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PUBLIC DISCLOSURE OF RETIREMENT PLANS

Moderator: MICHAEL J. MAHONEY. Panelists: DOUGLAS C. BORTON, TIMOTHY S. LUCAS, THOMAS D. SUNILA***

Disclosure of pension information to employees, stockholders and government has been a major public issue in the United States in recent years with enactment of the disclosure and reporting provisions of the Employee Retirement Income Security Act and, more recently, publication of the new accounting and disclosure requirements of the Financial Accounting Standards Board. Several aspects will be discussed.

1. How well do employees and stockholders understand the benefits, conditions, funding, administration and guarantees in their company retirement plans? How effectively can public disclosure of pension information improve that understanding?

2. What are the general public's needs for information about private and public retirement plans?

3. How well do current United States disclosure and reporting laws and regulations and the proposed financial accounting standards meet the information needs of employees, stockholders, government and public? What changes are needed?

4. What lessons can be learned from experience with Canadian requirements for disclosure and reporting?

MR. THOMAS D. SUNILA: As the employer's representative concerning the future of public disclosure of pension costs and liabilities, I can say with a measure of confidence that the actuary and the employer see eye-to-eye in this matter. In short, we too are opposed to balance sheet entries of pension liabilities and assets and are against arbitrary or uniform pension expensing.

This stance I suppose is rather predictable. And, indeed, members of the Financial Accounting Standards Board (FASB) have anticipated this response. Our motives have been ascribed in part to instinctual preservation of the status quo. There is undoubtedly an element of truth to what they say. Survival and self-preservation are also very real possible motives for the opposition - although I'm not about to defend our position from that perspective.

As an example of instinctual behavior against public disclosure

*Mr. Lucas, not a member of the Society, is Project Manager, Financial Accounting Standards Board, Stamford, Connecticut.
**Mr. Sunila, not a member of the Society, is Benefits Cost Advisor, Mobil Oil Corporation, New York, New York.

of financial information, I want to relate to you a rather ironic and amusing article I read in the February 12, 1981 edition of the Wall Street Journal. The title of the article is "Profits for Fiscal '80 Is Our Little Secret, Touche Ross Decides." I'm sure that you are all aware that Touche Ross is one of the major accounting firms in the world. At any rate, Touche Ross is attributed, in the article, with saying that it decided against disclosure of the firm's profits for several reasons including:

One, It believed the information already disclosed, adequately documented the firm's financial strength, and

Two, that the financial information was not comparable due to organizational differences among accounting concerns, and thus information on profits might be misleading.

Both arguments, I'm sure you'll agree have a very familiar ring.

The article, however, goes on to say that accounting executives privately admitted that it was foolish to disclose financial results because it is a no-win proposition. That is, if earnings soar clients complain, and if earnings fall, the firm's ability to attract new recruits suffers.

This attitude might be summed up in what must be one of Murphy's most basic tenets - that is, you're damned if you do and you're damned if you don't. So, Touche Ross avoided this financial dilemma and did not report its profits.

Fortunately for Touche Ross and for Peat, Marwick & Mitchell, who also declined to reveal profits, privately held firms have no public disclosure responsibilities or requirements.

So it seems instinctual behavior runs rampant even among the accounting giants and that even the fastidious independent accountant is not immune to the baser instincts of business and professional survival.

The Discussion Memorandum (DM) recently promulgated by the FASB seemed at first glance rather innocuous. It asked a lot of questions and took no positions. My beginning impression was that it was hokey. It began by discussing whether the employer's pension obligation was to the employees or to the plan and its trust, and whether or not pensions were deferred compensation. I'm sure most of us agree, for one reason or another, that the employer's obligation eventually comes down to an obligation to the employee and that pensions are indeed a form of deferred compensation. Then, throughout the DM, there were those ubiquitous references to the Elements - that god-forsaken reference that has a convoluted definition for words every layman simply understands. But as I read on my respect grew as my fears trebled. The FASB obviously understands the work of the actuary. They have developed their own demonstrative funding methods and their own scenarios, all of which are extractions of the real essence of the actuaries' concerns and calculations. And their questions became more and more probing. By the end of the Memorandum I was awed. Is it possible the FASB will pull the rabbit out of the hat and find the expensing procedure and liability calculation method that will distill the universe of pension finance down to a consistent, comparable, relevant and reliable financial statement?

