify as a minimum those changes caused by the following sources:

- a. Plan amendments
- b. Changes in the nature of the plan (e.g., a plan spinoff or merger)
- c. Changes in actuarial assumptions.

These changes are generally a by-product of our valuations. However, in most cases, if the valuation is not Unit Credit, it will require some extra effort.

Although it is no longer required, it is desired that the significant effects of other factors be identified such as those resulting from additional accumulated benefits (which could include actuarial gains or losses), interest and benefits paid.

It is clear to this reader that the issuance of Statement 35 marks the end of the era of so-called "rules of thumb" for estimating the impact of all but the least significant of ancillary benefits.

Reserves for ancillary benefits such as bridge and transition benefits, subsidized early retirement benefits, disability benefits, spousal benefits, lump sum death benefits and vested benefits should be calculated using multiple decrement tables based on assumptions deemed consistent with plan experience as to mortality, turnover, disability, termination of disability by either death or recovery, or retirement (at early, normal or postponed ages). The past practice of nominally loading the retirement benefit reserve calculated at a single retirement age by anywhere from 1½% to 12% for benefits of this character would seem to be no longer acceptable.

MR. ROBERT L. BEIN: In a way, we really should be grateful to the FASB for producing Statement 35 because a decent amount of additional business will be generated. This new business comes from a number of sources.

For one thing, we will certainly have numerous discussions with our clients explaining the requirements of Statement 35 as well as the follow-up Statement 36 which details what must be shown in the employer's financial statement. There will be discussions related to the actuarial assumptions being used for the present value calculation and a discussion of the differences between what's required to be presented now and how and what was required before.

We will also have to explain any differences between the assumptions used for the regular actuarial valuation and those used for Statement 35, giving us a chance to once again get into the discussion of implicit vs. explicit assumptions.

New business also comes from the need to do a more precise calculation than would have been the case for Schedule B. As Warren Orloff mentioned, the instructions for Schedule B are not precise and we, at least, read into those instructions a far greater degree of latitude in estimating values than would appear to be the case with Statement 35. A more precise calculation naturally costs more. For plans which normally have a valuation every two years or every three years, for example, we had intended to estimate the present value during the interim period by using the last complete valuation and adjusting roughly for changes in participation, salary, and service. The very precisely worded Statement 35 makes it clear that such a procedure would not be acceptable and an annual calculation should be made.

Those of us with clients of less than 100 plan participants never had to make the present value calculation for purposes of Schedule B. If a GAAP prepared financial statement is to be prepared, then Statement 35 requires that a calculation be made, clearly generating additional fees.

In a sense, Statement 35 is also an opening salvo in the battle toward disclosure and funding soundness of municipal plans--the beginnings of a PERISA statute. The FASB feels, correctly, that any pension plan financial statement which purports to be prepared using Generally Accepted Accounting Principles must follow the dictates of Statement 35. So to the extent that any municipal plan, through local statutes, requires a GAAP prepared financial statement, a present value calculation as described in Statement 35 must be prepared. Even where there is no legal requirement that a statement for a municipal plan be prepared under these accounting rules, it seems to me that Statement 35 provides additional impetus for municipalities to look more closely at their plans and develop the necessary actuarial figures.

Plans maintained by U.S. companies in foreign countries are also referred to in Statement 35. Statement 35 applies to these plans only when financial statements of such plans are intended to conform with U.S. Generally Accepted Accounting Principles. Statement 36 requires the disclosure of at least the unfunded vested liability for foreign plans, and there is the clear indication that the actuarial present value calculation is preferred for disclosure. This may then be another source of additional business for us.

How else will our business be affected by Statement 35 and its follow-up Statement 36? Well, I think there will be mounting pressure to have the actuarial calculation done as of the end of a plan year rather than the beginning of the plan year in order to make both the plan's financial statement and the employer's financial statement as up-to-date as possible.

This will force all those December 31st or January 1st valuations to be done within the first few months of the year. I'm sure we all see more and more of our clients sending employee data to us earlier and earlier as they improve their own data collection systems. These clients are insisting on shorter turnaround as well. Not only because they want to adjust their accruals earlier in the year but because their accountants want up-to-date, and not estimated, actuarial results for the employer's financial statement as well as the plan's statement.

These additional pressures may even turn consulting actuarial work into a seasonal business. Fortunately, the IRS and Department of Labor haven't come out yet with their ERISA definitions and rules for seasonal industries so we still have time to petition them to include us with the agricultural workers and the maritime industry.

