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EMPLOYERS' ACCOUNTING FOR PENSIONS AND OTHER POST-EMPLOYMENT BENEFITS—ADDITIONAL ISSUES

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The FASB has yet to raise more detailed issues on the topics of accounting for pensions. In light of the FASB's tentative decisions on the issues presented in the Discussion Memorandum, this panel will consider such detailed issues as:

1. Disclosure
2. Multi-Employer Plans
3. Plans Funded With Insurance Contracts
4. Plans Likely to be Terminated
5. Treatment of Other Post-Retirement Benefits

MR. JOHN S. AGATSTON: Welcome to our panel discussion on employer's accounting for pensions and other post-employment benefits-additional issues. Mr. Lucas will get us started by bringing us up to date on the progress of the Financial Accounting Standards Board (FASB) pension project.

MR. TIMOTHY S. LUCAS: The FASB pension project has centered around three fundamental questions.

1. The first question deals with a company which has no prior service cost. Consider a newly established company that has just completed its first year of operation. The company has a defined benefit, final-pay pension plan, and employees have rendered one year of service. In this case, the complications of prior service cost are absent. The question we have to ask ourselves is, "What is the obligation and what is the expense that the company should record for the first year of service?" Everybody agrees that an entry should be made to debit an expense and credit a liability. But what is the amount of such entry? How should it be measured? Perhaps most important, should there be a variety of measurement methods to choose from? Is the obligation of the company somehow changed by selection of a method? A majority of the Board members currently support the idea that there should be a single comparable method to measure the obligation for similar plans. Notice that the measurement of the obligation is a different problem from funding the obligation. The amount of the obligation is one thing. The budget for paying it off, or the maturity schedule, is another. The question is further complicated by a number of future events that will affect the amount ultimately paid out in benefits. Those future events require a number of assumptions under any of the approaches we are considering.

2. The second question concerns the recognition of experience gains and losses and changes in actuarial assumptions. Should such events be recognized in the accounts as they occur by adjusting the recorded

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liability so that each successive statement shows the best, most current estimate of the obligation?

A case can be made for immediate recognition, but at this time, a majority of the Board is leaning toward prospective recognition. This is based on an understanding of the approximate or estimated nature of the assumptions, which would result in fluctuations in the liability that reflect primarily changes in estimates rather than actual events.

3. The third question concerns prior service credit when a plan is amended or a new plan is established with prior service benefits. Should such an occurrence give rise immediately to an incremental liability?

   The FASB has tentatively decided that a liability does arise when an amendment grants prior service credit. However, the FASB is also convinced by arguments that prior service credit is granted with the expectation that future services will be rendered in return, even though the future services are not part of the written contract. As a result, the FASB has tentatively decided that the expected future services should be recognized as an intangible asset (the Board has not yet decided how to measure this asset). As a result, the plan amendment would not be expensed at the time it is adopted. Emphasis must be placed on the fact that these are tentative conclusions of the FASB.

The FASB is hoping to have tentative conclusions on these issues by the end of this year, and to have a document prepared at that time with a description of the conclusions. It will be at least 1984 before a final statement is available. The FASB is also hoping to have a second set of questions prepared by the end of this year. This would lead to a public hearing, probably early next year, and then we would start working on an exposure draft of a statement.

The primary subject of today's session is the second set of issues. The FASB realized at the inception of its current pension project that the issues were too complex to manage all at once. In the interest of making things manageable, the Discussion Memorandum focused on a single employer defined benefit pension plan. The Board has not begun addressing the second set of issues, so there are no tentative conclusions to discuss at this time.

MR. AGATSTON: The FASB's tentative conclusions could lead to an increased amount of pension liability or asset appearing on the balance sheet of the plan sponsor. If the FASB deems one method as appropriate for accounting accrual purposes, and we as actuaries use what we consider to be an appropriate funding method, additional liabilities may appear on the balance sheet. In the past, common practice has resulted in accounting and actuarial liabilities being measured in the same say.

