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EMPLOYERS' ACCOUNTING FOR PENSION PLANS

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° Current FASB Discussion Memorandum, Preliminary Views and Field Tests

-- FASB perspective

-- Actuaries' perspective

-- Plan sponsors' perspective

° Implications

-- Plan design

-- Plan funding

MR. CHARLES F. MILLER: Good morning. Our topic today is Employer's Accounting For Pensions. My name is Chuck Miller. I am responsible for Peat Marwick's Employee Benefit Consulting Practice in San Francisco. On my far right is Timothy Lucas. Tim, who most of you probably know, is the project manager for accounting on pensions at the Financial Accounting Standards Board, often known by its acronym FASB. Tim has been involved with the pension accounting project for about four years and is obviously very knowledgeable. Last night over dinner I suggested to Tim that he consider sitting on one of those carnival fall away boards above a vat of ice water. I thought at a dollar a throw we would probably cover the Society's annual budget for next year, given FASB's popularity with most actuaries. But since Tim insisted on too big of a percentage of the take, those of you with less than amorous feelings for FASB will have to take your best shot during the question and answer period.

On my immediate right is Gaylen Larson who is the Group Vice President and Controller at Household International, one of the largest multi-industry corporations in the nation. Gaylen formerly was a partner with Deloitte, Haskins and Sells. At Household he has oversight responsibility for over 60 defined benefit pension plans and has taken a special interest in the pension accounting area. Gaylen is very well qualified to give us the plan sponsor's perspective.

On my immediate left is Gerry Wilson. Gerry is a partner with Hewitt Associates. He is also in charge of their Actuarial Division and is Chairman of Hewitt's Executive Committee. Gerry will provide us with the actuaries' perspective in the pension accounting area.

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In order to allow Tim, our first speaker, to spend more of his time on current issues, including the recently completed field tests, I will spend a few moments to provide a brief description of the what and the why behind the pension accounting proposals.

The new proposed pension accounting requirements along with the thoughts behind them were published by FASB last November. Of course, these are still proposals and the Board invites comments. However, one should also remember that these proposals represent the Board's current thinking. The intention is that ultimately a final standard will be issued after due process procedures. This is currently expected sometime in 1985. A subsequent Discussion Memorandum was also released last April on additional issues in this area.

These proposals reflect a significant departure from current practice. They will require that certain pension data be reported as assets or liabilities in a Company's balance sheet. Currently, similar information is shown in a footnote or not at all. Pension expense will be determined as the net change in these amounts ignoring contributions. There is to be no choice in the method that is used to calculate the pension obligation and the method is specified as the projected unit credit method. As mentioned earlier, FASB has recently completed field tests and Tim will be discussing those with us in a moment.

An equally important question is "Why do we have these new pension proposals?". There are standards currently in place and generally they appear to be accepted and well understood. Recently there has been no large pension disaster that has brought forth cries for a reform in pension accounting. Why then is FASB considering change? FASB has justified undertaking this pension project at this time based on the following perceived criticisms of the present accounting rules.

First, financial statement usefulness. Significant unfunded obligations and, in some cases, significant net assets are omitted from the statement of financial position rendering this statement less useful than it otherwise could be.

Second, comparability. The pension cost of one company cannot meaningfully be compared to another. For example, under current pension accounting, that is, Opinion 8, two plans with the same terms and the same benefits and similar employee groups can recognize significantly different costs and liabilities depending on how long it has been since the plan was initiated or amended and depending upon amortization periods and the choice of actuarial method.

Third, understandability. Even sophisticated users of financial statements cannot fully understand the impact of pension arrangements on financial position and results of operation. This issue of understandability has been in my opinion perhaps the strongest "behind the scenes" catalyst leading us to these new FASB proposals.

The pension actuarial area has always appeared complex for non-actuaries primarily for two reasons. First, it is truly complex, involving present value techniques based on life contingencies. In my experience, most accountants are familiar with present value techniques and this, in and of itself, does not present an insurmountable hurdle for understandability.

The second reason for pension actuarial complexity is the terminology or perhaps jargon we actuaries have adopted over time. Of course, accountants have their own language or jargon. However, among financial people the accountants' language is widespread enough to be analogous to English, whereas, ours might more aptly be compared to Swahili. Although we can speak Swahili amongst ourselves it is important for us to focus on our English if we wish to influence FASB in its consideration of its Preliminary Views. To have an effect on the standard setting process we must make sound, coherent arguments in a language accountants understand for our good and for theirs. Today I look forward to hearing a few such arguments. Now I would like to introduce Tim Lucas.