But there are longer range implications stemming from Statement 35 and Statement 36. What is likely to happen first is a requirement of additional employer disclosure of benefits other than pensions. The FASB has a current project related to this topic. This project will consider what information, if any, should be shown with regard to post-retirement life insurance and post-retirement medical insurance. One possibility is to just describe the nature of these benefits but I think a more likely result will be the requirement to disclose the present value of such post-retirement benefits.

It's also easy to see how this concept of disclosing cost implications of benefits with a distant payout period can be extended to other benefits that are currently handled on a term cost or terminal funding approach. This could include worker's compensation benefits, for example, Black Lung benefits for coal miners, a benefit with a huge potential liability. It's even conceivable that a present value figure will have to be attached to benefits for active employees--benefits such as life insurance or medical insurance--to the extent that today's costs may be significantly understating future costs.

But why should the FASB stop with disclosure? Why shouldn't post-retirement life insurance, post-retirement medical benefits, various worker's compensation benefits, all succumb to a pre-funded approach, where a charge against operations is established for these post-active employment benefits. For young companies in particular, companies which have not reached a mature state in the relationship between the number of retirees and the number of active employees, earnings per share may drop significantly because of a requirement like this to account far in advance for post-retirement non-pension benefits.

Most devastating of all would be the requirement that pension liabilities as well as other post-retirement benefit liabilities be put on a company's balance sheet. And yet this is but another logical step in an evolving set of accounting requirements.

What is the future of the actuary in the accounting requirement scenario I've described? Well, on the one hand, there is the excellent potential for additional business, with the need to establish actuarial costs for non-pension related post-retirement benefits and possibly even pre-retirement benefits. But at the same time, there is an ever-present danger that the move toward uniformity suggested by Statement 35 and Statement 36 may be a gentle push toward closing the open door of actuarial assumptions and procedures.

Of course, it's quite logical from an accounting viewpoint, from the FASB's viewpoint, to establish uniform standards for disclosure of pension plan information. This not only permits an examination of a single plan's status but also facilitates the comparison between plans. True, at the moment each actuary can select his own assumptions for the present values being shown. But how long will it be before the FASB says in another Statement 36 that "a more uniform approach is needed to better compare the financial status of plans," one company vs. another, and specifies the interest assumption and perhaps the other assumptions?

The succeeding step is clear: with the current funding status shown on a comparable basis for all plans, using uniform assumptions and effectively the Unit Credit Cost Method, it's very easy to say that an analysis of the financial statements of several employers would be enhanced if the annual provision for pension expense were on a consistent, uniform, basis for all plans with common assumptions and methods.

As is the case with Statements 35 and 36, these pronouncements would not represent edicts for changes, nor would they be in direct conflict with the flexibility provided by ERISA. Rather, they would be presented as standards which every self-respecting CPA would have to follow if he is going to render an unqualified certification that a financial statement has been prepared in accordance with GAAP. It can be an effective

back door approach for the FASB to regulate the actuarial profession.

I obviously wouldn't want this scenario to be played out. I still have many working years before reaching my non-mandatory retirement age, whatever that is, and I'm not suggesting that there is an 80% or even a 60% chance that the events I've described will come to pass. But it is possible, and we have to continue to exert the kind of pressure and "moral suasion" which has successfully been used in the past to mitigate some of the FASB's more drastic proposals.

MR. GREG SKALINDER: I am interested in some of the statements that I've heard here today saying that calculations under FASB 35 and the assumptions used are consistent with those used for Schedule B. In particular, I see two significant areas of difference.

First, paragraph 18C of FASB 35 requires recognition of automatic benefit increases specified by the plan that are expected to occur after the benefit information date. That clearly means that if you have a negotiated plan with negotiated benefit increases on an annual basis, that FASB 35 says the amount to be reported is to be based on the highest benefit specified by the plan. That is quite contrary to my understanding of the Schedule B requirements.

The second difference is in the area of the interest assumption. There even seems to be an internal conflict within FASB 35. The preamble to paragraph 20 requires that all the assumptions "shall reflect the best estimate of the plan's future experience." Then, item A says that the assumed rate of return "shall be consistent with returns realistically achievable on the types of assets held by the plan and the plan's investment policy." I do not see that these two standards are consistent. Furthermore, the best estimate assumption is required for Schedule B. Under that standard, it would be inappropriate to consider the particular holdings of a pension plan as of a current date or their current investment philosophy since investments will be made over a considerable period of time.

I would appreciate your comments on these two inconsistencies.

MR. CASSEL: Let me make one caveat first. I cannot speak officially for the Board as far as interpreting the document and its requirements but I would be happy to share with you my personal views on any of these particular issues.