MR. LUCAS: Let me repeat that the FASB has not decided, even in the most tentative way, what method to use to determine the obligation. The Board is leaning towards a consistent measurement of the obligation. We recognize that there should be funding flexibility through different actuarial cost methods, yet we are trying to measure the obligation that exists today.

MR. JOHN A SCHOF: If the FASB is going to set a standard procedure for measuring such obligations, won't this result in the performance of two valuations for each plan each year?

MR. LUCAS: Yes, except in those cases where the FASB method and the funding method coincide.

MR. AGATSTON: This is similar to FASB statements number 35 and 36, where certain liabilities are required for disclosure. An extra expense for determining such liabilities does occur. Many actuaries now use different interest assumptions for valuation and FASB statement number 36 disclosure requirements.

MR. SCHOF: We simply give the accountants what we have under our valuation assumptions.

MR. LUCAS: One of the requirements of statements 35 and 36 is that salary progression not be included. Does that not require a separate valuation?

MR. SCHOF: No. It is part of our regular valuation. Our computer generates the required numbers automatically.

MR. LUCAS: The FASB does recognize that there could be an increase in the cost of performing annual valuations, although much of the cost might be one-time cost. Once the computer programs are changed, all the basic input data is the same.

MR. WILLIAM J. SCHREINER: Is the Board optimistic about determining a single method which would be suitable for these purposes?

MR. LUCAS: We are optimistic about determining a single method to be applied to a single type of plan. This does not necessarily mean that a final pay plan and a flat benefit plan would use the same method. There is some optimism that the range of methods can be narrowed. The Discussion Memorandum defines five attribution approaches. There are a number of actuarial cost methods which might fall within any one of those families. Thus far, the FASB has only spoken in terms of those families in trying to select one family. It would be surprising to see the FASB go beyond that level of specificity. We need to determine how different the results would be under the various methods before a decision is made.

MR. AGATSTON: At this time, we move on to discuss disclosure of these items. There are three things to consider:

1. What do people look for in a financial statement?
2. Comparability
3. Suggested types of disclosure.

When looking at the current financial status of a pension plan, one uses the balance sheet, or static approach. This is quite useful in the case of plan termination, and it may imply pressure for increased funding should there be a very large unfunded liability.

Another item which one looks at when evaluating pension costs is the expected future costs. When interested in buying a company, a prospective buyer will often attempt to determine the expected future costs of any existing pension plan. This is usually done using the current plan design and demographic conditions. The assumptions and funding method chosen are, of course, at the discretion of the actuary.

Comparability of pension plan costs is a very difficult goal to achieve due to the fact that there are different types of plans, and different types of cost methods. Often you are trying to compare apples and oranges.

There are four basic concepts to consider when trying to compare pension plan costs. Two of these concepts involve anticipation. The issue is how much of the ultimate cost is anticipated by current funding. Two types of anticipation are benefit anticipation and actuarial anticipation. Benefit anticipation occurs if we project salaries or assume that plan provisions will be liberalized. Actuarial anticipation is a result of the funding method chosen. The unit credit funding approach reflects the fact that one year's accrual of benefit is more expensive for an older person than for a younger person, whereas the entry age approach has a levelling affect on funding.

The current disclosure requirements of FASB numbers 35 and 36 are consistent with regard to anticipation. There is no projection of benefit beyond the present, even if the plan is of the final pay type. At the same time, using the present value of accumulated benefits is a unit credit type of approach.

The third concept to consider is the spreading factor. Some plans spread costs as a level percent of pay, some spread an absolute level amount, and some spread in other ways. Some spread over a certain number of years, and some spread over the future working lifetime of the active participants.

The fourth concept is a separation of true current cost from past service cost. The past service cost tells you what should have accumulated if the plan were fully funded from the start. The current cost tells you what the plan really costs today. These pieces of information are quite useful.

As to what all of this means in terms of disclosure, it is difficult to develop a single disclosure number to represent so many varying factors. We are faced with either an over-simplification for the benefit of the users of financial statements, or a more complete disclosure which may be too cumbersome to handle in the context of financial statements. Thus, we are faced with either mini-disclosures or maxi-disclosures.