It can't be! Because it doesn't exist.

The result of this siege on actuarial expertise by the accounting profession would more likely be a complex, lengthy compendium of rules and procedures for pension accounting based on the myriad of circumstances currently in existence in today's pension environment. The responsibility to bring that information together, however, for accounting purposes belongs, I believe, to the actuarial profession. The American Academy of Actuaries should be charged by the FASB to do just that.

By the way, that alliterative list of adjectives - consistent, comparable, relevant and reliable - comes straight out of Appendix D of the DM. It's entitled the FASB's Conceptual Framework. In the Appendix, the FASB has developed a convenient hierarchy of adjectives to describe accounting requirements and they have developed logical relationships among these adjectives. I'm not sure if this categorization is remarkable or amusing.

Despite my less than oblique innuendos, the FASB and the DM have impressed me. And I too am convinced of the necessity to improve the reporting and meaning of pension expenses and liabilities in public financial statements. The task before the FASB and the actuarial profession is formidable. However, I believe there needs to be an acknowledgment of the limitations because the possibilities are limitless.

To digress for a moment, I would like to relate a thought that crossed my mind in preparation for today's talk. As a student in a logic course, I can recall having studied Godel's Proof, named after a brilliant, young mathematician who very incorrectly proved the inherent inconsistency of number theory. At this discussion I had a grandiose fantasy that I would present the Sunila proof that the conceptual framework to pension accounting is non-existent. I was convinced that this would make me the messiah of the actuarial consulting profession and that fellowship would be bestowed upon me automatically without further exams. Unfortunately, instead of an inconsistency theorem on pension accounting, what I have is a constant Part-5-migraine from risk theory.

But, back to the business of the DM. Although the DM takes no stand, it has implicitly suggested radical changes to the current accounting of pension costs and liabilities - the actuarial pension liability is a figure which the FASB is very methodically trying to nail down - a standard method of expensing future pension costs - which need not be the funding method, and finally, reserved for a future DM is a review of the actuarial assumptions.

First, considering the possibility of balance sheet entries of pension assets and liabilities - this would be nothing less than - according to a Mercer Bulletin - the most significant accounting change made in financial statements in this century. I heartily agree. There are 400 billion dollars in private pension plan assets. Pension assets are clearly not employer assets. There is even controversy over whether or not employees should have control over pension assets. For many companies, the amounts involved may be large in relation to their net worth. Inclusion of the amount, together with the liabilities, would distort the true financial picture of a company.

I believe the current accumulated liability figure called for under FASB Statement No. 36 is an important on-going figure that should be reported - but in a footnote. It does admittedly have shortcomings and its importance is often exaggerated. In fact the exaggerated significance of the accumulated liability or accumulated vested liability figure has placed employers in a dilemma. On the one hand, the presence of assets in excess of the liability has unions demanding improved benefits and on the other hand, deficits have indicated to some financial analysts that the financial integrity of a company is in jeopardy - another one of those no-win propositions. A boilerplate statement in the footnote placing these figures in perspective would be a welcome relief.

Perhaps a Mercer suggestion, from the same bulletin, to uniformly use PBGC assumptions would relieve the accumulated liability figure of the lack of comparability the FASB is so concerned about. If the liability were also shown as an eventual payout figure, by valuing the accumulated benefits at a zero interest rate, its comparison to the PBGC number would enhance the significance of the interest assumption. This information in a footnote, of course, could be further expanded to indicate when in the future 50 and 100 percent of the payout would be accomplished. This would certainly be a more reliable number - since mortality assumptions are considerably more accurate than interest assumptions. Perhaps another way to present the expected payout from the trust for the accumulated benefits would be to ascertain how much of the payout would be completed after 10, 25 and 50 years. The payout figure would be a very close estimate to the eventual cost to the trust for the accumulated benefits. And it would be a comparable number, although it might be a frightfully large number. But again, all this would belong in a footnote.