In regard to your first question, that issue is not specifically addressed anywhere in the document. But you can look at particular aspects of the document and interpret them to arrive at an answer to your question. In that situation, for those employees who are presumed to be rendering service

through the scheduled benefit increases, the future benefit increases should be considered in determining the actuarial present value of accumulated plan benefits for service rendered to date. This is consistent with the requirements of paragraph 18B which says to take into account projected service in determining the eligibility for particular types of benefits. Here there is clearly a scheduled increase for a benefit that will be granted providing there is sufficient service rendered.

In regard to your second question, I am not aware of any conflicts between the instructions to Schedule B and FASB 35. There is the requirement that the assumptions be explicit in the current Schedule B. If you can point out something more specific, I'd be willing to address it, but I am not aware of anything that would indicate that there is a conflict.

MR. SKALINDER: It has to do with the language that the assumed rate of return shall be consistent with returns realistically achievable on the types of assets held by the plans as of the benefit information date and the plan's investment policy. That does not necessarily produce what I as an enrolled actuary believe appropriate for the best estimate long-range rate of return. It is unrealistic and inappropriate to assume that a plan's investment policy will remain unchanged or that the nature of the mix of assets held by the plan will continue into the future.

MR. CASSEL: You are reading something into FASB 35 that is not there. The document is not saying that you take the "current interest rate" reflected in the plan's portfolio and use that as your long term interest rate. It is saying that you take into account that particular stream of income using a market value basis and also consider reinvestment of the income and proceeds upon disposition. You do take into account the returns that will be available for those reinvestments. You should use a set of interest rates applicable for the period of deferral as well as the anticipated investment philosophy of the plan administrator.

MR. KURT PIPER\*\*: Inasmuch as the Society requires actuaries to take personal responsibility for their work, can I assume that financial statements are also going to be signed by actuaries in the future, or will accountants be taking responsibility for actuarial findings?

MR. CASSEL: I understand the need for clear indication by the actuary of his findings when he submits them to the plan administrator. But the plan administrator is the individual who has responsibility for the content of the plan's financial statements. There may be various sources from which he obtains that information--an insurance company, a bank trustee,

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\*\*Mr. Piper, not a member of the Society, is employed by National Associates, Inc.



an actuary. The financial statement is an aggregation of all of that information. Whether or not, in expressing his opinion as to whether the financial statements are in accordance with GAAP, an auditor will make reference to the work of the actuary, is a question of how the auditor issues his report. This is not an area that is within the FASB's jurisdiction. We have no ability to promulgate the rules by which auditors make their audits.

This is an issue which has been of concern to the actuarial profession and is now being discussed between the AICPA and the actuarial profession in its development of an audit guide for the assistance of auditors in making examinations of defined benefit pension plans. An exposure draft of that audit guide will be issued soon, and I would encourage you to read it and provide your input to the Auditing Standards Board which is the organization that will be dealing with the particular question which you raised.

MR. PAUL GEWIRTZ: The major purpose of FASB 35 and 36 is to enhance the usefulness of disclosure to participants and to the investing world. There are some industries where the reality of present value of accumulated benefits is not their reality. For example, in the steel and auto industries there are massive benefits known as shutdown obligations that are triggered when a major operation or plant closes down. Was there any attempt made by the Board in FASB 35 or 36 to incorporate for certain industries such things as shutdown obligations in disclosure?

MR. CASSEL: Your questions pertain primarily to employer reporting as opposed to plan reporting. Let me address just plan reporting for the moment. In considering the basis for the plan financial statements, it was considered whether the assumptions used in determining the actuarial present value of accumulated plan benefits should be made on a terminating assumption or an ongoing assumption. The conclusion was that for the large majority of plans, termination is not reality--that they are, in effect, ongoing plans, and the most useful information is one that is provided on that basis.

If a plan is anticipated to terminate, then Statement 35 may not apply. The document specifically says that it is not intended to apply to plans that are expected to terminate.

As to whether the surprises that result from a shutdown are items of information that would be useful to investors and creditors of the employer, this is really an issue that we will be addressing in the employer project which is getting underway now that we have Statement 35 out. We will be addressing whether, if there is a liability, it is a liability that is based on a termination approach or a legal definition of liability or whether it should be based on an ongoing approach. Even if it is determined to be on an ongoing approach, we will probably solicit opinions on whether there

should be supplemental disclosures of what might be the impact of termination. These are issues that are clearly of concern and we will be addressing them in the other project.