One possibility for a mini-disclosure would be a five year history of costs and contributions showing contributions and pension expense as dollar amounts and as a percentage of payroll. Any large changes would be footnoted. This approach might not tell all that much, but could indicate the direction costs are taking.

A more detailed approach might consider the fact that pension costs reflect a variety of factors such as plan design, the actuarial method, the actuarial assumptions, demographic information, etc. All of these items could be segregated, and the effect of such items on plan costs could be analyzed.

MR. LUCAS: One fact which is becoming more and more obvious to me is that there is relatively little true understanding of pensions and pension accounting among financial professionals outside the actuarial profession. There is significant opportunity for improvement in communications and in financial reporting via disclosure of pension plan information.

Disclosure questions relate to information reported in footnotes or supplemental schedules. That information may supplement or further explain information included in the statements themselves. In addition, disclosure may provide information that is useful but is not the kind of information that fits in the financial statements themselves. The purpose of disclosure, in general, is to provide information that will help financial statement users to understand more about a company's status or operations.

The items which will be considered for disclosure by the Board include the following:

1. Information on return on pension assets, perhaps over five or more years.

2. The ratio of pension expense to related wages.

3. Actuarial assumptions, especially discount rates and perhaps the salary progression assumption. FASB statement number 36 currently requires the disclosure of discount rates.

4. Information concerning foreseeable increases or decreases in funding requirements or expense. Such information would be most useful but is difficult to determine. There is considerable resistance to the idea of disclosing forecasted information in financial statements, as the reliability of such information is suspect.

5. Frequency and dates of actuarial valuations and plan amendments.

6. Any information concerning waivers of ERISA funding requirements.

7. Information concerning the type of plan formula.

8. Information about the employee group. For example, the average age of the active employees is quite useful to know.

MR. JEREMY GOLD: Payroll information is very useful. Why is it that payroll information is not directly available in financial statements? Is that issue currently being addressed?

MR. LUCAS: One way to make payroll information available would be to require disclosure of the ratio of pension expense to covered wages. This would enable us to back into the payroll figure given the pension expense figure. Payroll is <u>not</u> currently required as a separate line item. This has often been criticized.

There are really two questions here. The first concerns the disclosure of payroll information. The second question is, "Why single out pensions for all this disclosure information?" All of the payroll expense is included in expense on the income statement. The problem is that the number is not always segregated. The FASB does not have very rigid guidelines for breaking down most types of expenses.

MR. JAMES BEIRNE: Most plans disclose the information we are discussing. Are you saying that the Board is considering having the employer include such information in financial statements as well as the plan?

MR. LUCAS: Yes, that is what we are discussing.

MR. BEIRNE: In the Discussion Memorandum one of the topics addressed was symmetry among reporting by the employer and reporting by the plan. Where do things stand on this issue? Will we eventually have symmetry? If the employer reports a liability, will the plan report it as an asset?

MR. LUCAS: In that sense, we are not necessarily headed toward symmetry. The Board has said that there is no fundamental requirement that the two should be equal. There are some practical advantages to symmetry. One advantage is that only one number need be computed.

MR. BEIRNE: From practical experience, I have found that if you do not compute one number for both the plan and the employer and you happen to work for both parties, then there is quite a bit of explaining to do when either party looks at the numbers.

MR. LUCAS: This question has arisen with the disclosure required under statement 36. Sometimes the interest rates used for funding purposes and statement 36 purposes are different, and some companies disclose both rates. The Board applauds this disclosure. However, any time you create more than one way of accounting for what some people think is the same thing, you do create the possibility of some confusion.

MR. BENJAMIN E. FELLER: Where in the financial statements will such disclosure information appear?

MR. LUCAS: The disclosures we have been talking about most recently are footnote type disclosures, or conceivably could be part of some kind of supplemental pension report. Earlier, when we were discussing measurement methods and the three fundamental questions on which the FASB project was based, we were discussing items which will appear on the balance sheet and income statement.

MR. AGATSTON: We now move to the topic of post-retirement benefits with Mr. Marvin Greene.