As an exercise in the effect of balance sheet entries of pension liabilities and assets, I suggest to the FASB that it recreate representative companies' past balance sheets with pension assets and liabilities in order to determine how the financial outlook of a company would be distorted, both favorably and unfavorably, through an excess or a deficiency in pension assets against pension liabilities. Of particular interest would be the effect of plan improvements on the balance sheet's shareholder's equity from one year to the next.

The inevitable consequence of balance sheet pension liability and asset entries would be fewer and more modest plan improvements - a less than desirable result.

On the income statement side of the financial statement, the objective of pension expensing is already achieved through funding methods. I say this because accrual accounting is supposedly a method to recognize an expense in an orderly manner regardless of the timing of the related cash outflow.

In the case of the funding of a pension trust, just that is accomplished. The pension trust is, in a manner of speaking, a vehicle for accrual accounting. Albeit a real cash flow into the trust occurs.

The FASB in the DM alludes to the possibility that arbitrariness in pension expensing might be required to obtain the results sought by its conceptual framework. If the FASB attempts to mandate an arbitrary method of pension expensing in the interest of consistency and comparability, the ramification could be ominous. My conjecture is that a standardization of pension expensing would by osmosis result in a standardization of funding - because (1) to consistently expense a higher figure than funded, due to different cost methods, would be viewed as deceitful to employees or (2) to consistently fund a higher figure than expensed would be upsetting to shareholders. The resultant uniformity in funding would further intimidate private pension growth. Employers need the latitude currently afforded them in pension funding - without it economic survival would be made a notch more difficult.

Finally, the FASB's concern about the actuarial assumptions has been delayed to a later publication. The need to focus on assumptions to attain the desired consistency and comparability must have been acutely obvious with the implementation of FASB Statements No. 35 and 36. Although the statements explain in detail the calculation procedures, the range of interest assumptions used to value the accumulated benefits have varied even more widely than that used for funding purposes. The less than definitive request for an interest assumption consistent with the market value of assets is responsible for the gamut of interest rates.

In conclusion, then if pension accounting is to change and if pension finance is so easily misunderstood and if it is not necessarily related to a company's financial prospect, the footnote is certainly the best place for information on pension assets and liabilities. There the liability information can be expanded with figures and explicative to make the nature of the liability more clear. With regard to pension expensing it should be governed by the unique characteristics of the plan and the company's present and future financial prospects. Acceptable expensing procedures can be delineated by type of plan and other significant factors.

Both these tasks should be delegated to the actuarial profession and the Academy by the FASB in recognition of their expertise and knowledge. The results should, of course, be subject to the FASB's approval.

As a final note, however, I would like to say that the FASB is certainly within its jurisdiction to seek to improve pension accounting. The actuarial profession must meet the challenge and offer a constructive, unified voice; otherwise, it deserves to be considered a gadfly to progress in pension accounting.

Thank you for your attention.

MR. MAHONEY: Our next speaker is Timothy Lucas of the Financial Accounting Standards Board. Tim is the Project Manager and principal author of the Discussion Memorandum: Employers' Accounting for Pensions and Other Postemployment Benefits.

MR. TIMOTHY S. LUCAS: Thank you for inviting me to participate in your meeting. This is a very timely opportunity for me to participate in a dialogue with, and learn from, members of the actuarial profession. It is an opportunity I relish. I hope it will be mutually enlightening.

I am a project manager at the FASB. I am primarily responsible for the Board's current pensions project, Employers' Accounting for Pensions and Other Postemployment Benefits. That project involves a major interface between your profession and my own. It is an important project. It may result in significant changes in how pension information is reflected in the financial statements of employer corporations -- your clients.

Those financial statements are important to your clients -- the managers of corporations -- and therefore the decisions that will be made by the Board in the next few years are important to you.

The FASB's pension project is in its initial stages. No decisions have yet been made. Your input to the Board's decision process, individually and as a profession, is vitally important to us. I encourage all of you to participate in that process and help us make the right decisions.

I would like to do two things to start this morning's discussion off. First, I would like to tell you a little bit about the FASB's pension project. I can't tell you what the answers will be, because there are no answers yet. But I will tell you about a few of the questions.

Second, I will briefly address some of the questions set out in the program for this session.