MR. GEWIRTZ: You made the comment earlier that in calculating the present value of accumulated benefits, in a pay-related plan, that if the employee salary history is not available and if you are calculating just prior to the implementation date of the statement, then a reasonable approximation would be acceptable. Can we infer then, that after the implementation date, the present value of accumulated benefits must necessarily take into account the actual salary history as of the calculation date and that approximations of that history would not be acceptable in the future?

MR. CASSEL: The approximations would be accepted, again with the caveat that they should not be significantly different from the actual data. If you can satisfy yourself, statistically or otherwise, that you are using approximations that will not result in significantly different data, then those approximations would be acceptable.

MR. GEWIRTZ: Statement 36 defines net assets as the market value of assets plus any accrued liability, namely any expense items that have not been matched by cash contributions. It used to be that Opinion 8 would further subtract out any prepaid pension expense--that is, any actual cash contributions in excess of amounts charged on the books. Why was this subtraction of prepaid pension expense not incorporated in the Statement 35 definition of net assets?

MR. CASSEL: First, let me briefly summarize what is in Statement 36 for those of you who are not familiar with it. Accounting Principles Board Opinion 8 is the existing authoritative literature which describes how the employer's financial statements have to reflect certain information with regard to pensions. Part of those requirements included disclosure of the unfunded vested liability. You ascertained the unfunded vested liability by taking the vested liability and comparing it with the net assets available in the plan and with certain additional debits and credits. What we did in Statement 36 was to delete that requirement from Opinion 8 and substitute it with a requirement to disclose the aggregate information stemming from the financial statements of the defined benefit pension plan of that particular sponsor.

We did so for various reasons, including not only the requirements of Opinion 8, but also the SEC's requirement for financial statements submitted to it, for the disclosure of unfunded prior service cost. In combination, the requirements of Opinion 8 and the SEC really provided rather useless information. So in Statement 36, the Board felt that as an interim measure--interim in the sense that the entire area of disclosure will be one part of the reconsideration of Opinion 8, which is underway--we ought to require to be disclosed the

information that is available, that is comparably determined and that would provide useful information to investors and creditors and that is the information from the financial statements of the defined benefit pension plans prepared in accordance with Statement 35.

As to why we dropped out that one piece that you asked about, we did not ascertain what purpose inclusion of that information had ever had. It is not in any way an appropriate factor in assessing what the status of a pension plan is. In other words, the status of a plan that may be 100% funded is that it is 100% funded, regardless of the fact that the employer has not yet chosen to run part of the contributions that made that plan fully funded through its income statement. What we were trying to do is to disclose what the status of the plans were in the footnotes.

MR. JAMES LAWS: FASB 35 offers two different types of disclosure, one wherein the actuarial information is incorporated directly with the asset information and the second one where the actuarial information is actually shown on a separate page. Will it be up to the accountant to decide which disclosure is used or can the plan sponsor tell the accountant which one he would prefer?

MR. CASSEL: As I indicated earlier, the Board sees the plan administrator as the individual responsible for the content of the financial statement. In that sense, if the plan sponsor dictates a particular presentation and if it is in accordance with Statement 35, that is what governs. It is not the role of the independent accountant to say that you have to do it one way as opposed to another way if both ways are acceptable under the requirements of the document. He may try to influence the sponsor in one way and the actuary may try to influence him in other ways. Where there is judgment to be exercised, the responsibility for the exercise of the judgment lies with the plan administrator.

MR. STEVEN EISENBERG: My question has to do with Taft-Hartley plans, which are very large plans. We do a sampling valuation for some of our plans, using a 1% or 2% sample of the participant data for the valuation. Is that still acceptable under FASB 35?

Secondly, for one of our plans, we receive data three years after the end of the plan year. We do use the most recent plan amendments and apply it to this data. We are unable to obtain information any faster than this from the administrative offices. I would like your comments on this situation.

MR. CASSEL: Whether a 1%, 2%, 20% or 50% sample is appropriate depends on the actuary's judgment as to what is necessary in the particular facts and circumstances. I am just not qualified to tell you whether a 1% sample selection is

adequate. My naive response is that it seems to be a very low number, but I won't go beyond that.

As far as the problems that you have had with the data, you do have a problem. I am not sure that we can say that if you have problems, you can ignore them and wait until they go away. Have you decided what you are going to do for DOL reporting purposes? They ask you for current information, not information that is three years old.

MR. EISENBERG: We have not had to prepare a Schedule B yet.

MR. CASSEL: Admittedly, there is going to be a problem in many situations where some necessary data will not be available. There really is not any exemption from the document on that basis. If the data is not available, then the financial statements will have to indicate that the information is not provided because the data is not available. Under those circumstances, you do not have GAAP financial statements.