MR. MARVIN H. GREENE: The FASB Discussion Memorandum raises the issue of how post-employment benefits other than pensions should be accounted for. The Discussion Memorandum states that the focus on this issue is on identifying how such benefits are similar to or different from pensions. My remarks today will consider two aspects of this question:

1. the nature of the employer's commitment to pay welfare benefits compared to the pension benefit commitment, and

2. the relative magnitude of the welfare benefit liability compared to typical pension liabilities.

There is no doubt that the nature of the employer's commitment in the welfare benefit area is different from his commitment in the pension area because companies can escape these welfare benefit commitments quite legally. This is not the case with respect to pensions, where accrued benefits are protected by law. However, when asked what they would do if forced to discontinue these plans in the future, many companies frequently express firm commitments to some of their current and prior employees.

These commitments are usually:

- o to their current retirees at the time of discontinuance,
- o to those eligible to retire at that time, and
- o to those with long years of service.

Generally, the commitments take the form of grandfathering benefits either fully or on a pro-rata basis.

Moreover, these post-retirement welfare benefit commitments often translate into measurable benefit obligations which are remarkably similar to pension liabilities with the same issues on expensing and disclosure of liabilities.

For this case study we assumed that medical inflation will outpace general inflation as measured by the CPI in the long run by 1/2%. We also assumed that the salary scale will exceed inflation by 1/2%. Further, we assumed that the investment return will equal the inflation rate plus 1%. And finally, the Part B Medicare premiums will increase with the CPI.

Using these assumptions, we calculated the welfare and pension liabilities and displayed the welfare liability as a percent of the pension liability for a 10-, 20- and 30-year career employee retiring at age 62.

For this company to provide a full range of post-retirement welfare benefits to individual employees, it must accumulate anywhere from 60% to 175% of what it accumulates to pay for pension benefits.

Several of the ratios exceed 100%. This means that, in some cases, liabilities for post-retirement welfare benefits can exceed those for pension benefits. However, these numbers are somewhat misleading in that escalation in medical costs due to inflation have been explicitly recognized whereas post-retirement ad hoc pension increases often granted by employers have been ignored.

The relative liabilities for post-retirement welfare benefits increase dramatically for short-service employees. This is because pension benefits are related to service, and long-service employees generally get larger pension benefits that short-service employees. On the other hand, post-retirement welfare benefits are usually independent of service.

In this case study, the cost of the pension plan is 9% of payroll. The study is based on a mature company with 10,000 active employees and 1,200 retirees. In 1982, accumulated pension liabilities were 90% funded. For projection purposes, we assumed a constant active employee population.

Currently, this company is paying 1% of payroll for welfare benefits to today's retirees. This is on a pay-as-you-go basis. By the end of the century, it will reach 3% of payroll; by 2020, it will exceed 4% of payroll.

The story is much the same for the size of the unfunded liabilities on an FASB 36 basis. The pension plan currently has an $11 million unfunded accumulated liability on an FASB 36 basis. The post-retirement welfare plans now have a $100 million unfunded accumulated liability on a comparable FASB 36 basis.

It must be remembered that most welfare plans will not show these same relative numbers. Obviously, costs depend on the employee group, the array of post-retirement welfare benefits provided and the funded position of the pension plan. The fact is that most pension plans have been accounted for and funded over many years. In many cases, enough assets or book reserves have accumulated to provide a substantial portion of the pension liabilities and produce lower pension costs. But this is not the case for post-retirement welfare benefits. For companies whose pension plans are well funded, the accrual costs for a generous array of post-retirement welfare benefits could exceed the current cost of the pension plan.

Now that we have discussed the 1982 numbers, we will examine how these welfare liabilities grow with time compared to pension liabilities. We will look at what happens if you start expensing for these benefits using pension-type actuarial cost methods that spread these costs over a full working career.

The total welfare liabilities are reasonably large compared to the pension liabilities. We discovered, in this case study, that the pension plan assets would soon exceed liabilities while the welfare plan assets do not even equal associated liabilities until after the turn of the century.