The first step in an FASB project is what we call a Discussion Memorandum (DM). A DM is an analysis of accounting issues. It is an attempt to define the questions and to describe the pros and cons of possible answers. It does not advocate any particular answers and, therefore, it is described as a neutral document. A DM solicits comments from the public on the issues and the possible answers. Based on those comments, the Board then considers the issues and presents proposed accounting standards.

We published a DM on pensions in February. I have a few copies with me if you would like to have one. Comments may be submitted in writing or at a public hearing to be held in July in New York.

The DM addresses a number of issues that relate to what some believe are shortcomings of the current accounting approach which is based on your actuarial cost methods. I want to mention two of those issues.

First the liability issue, is there an obligation to provide pension benefits that should be recorded as an accounting liability? Is "unfunded prior service cost" really an accounting liability that is improperly left off the current balance sheet? Is "unfunded vested benefits" such a liability.

I should hasten to note that one of the problems that has inhibited communication between your profession and mine is semantics. An accounting "liability" is different from an actuarial "liability".

Accounting liabilities have been defined as "probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events."[1] The key part of that definition is the notion of a <u>present obligation</u> as a result of past events.

Another of the issues in the DM is the "choice of cost methods" issue. Should there be one method for measuring pension cost in an accounting sense as contrasted with the choice of actuarial cost methods appropriate for funding purposes?

Here again we must be very careful with words, because cost is another word that means one thing to an accountant and something different to an actuary.

Both of these words, "liability" and "cost" and the related issues are right at the boundary where accounting and actuarial science overlap. These are the areas where we most need your input and assistance, and yet, these are the areas where we have the most difficulty understanding one another.

The differences between accounting language and actuarial language -- between my "cost" and "liability" and yours -- are a result of differences in our objectives.

1 Statement of Financial Accounting Concepts No. 3, <u>Elements of Financial Statements of Business Enterprises</u>.

I'm sure you know far more about the objectives of the pension actuary than I do. I won't presume to try and define those objectives, but basically they relate to funding or budgeting.

The objectives of accounting and financial reporting, on the other hand, are primarily concerned with providing information:

- Information about economic resources of a company and the claims to those resources.
- Information about events and transactions that increase or decrease those resources and claims.
- Information that is useful to investors, creditors and others in making economic decisions.

To illustrate how differences in objectives affect us, let us think a moment about a particular event. Suppose a company has decided to amend its pension plan to increase benefits. You, as the actuary, and I, as the accountant, view the change from our separate perspectives.

From a funding or budgeting point of view (yours) there is no reason in the world that the total increase in benefits should be funded all in one year. Indeed, such funding would often be impossible.

But from an accounting perspective the view may be different. I as the accountant must be concerned with whether something has happened that needs to be reported.

- Has a claim to some of the company's resources been established?
- Does the company have a present obligation based on past events? (Past events here include service to date and the plan amendment event.)
- Is the plan amendment an event that increased the employees' claims to the company's resources?
- Is information about the plan amendment likely to be useful to an investor or a creditor?

None of these questions lead easily to specific accounting answers. But all of them suggest that the accounting answers may be different from the funding answers because the objectives are different.

Of course, funding itself is also an economic event and it is likely that the amount the company and the actuary decide to fund will continue to be an important part of accounting information. It seems to me that the funding information relates to the maturity of the pension obligation, when is it to be paid? That is important and necessary information, but we also need information about the amount of the obligation or claim to the company's resources and how it has changed. The shape of that information and how best to fit it into financial reports are the questions the Board will address over the next few years, with your help.

MR. MAHONEY: Our final speaker is Mary Adams who is substituting for Douglas Borton. In essence, Mary will present remarks previously prepared by Doug.

MARY ADAMS: I will begin by reviewing the present pension disclosure requirements involving the actuary. The requirements with respect to reporting and disclosure information on corporate financial statements are based on Opinion No. 8 of the former Accounting Principles Board. This Opinion was issued in 1966 and was modified last year by FASB Statement No. 36. Opinion 8 originally required the disclosure of the amount of any excess of the present value of vested benefits over plan assets; as modified, the amounts of both the actuarial present value of vested and nonvested accumulated plan benefits and the market value of plan assets must be reported. The interest rate used in these actuarial calculations also must now be disclosed, together with the date as of which the information is being reported. The methodology for determining the actuarial present value of vested and nonvested accumulated plan benefits is set forth in FASB Statement No. 35, which also was issued last year. This statement establishes the rules for providing actuarial information in connection with audited financial statements of pension plans. It does not become effective until the 1981 plan year, whereas FASB 36 is already in effect beginning with 1980 annual corporate financial statements.