MR. BEIN: Where Jules says that he does not feel that he could possibly say whether or not a 1% or 2% sample is adequate, who is going to say that it is inadequate? You are the enrolled actuary.

MR. EISENBERG: I was not asking whether or not it was adequate. That is up to us to determine. I was asking if a sampling technique would be acceptable if, in our opinion, the sample was adequate.

MR. CASSEL: Sampling techniques are acceptable methodologies for determining the information if you have what you consider to be, and others would consider to be, an acceptable statistical methodology.

MR. JAMES COLBURN: It's true, is it not, that GAAP statements are really not required by ERISA? What is required is that an audited financial statement be submitted, but that it does not have to be based on GAAP. Is that correct?

MR. CASSEL: There is a requirement that allows you to have dual reporting. This gets into the DOL regulations, and obviously I am not with the Department of Labor, so I can only give you my interpretation of what they are. The DOL said in 1975 or 1976 that plan administrators had a choice. They could prepare GAAP-based financial statements which appears to be what ERISA requires. Or they could provide information that did nothing more than aggregate pieces of the Form 5500 and provide the information which is required by DOL regulations, and then have a footnote attached to the compilation of that data saying what the exceptions from GAAP were. So, it is true that you do not have to provide GAAP financial statements, but you do have to indicate, for plans of 100 or more participants, what the departures from GAAP are. Of course, under those circumstances, the auditor's report would be expressed in an

entirely different manner than would be the situation if the financial statements were in accordance with GAAP.

MR. THOMAS CROCKER\*\*\*: As the discussion here has already noted, the statement requires in paragraph 18C that automatic benefit increases that are contingent on being in service in the future must be taken into account in arriving at the accumulated plan benefits as of the valuation date. This seems inconsistent with the dictum in paragraph 170 that future salary increases should be excluded from consideration in arriving at the same item. This inconsistency seems further magnified by the requirement in paragraph 20B with respect to recognition of the effect of rates of inflation on benefit increases yet to be granted. Could I have some enlightenment on this apparent inconsistency?

MR. CASSEL: There are some people who share your view that there is an inconsistency and others who do not. There are two ways to approach the issue of future salary progression. You can assess it both from conceptual approaches and from pragmatic approaches. Individual Board members were split on the conceptual approach. Some clearly viewed the two items you indicated as distinct and separate. The future salary issue is one that is solely related to service. Automatic cost-of-living adjustments (COLA) are not. In other words, if you have a COLA plan, you get those future benefit increases whether or not you render future service. That is not true with future salary progression. You can not get any increments from future salary progression unless you render future service.

Others believe that, conceptually, with regard to the interest assumption, this assumption stands on its own. A plan can earn whatever the market will provide as far as rates of return, regardless of whether the plan is a fixed benefit plan, a final pay plan or a career average plan. Investment returns are independent of plan formulas, and therefore there is not an inconsistency in saying that the interest assumption should reflect the expected rates of return.

There are others who say that if the plan is ongoing and employee service will continue to be rendered, that for those plans where the benefit is based on future salary, that at the benefit information date, there is implicit in that promise some recognition that there will be adjustments in the future, and therefore they do see a conceptual inconsistency.

Those are differing views that individual Board members had with regard to that particular issue from a conceptual point of view. From a pragmatic point of view, the actuarial profession indicated that it would not accept recognition of future salary progression. The DOL, in its revised Schedule B, also did not choose to recognize future salary progression.

\*\*\*Mr. Crocker, not a member of the Society, is employed by the California Public Employees Retirement System.

Pragmatically, you also must look at what the methodology would be to reflect it. Even those who would want some aspect of future salary reflected for final pay plans, there was a great deal of diversity of opinion as to how you would do it. So conceptually you would first have to conclude that you should include it, then you would have to get agreement as to what the appropriate methodology was. There was not even agreement among proponents of the issue as to what the methodology should be.

To summarize, on the pragmatic side, the Board was very conscientious in arriving at the final statement as to what the implications were on a cost-benefit basis for every significant requirement in the document. Much of the reason why the incremental cost of applying Statement 35 is within acceptable limits is because of the changes that the Board made to the initial exposure draft requirements. If the Board was to require future salary progression in the computations, you would have to consider the incremental cost to plans of having that information developed - a) by actuaries who did not think that it was appropriate to do so, and b) that was not required already for DOL reporting purposes.

On a pragmatic basis, the Board concluded that it should exclude future salary progression. So there were some who for both pragmatic and conceptual reasons believed it was appropriate to exclude it and some who conceptually might not have chosen to exclude it but in the aggregate felt it was the appropriate answer. There are no dissents in the document as to the exclusion of future salary progression.