In summary, then, we have the following observations:

1. How you define "commitments" will determine the size of the liability.

2. Total post-retirement welfare liabilities can be substantial.

3. Financial planning may well be as important for post-retirement welfare benefits as for pensions regardless of the position taken by the FASB.

MR. SCHREINER: I am disturbed by your presentation in the following sense: you have demonstrated that it is possible for these commitments to be quite substantial and have serious financial implications. However, there is an implication that the problem is perhaps more widespread than this demonstration.

MR. GREENE: I did not mean any implication concerning whether the situation is widespread. However, I can almost guarantee that it is more widespread than you think it is.

MR. GOLD: There are two thoughts which come to mind as a result of your presentation, which might come to an employer's mind as well.

1. Employers may not hire older people as quickly as younger people, as benefits for the older people are more expensive.

2. Employers may pay more attention to the design of these benefits, in particular relating them to years of service, and have employees earn such benefits incrementally, much in the same way as pensions are earned.

MR. GREENE: I did not intend to put any specific ideas into an employer's head. I merely wanted to point out certain facts.

MR. MICHAEL MUDRY: The Discussion Memorandum refers to post-employment benefits, and Mr. Greene refers to post-retirement benefits. Is there a difference?

MR. LUCAS: Conceivably, yes there is a difference. The FASB was trying to be as broad as possible and, in doing so, used the term post-employment benefits. This allows for accounting of such items as termination indemnities, etc.

MR. AGATSTON: Mr. Michael Kaplan will now discuss multi-employer plans.

MR. MICHAEL H. KAPLAN: I will address the issue of how the Discussion Memorandum applies to multi-employer pension plans.

The fact that differences exist between single employer and multi-employer plans was expressly recognized in the FASB Discussion Memorandum on Employers' Accounting for Pensions and other Post-Employment Benefits. Paragraph 24 of the Discussion Memorandum states that one situation to be addressed at a future time is the matter of multi-employer plans.

Major differences between multi-employer and single employer plans involve sponsorship and obligation, as follows:

1. In a single employer plan the employer is the plan sponsor. In a multi-employer plan the Board of Trustees is the plan sponsor.

2. In a single employer plan the employer's obligation is to provide the benefits promised. In a multi-employer plan the employer's obligation is to continue the contributions agreed upon in the collective bargaining agreement.

We have recognized these differences in the reporting requirements of A.P.B. No. 8. For single employer plans, we have consistently reported the present value of vested benefits, since these benefits represent the employer's obligation. However, for multi-employer plans we have not allocated the present value of vested benefits among each of the employers contributing to the plan. There are three reasons for this:

1. The obligation of the employer, as previously stated, is only to make required contributions.

2. The multi-employer plan is a pooled arrangement, and such an allocation would not produce meaningful results.

3. The allocation of the present value of vested benefits in some cases would be a tedious and expensive task. In other cases, it would be an impossible task due to the lack of data.

Therefore, it remains our considered opinion that the present value of vested benefits is a figure that should not be allocated among employers contributing to a multi-employer plan.

The passage of the Multi-Employer Pension Plan Amendments Act of 1980 (MEPPA) further complicated the issue by the creation of employer liability in the event of withdrawal. Of all of MEPPA's provisions, that which causes the most concern among employers contributing to multi-employer plans is the withdrawal liability and how it might be reflected in their balance sheet.

We believe that the <u>potential</u> withdrawal liability of any employer should be reflected in neither the balance sheet nor in a footnote for the following reasons:

1. Withdrawal liability is a contingent liability and does not attach unless an employer actually withdraws. Whether or not an employer withdraws in the future will most likely result from a business decision on the employer's part and does not reflect the employer's current financial status.

2. The purpose of disclosure in an employer's financial statement is to reflect its obligation on an ongoing basis. An employer's withdrawal does not reflect its ongoing obligation to the plan, which is the continuance of contractual contributions.