The present disclosures tend to emphasize existing pension obligations and the assets available to meet them, rather than the long range funding status of the plan and the future contribution levels which might be anticipated. It is interesting to note that FASB 36 did not change the upper and lower limits of pension expense to reflect the minimum required contributions and the maximum deductible contributions under ERISA, even though these have been in effect since 1974. Moreover, no disclosures are required regarding the actuarial cost method, assumptions or amount of unfunded accrued liabilities for funding purposes, although the period over which these liabilities are being amortized must be shown.

The actuarial present value of accumulated plan benefits calculation follows the methodology of Interpretation 3 of the American Academy of Actuaries. Under this approach the vested and nonvested liabilities are computed on a continuing plan basis, essentially on the assumption that the existing benefits are frozen. Therefore, no future salary increases nor plan improvements are taken into account. FASB 35 indicates that the interest rate used should be a realistic measure of the rate of investment return which may be anticipated over time on the market value of the assets. While the method of calculating the present value of vested benefits remains about the same as under Opinion 8, the guidelines for selecting an interest rate are new. In addition, Opinion 8 did not specify the asset valuation basis to be used.

Although Interpretation 3 was developed by the Academy's Committee on Pension Actuarial Principles and Practices in response to a request by the FASB, it is important to recognize that the Academy has consistently taken the position that there is no single measure of pension obligations for all purposes. In developing Interpretation 3, the Committee felt that it was important to adopt a method which did not favor one particular type of benefit formula over another. Therefore, even though it is sound actuarial practice to anticipate future salary increases in determining the contributions for a final average pay plan, the Committee felt that it would place these plans at a disadvantage in relation to flat benefit and career pay plans if future salary increases were to be taken into account. The FASB had indicated that it desired a measure of the liabilities under a continuing plan rather than a terminating plan. While many actuaries feel that the use of a smoothed asset value which averages market fluctuations over a period of time would be more appropriate for disclosure purposes, the FASB insisted that market value be reported.

Now that many corporate annual reports have published FASB 36 information, it is possible to analyze the nature of the data reported. The interest rate used to determine the actuarial present value of accumulated plan benefits varies considerably. Studies we have made show that many employers are reporting on the basis of the PBGC published interest rates, which were about 8% at the start of 1980, or the valuation interest rate, which is generally lower. However, the overall range of interest rates used varies from 4.75% to 12.2%. The 12.2% rate approximates the yield available on U.S. government bonds at the beginning of 1980 for the periods over which the accrued benefits are deferred under a typical plan. Assuming a 10% change in the present value for each 1% change in the interest rate, the actuarial values computed on the two extreme interest rates would vary by a factor of two. When the leverage of the existing assets is taken into account, the relationship between the uncovered liabilities on 4.75% and 12.2% is even greater. The range of interest rates used makes a comparison of reported amounts among companies generally invalid - unless adjustments are made - and probably also limits the value of these disclosures to participants.

Although financial statements are the responsibility of the employer, subject to review by his outside auditor, actuaries may be criticized for the wide variations in the interest rates which have been used. Since this was the first year in which these numbers were reported, there may have been some confusion regarding the nature of the assumptions to be used, particularly since it was rather general practice to calculate the present value of vested benefits under Opinion 8 by using the valuation interest rate. The FASB anticipates that the interest rate will be adjusted to reflect significant changes in market and economic conditions from year to year. Therefore, it is very possible that the range of rates will narrow in the future.

The SEC has suggested that employers provide supplemental information reflecting the effect of future salary increases on these present values in the case of final pay plans. However, very few employers have followed this suggestion.