3. Withdrawal liability, if shown in the balance sheet or as a footnote, could be misleading. This is because an employer could withdraw under different circumstances, each of which would result in different amounts of withdrawal liability. The circumstances under which the liability might differ are as follows:

   a) a cessation of the employer's obligation to contribute
   b) the sale of assets
   c) a withdrawal due to an insolvency leading to liquidation or disolution
   d) partial withdrawal

4. In the event of a contemplated sale of assets, the purchaser may be under the false impression that by assuming participation in the plan, he has taken on a withdrawal liability equal to that of the seller. However, under the provisions of MEPPA, the purchaser, as a successor, assumes for withdrawal liability purposes only the contributions made by the seller in the year of the purchase and the four preceding years. Thus, depending upon the date of the transaction, the purchaser's liability might actually be considerably smaller than the seller's.

5. The Trustees of a multi-employer plan may change the existing formula for determining withdrawal liability at some future point.

MEPPA has changed the obligation of the employer contributing to a multi-employer plan. However, for the above stated reasons, we do not believe that there is any one number that would be appropriate to be reported in the employer's financial statement. We would, however, recommend that there be a footnote which discloses the fact that the employer participates in a multi-employer plan and that it may be subject to a withdrawal liability in the event it withdraws from the plan in the future.

MR. LUCAS: The accounting standards executive committee of the AICPA, which is a senior technical committee on accounting, has made a formal written request that the FASB consider the application of existing accounting standards to the multi-employer situation under the new law. They have asked us to determine what ought to be disclosed this year. The Board may or may not be willing to take this issue up right now. At one time, this issue was scheduled for discussion on May 5, but that was postponed. Toward the end of the summer the Board will probably decide whether they want to address this question formally.

MR. KAPLAN: If the Board decides not to take up this question, where does it leave us?

MR. LUCAS: It probably leaves us with some diversity in practice in terms of the way the requirements for disclosure will be interpreted. If the Board does decide to create a standard on this issue, it would be creating another interim adjustment to pension accounting rules. Whether the Board is willing to undertake another interim adjustment is an issue. FASB statement number 36 was an interim adjustment, to be in effect only until the current project which I am working on is completed.

The staff did issue what is called a technical bulletin in February, 1981. That technical bulletin began to address this question and pointed to the appropriate existing accounting rules concerning this issue. However, the technical bulletins are limited in use.

In commenting on Mr. Kaplan's presentation, the point he made that the problems of multi-employer plan accounting and other aspects of managing multi-employer plans are complicated by the current legal questions is certainly well taken. The FASB hopes that the legal situation is somewhat clearer by the time it addresses the multi-employer plan issue. In the interim, an excellent case can be made for disclosure and footnotes concerning an estimate of the withdrawal liability. The Board is pleased that some companies have done so.

Mr. Kaplan states that the withdrawal liability is contingent. This may or may not be true. One situation occurs when a company terminates and then a withdrawal liability exists. The liability is usually the continuation of contributions. Another alternative is not to terminate but continue in the plan and make contributions. The contributions are the same, but they are called by different names. It is the contributions which are contingent not the liability. This is not the kind of contingency we have in a lawsuit, where there may or may not be a future disbursement.

In addition, even if it were a contingent liability, material contingent liabilities are generally required to be disclosed under certain conditions in the footnotes of financial statements. The question we need ask ourselves is, "Given the range of people who use financial statements of companies which participate in multi-employer plans, can some estimate of the amount of this liability be provided at a reasonable cost?" Whether something should appear on the balance sheet is an entirely separate item, and this has been put off.

With regard to the practical difficulties of splitting up the withdrawal liability, the problem is particularly obvious when employees work for different employers during their career. Under MEPPA, the sum of the withdrawal liabilities does not necessarily cover all of the obligations to the employee.

The crucial conceptual question with regard to multi-employer plans is to what extent the plan in question is a defined benefit plan, in substance, as opposed to a defined contribution plan. Under a defined contribution plan, once a contribution is made for a particular year, the obligation with respect to that year has been completely satisfied. This is not true of a defined benefit plan. MEPPA may have changed defined contribution plans into defined benefit plans in this regard.

MR. KAPLAN: How is this so?

MR. LUCAS: Under MEPPA, even though a contribution has been made for a particular plan year, the obligation is not necessarily extinguished. It is possible that more payments will need to be made.