A question which is being asked is "How well do participants understand the operation of the pension plan under which they are covered?" There is no question that considerable benefit information is available from the summary plan description which must be distributed to participants for plans which are covered by ERISA. Many employers supplement this information with personalized benefit statements which provide the participant with the amount of benefit he has earned to date and an estimate of his projected benefit at retirement. The degree of understanding by participants will, of course, reflect the attention which they give to this type of information. In the area of benefit security, most participants are probably interested in the amount of benefits they would receive if the plan were to terminate. I would expect that most participants are aware of the fact that benefits are guaranteed by the Pension Benefit Guaranty Corporation but they may not be aware of the limitations on these guarantees. Participants also are not generally aware of the effect which the asset priority allocations could have on their benefits upon plan termination. While the current funding status of a plan may be of interest to participants, they probably are not particularly concerned about the current financial position of the plan so long as they feel that their employer is a viable organization which will be able to make the necessary future contributions. Unfortunately the information required by FASB 35 and 36 will tend to fluctuate considerably from year to year. For example, the actuarial values could increase as a result of plan improvements while the assets will fluctuate with changes in the security market. Variations in the value of fixed income securities may be compensated for to some extent by revising the interest rate used to determine the actuarial present value of accumulated plan benefits. However, studies indicate that in recent years there has not been a close correlation between interest rates and the market value of common stocks in the short term. A further consideration is that the amounts reported in corporate financial statements generally are combined for all plans of the company, so that the participant may have to look either to the plan financial statement or Schedule B to obtain a measure of the benefit security under the plan by which he is covered.

The information which analysts and shareholders would like to have is different from that in which participants are interested. Basically analysts and shareholders want to know whether the benefit levels are abnormally generous or low and what the impact of future contributions is likely to be on the financial resources of the corporation. Moreover, they are interested in comparing the pension obligations and costs of one company with others, while participants are interested only in the plan under which they are covered. A major concern of investors is the potential liability to which the company would be exposed if the pension plan was terminated. Although the actuarial present value of vested accumulated benefits often is viewed as a proxy for the plan termination liability, this may not be appropriate where costly additional benefits would be triggered by a plan termination.

As the previous speaker has noted, the FASB's latest Disclosure Memorandum addresses a number of topics which are of interest to actuaries. Theoretical considerations as well as traditional practices are considered in great detail in connection with the proper determination of pension obligations and pension expense. In reviewing the Discussion Memorandum, I believe there are a few basic concepts which actuaries should keep in mind.

Most important is that financial disclosures should not have the result of affecting the proper funding of a pension plan. Although accounting charges may differ from the contributions, most employers would prefer to expense the amount which is actually contributed to the plan. Therefore, financial disclosures should not be based on methods or assumptions which may adversely affect the long range soundness of the plan. To illustrate, the pension expense charge does not equal the amount of the increase in the actuarial present value of plan benefits plus the benefit payments. Therefore, there is an apparent inconsistency between the reported present obligations of the plan, which reflect historical salary and employment data, and the pension expense, which ordinarily reflects an allocation to the current year of the projected obligations of the plan which are not covered by the existing assets. A determination of the minimum contribution under ERISA as the difference between the present value of unfunded accrued benefits at the beginning and end of the year would not be acceptable to the IRS. However, it would be consistent with the way in which the plan obligations are reported.

I believe that pension expense charges should be rational and consistent from year to year. This means that the actuarial gains and losses should be smoothed, so that pension expense is not distorted by abnormal experience in a particular year. As a corollary, the cost of plan improvements should not be fully expensed at the time the improvements are made.

A major issue which may not directly affect actuaries, other than with respect to their own companies, is whether pension assets and liabilities should be included in the corporate balance sheet. Irrespective of how pension information is reported, I feel it is important for actuaries to have input regarding the nature and explanation of the actuarial information which is presented. In addition, I personally feel that some flexibility should be retained because pension plans themselves and the corporations which sponsor them are different and have different needs.

It goes without saying that the cost of preparing the information should be consistent with the value of the information to plan participants, shareholders and others. If, for example, the method of determining pension expense is not acceptable to the Internal Revenue Service, unnecessary duplicate calculations would have to be made.

I also think it is important that traditional methods not be discarded unless the replacements are clearly better.