MR. AGATSTON: We will now address the issue of accounting for plans likely to be terminated.

MR. LUCAS: The FASB has not really begun to address this issue yet other than discussion of some preliminary staff thoughts.

Let us assume for a moment that the Board decides that there is an obligation under the typical defined benefit plan. With insured plans it is necessary to separate the insurance contracts into two types. The first type of contract is the typical insurance contract where the risk is transferred to the insurer, as in a fully paid up annuity plan. The second type is the investment type contract. Many contracts involve the insurer acting as investment manager, but not assuming any of the risks, the risk of mortality, for example. In such a case, the employer's position is essentially the same as it is in a trusteed funded plan.

MR. GREENE: With regard to the investment type of contract with an insurance company, what do you see as the market value of such contracts which involve a single sum deposit and guaranteed interest rates?

MR. LUCAS: FASB statement number 35 avoided this issue. One could probably compute a surrogate for the market value based on relatively current interest rates.

MR. KAPLAN: One way to get a market value is to ask the insurance company what proceeds would be payable <u>today</u> if the contract were cancelled by the contractholder and all funds available were withdrawn.

MR. MUDRY: In the case of a post-retirement death benefit paid for by one year group term insurance, if the insurance arrangement is terminated, would we not need to record a liability for any benefits promised to those who have already retired, assuming those benefits are preserved?

MR. LUCAS: To the extent that there is an obligation, yes.

MR. AGATSTON: We would now like to open it up to any questions on any of the subjects discussed today.

MR. HOWARD ROG: How is the present accounting going to be changed with regard to plant closings?

MR. LUCAS: The Discussion Memorandum calls for a reexamination of the question of accounting for a plan termination or a plant closing in addition to the situation where the company fails. These issues are interrelated, but somewhat different.

Suppose the FASB decided that the present value of accumulated plan benefits as developed now in accordance with statement 35 should be a liability on the balance sheet. This would significantly reduce the impact of a plan termination or plant closing in terms of an accounting change. Currently we have a suddenly arising obligation, but if the liability for benefits to date were already on the balance sheet, only the increase in accumulated benefits created by the plan termination, if any, would cause an increase in liability.

MR. ROG: Are we still going to use the section 415 limitations on benefits, or will we be allowed to project these limitations?

MR. LUCAS: Section 415 of the IRS code applies only to funding and tax deductibility of contributions, not to accounting.

MR. GOLD: Are there any implications here for a flat dollar plan?

MR. LUCAS: The implicit interest rate approach is one which the Board seems somewhat uncomfortable with. The Board does realize that the results are not the same as if explicit interest rates and salary progression rates are used, but removing inflation from both items is something which has been discussed.

MR. AGATSTON: There are some potential problems with this approach. A post-retirement cost of living increase rate is implicitly assumed by using a real rate unless dual rates are used. In a Social Security offset plan, the leveraging effect is lost if only a real rate is assumed.

MR. KAPLAN: Implicit rates are most appropriate in flat dollar plans, as one should not project that the flat dollar amounts are going to be increased. Use of an implicit rate also avoids actuarial losses if the rate is not realized. In a salary related plan, if inflation is built into both the interest and salary scale assumptions, a lower than expected rate of inflation will result in losses on investment return, but there will probably be gains on the salary scale assumption.

MR. LUCAS: The future inflation issue is one that has troubled the Board for quite some time. When statement 35 was approved, salary progression was left out as the Board did not want to put future events in the financial statements. However, a market type interest rate is used. Thus, there is inconsistency in that inflation is implicitly part of the market type interest rate, but inflation is not considered on the salary side.

MR. AGATSTON: Mr. Lucas will now close our meeting by telling us a bit about the FASB plans for transition to any new rules which may develop.

MR. LUCAS: An important set of questions will deal with how companies are allowed to make the transition to new procedures. If our project results in significant changes, the short run impact of the changes will be of concern to many people, including the Board. To cite just one example, recording accumulated benefits or some measure of prior service cost as a liability could put some companies in default under credit agreements. Transitional provisions, such as a several year delay in required implementation, can greatly reduce such effects.