The Discussion Memorandum also covers the question of whether additional disclosure and expense information is needed for non-pension post-employment benefits. This is an area in which very little study has been done within the actuarial profession. My feeling is that actuaries should not necessarily be bound by the procedures which have developed through the years with respect to pension benefits in accounting for these other types of benefits.

The Discussion Memorandum will have a considerable impact on the work of pension actuaries and I urge all actuaries who practice in this area to familiarize themselves with the issues involved and to make appropriate comments.

MR. BARTON G. FLEMING: Why is so much disclosure required and why is it necessary to put such constraints on the actuarial assumptions? Why don't we just disclose what we are already doing in the footnotes to the financial statements?

MR. LUCAS: The idea of disclosing additional detail on how amounts are computed as opposed to narrowing the scope of the methods of computation is something that the Board will consider. It might be argued that the Board took an initial step toward disclosure in FASB 36 by requiring the disclosure of the interest rate assumption.

The Board recognizes that there is a wide range of users of financial statements--from the highly sophisticated, multidisciplined groups such as brokerage houses to the less sophisticated such as the individual investor--and the Board tries to balance the various needs of all these users.

Frequently we are criticized for putting too much information in the footnotes--information which could only be understood by highly specialized individuals. According to analysts, bankers and other users of financial statements, some of the information required in FASB 36--such as accumulated plan benefits--is difficult to understand.

The problem is to translate the pension information into the language that is already understood by businessmen. These individuals have an understanding of such terms as assets and liabilities. Thus the Board is tending toward disclosure rather than trying to bring everybody to one method.

MR. THOMAS J. CAVANAUGH: FASB 35 says that it applies to governmental plans; yet the National Council on Governmental Accounting told its members not to comply with FASB 35 until they had a chance to look it over. Is there any FASB response to the NCGA position? Why should actuaries and users comply with FASB 35 when the accountants on the NCGA say don't comply with FASB 35?

MR. LUCAS: The whole question of setting accounting standards for state and local governments is still unresolved. There has been a proposal to establish a Governmental Accounting Standards Board (GASB) and an organizational committee is currently reviewing the matter. The FASB is participating in this study. There are serious questions as to whether GASB is viable or even necessary.

One of the concerns of governmental officers is that if they are included in FASB, they would be squeezed into a business mold. In my opinion there is no real need for separate governmental standards--particularly with respect to pensions.

Another point to consider is that generally speaking, there is no formal requirement for state and local governments to have audits similar to those required by the SEC.

MR. GREGG L. SKALINDER: I disagree quite significantly with almost everything Mr. Sunila said; however, I'll limit my questions to two specific points. Why is it necessary for expensing and funding to be tied together? While it may not be common, it is not unusual for expensing and funding to be at different levels. I assume one of the reasons you made your statement was that you assumed the expenses would be higher than the funding. My second question relates to your statement that pension assets are not employer assets--what about the liability to the PBGC? The employer is liable to the PBGC if not the participants; therefore, why aren't the pension assets employer assets?

MR. SUNILA: In those situations where the company expenses pension costs for amounts greater than they contribute, the amounts are usually based on the same funding method. For example, if for the particular funding method there is a minimum and recommended level, the company will fund the minimum and expense the recommended amount.

I am unaware of any situation where the expensing level is based on a funding method different from the funding method employed. Have you ever seen such a situation?

MR. SKALINDER: I never have; but my main point is why not? I don't see any theoretical objection to doing so.

MR. SUNILA: I'm only guessing, but I think the inertia of a different expensing method would force funding to be different.

MR. LUCAS: Overseas it is very common to have different expensing and funding methods. In Germany there is no funding because there are no tax advantages; typically companies carry a balance sheet reserve.

MR. SKALINDER: Tom, do you mean to say that you thought it would be somehow misleading to participants to have different methods?

MR. SUNILA: Yes. You brought up the point I was trying to make, that the expensing would be greater than the funded amount. Probably, the course of least resistance would be to expense the unit credit method and fund something else.

As to your other question--in my opinion the pension obligation eventually comes down to an obligation to the employees. However, I don't see this obligation becoming part of the balance sheet. Also, I don't see where the pension assets would ever revert to the company.

MR. SKALINDER: Admittedly, there are restricted uses of the assets. I see the employer liability as being to the PBGC and if, under ERISA, that liability does exist as a real liability of the employer--why don't the pension assets also belong to the employer?

MR. LUCAS: There are some characteristics of pension assets that are similar to other corporate assets, even though the pension assets legally belong to the trust and can't be used for accounts payable. For example, if the investment performance is higher than anticipated, the employer's future contribution obligations will be reduced; similarly, if the investment performance is less than expected, the employer will have to make additional contributions. Thus, the risks and rewards of ownership accrue, indirectly, over a period of time to the employer. Hence, the argument that pension assets are employer assets does have some theoretical validity--at least sufficient enough to have the question seriously discussed.

MR. SUNILA: Right, but I think it's indirect enough to keep it off the balance sheet.

MRS. ADAMS: I have a couple of observations. In essence, companies expense and fund on the same basis, except for unusual circumstances. There are some large companies that use projection valuation methods for financial forecasting and in such situations they may occasionally expense pension costs based on the results of those valuations.

In my opinion the determination of an employer liability as of a particular point-in-time is a very nebulous thing. There are so many variables, such as whether the amount is net or gross or whether the plan is ongoing, terminating, growing, shrinking, etc. I would be very nervous about putting such an amount on a corporate balance sheet.

MR. PETER B. HUTZEL: I think Mary stated part of what I wanted to comment on. I have seen situations where the company has expensed an amount entirely unrelated to the funding of the pension plan. Many accountants have taken the position that upon the discontinuance of a significant operation or upon a plan termination, the company should book the unfunded vested liability or the surplus of assets, whichever is applicable. The amount booked is completely unrelated to the funding method in use.

MR. SKALINDER: It seems to me that what lenders and investors need may not dictate a particular expense requirement. Employers should be able to use whatever methods and assumptions they want and which are acceptable to the enrolled actuary. What the community needs is sufficient information for arriving at a reasonably predictable flow of earnings and sufficient disclosure where there is a discontinuity in the expensing method. Could we have a little more discussion on this?

MR. LUCAS: The purpose of financial reporting is to show what happened. In showing what happened it seems to me that it is kind of opposite to saying that the financial community needs a stable and unfluctuating expense flow. This approach is great for funding.

If you are trying to report what has happened, there is fundamental distinction between knowing what has happened and having something smoothed. The purpose of smoothing is to eliminate fluctuations--and these fluctuations may be the most important part of the accounting information.

There is a difference between avoiding the economic fluctuations which produce earnings in one year and losses in another year--and that's management. But when you get to accounting and arrange the accounting--so even if there are economic fluctuations, it doesn't show up in the financial reports--that's a different situation. One of the problems we have is trying to draw that distinction in pension accounting. One man's economic reality is another person's unreasonable and irrational fluctuation. It's at least as serious to report fluctuations that have no economic basis as it is to ignore those fluctuations that have actually happened.

MR. BENJAMIN I. GOTTLIEB: Would Mary Adams please expand a little bit on the logic of not using a salary scale in the FASB 35 calculations? I think she stated that the use of a salary scale would put final pay plans in a different light versus career-average plans, but shouldn't final pay plans be shown in a different light? Don't they have different liabilities attached to them?

MRS. ADAMS: Yes, they do. When you talk about an individual accrued benefit at any particular moment, it is what the individual has accrued to that point. The Committee, in reviewing this matter, came to the conclusion that such a calculation had to be based on historical salaries.

If you talk in terms of accrued benefits based on projected salaries, the final pay plan accrued benefit would be substantially greater than that under a career-average plan or flat benefit plan.

In my opinion the pension information that is disclosed should be disclosed by the actuary, taking into account what he knows about the plan. It should be the actuary's responsibility to disclose what the employees should know.

MR. LUCAS: Mary, you limit that disclosure to the employees. Would you include shareholders?

MRS. ADAMS: Yes, I would.

MR. LUCAS: I agree that the information to be disclosed should come from the actuary. The problem is what form should it take. Information disclosed in footnotes based on APB No. 8 requirements is certified by the accountant but it comes from the actuary.

MRS. ADAMS: I think the problem is SAS No. 11, which prohibits the accountant from stating his reliance on the actuary.