MR. TIMOTHY S. LUCAS: Thank you very much. I appreciate the opportunity to be here today. Sessions like this are very important to the FASB, and we welcome opportunities like this to have a chance to talk to folks like you. In this particular project we are dealing with a subject area that is of great interest to your profession as well as my own. In trying to deal with the problems we see in that area we really are seeking your help. Sessions like this provide us with an irreplaceable opportunity to gain further input and understanding of the problems involved in the proposals from people who are knowledgeable about them.

I want to start out by saying a few words about how I view the Board's Preliminary Views proposal. Time certainly would not permit me to cover this in complete detail. It's probably unnecessary anyway as many of you probably have a better grasp of the details than I do. I would like to point out that, at least in my view, the proposal is considerably less radical than some have suggested once you get to understand it. In many respects, aspects of this proposal are just different ways of describing, perhaps translating, Swahili into English or Swahili into accounting. Aspects of this proposal are similar in their underlying mechanism to things that are done as part of your work today. The proposal would simply lay out some of those details and standardize them to make them more understandable to the rest of the world.

The Preliminary Views proposal as it relates to pensions can be summarized in just five points. I should start by pointing out that I am leaving out perhaps one of the most significant parts of the proposal and that relates to the other post-employment benefit questions. That question is the subject of a separate session to be held tomorrow morning and I will therefore try to stay away from the subject of other post-employment benefits. The fact that I am ignoring that as part of this session should certainly not be taken as any suggestion that it is in any way less important than the other aspects.

First, the Board has proposed a single method for computing the amounts of both the costs and the liability involved in the operation of a pension plan from the employer's point of view. The method proposed is the projected unit credit method. We believe that a single method would enhance the understandability of the information. In particular, we believe that a single method is most appropriate if we are going to try to measure an accounting liability related to pension plans.

Second, the proposal would include on the employer's balance sheet a net pension asset or liability. I say net because the proposal calls for subtracting from the amount of the obligation the fair value of the assets so that the amount presented would be the unfunded amount or the net liability. In some cases the assets of a plan exceed the amount of the obligation and in that case we would show a net asset.

Third, we propose to recognize the cost of retroactive plan amendments over future periods. Now that is far from a radical suggestion since that is exactly what we do now. This proposal includes recognition of an intangible asset in order to accomplish that. Perhaps the most important aspect is that the Board does propose to recognize the cost of those retroactive plan amendments over a period based on the remaining service of current employees. That is a change from current practice.

Fourth, the proposal includes a device we call the Measurement Valuation Allowance that is intended to minimize or reduce the volatility of the measurements that are involved. This is certainly not a new thing. There are a number of people who have viewed it as a radical change from current practice but I am sure all of you know that the items in the Measurement Valuation Allowance are, under current accounting, recognized on a deferred basis. The big difference here is that we would standardize the period of amortization and perhaps, more important, we would propose to disclose the amount of unamortized or unrecognized portion. Those actuarial gains and losses and effects of changes in assumptions that have not yet been run through the books would be disclosed as part of a footnote.

Finally, the proposal includes some suggestions on transition. These get involved in some very technical accounting questions. I will not go into them in any great detail. But the Board has attempted to provide at least a partial means of reducing some of the problems that people have seen in the proposed change.

When you put all of that together, perhaps the most significant changes that are proposed affect the balance sheet. The balance sheet or statement of financial position of a typical company after the implementation of these changes,would be expected to reflect two new items (see Exhibit 1). On the right hand side we would have the net pension liability. In some cases that could be an asset. On the left hand side we would have the intangible asset. The main thing I want to focus on at the moment is the breakdown of the net pension liability. There would be, in the footnotes, some information about the components that make it up (see Exhibit 2). I think that you will all agree that there is a lot of similarity between the information in that footnote and some of the computations that go on now in arriving at the numbers that appear in financial statements.

Looking at the footnote a little bit more in detail we would propose to disclose in the footnote basically the same number that is required by Statement 36 today: the pension benefit obligation or the actuarial present value of accumulated plan benefits. For plans that include future salary as part of the plan formula, we would have an additional increment of obligation that relates to the salary progression factor. I will say a little bit more about that later because that is one of the controversial aspects of this proposal.

Then, we would deduct the fair value of the plan assets and finally we would factor in the Measurement Valuation Allowance which would be added or subtracted and which would contain those deferred gains or losses. All of that is by way of a little bit of review.

I also want to say a few words about why the Board undertook this project or why it is headed in the direction it is headed. If you look behind the details (the computations, the footnotes and the disclosures), there are some basic foundations that underlie the Board's approach to this. Those who would understand the approach or would like to work on suggesting changes to it would probably do well to focus on some of these foundations.

The Board views pensions from an accounting point of view as a form of compensation. I do not think that is a dramatic change from current practice. I think that is a notion that underlies Opinion 8 as well. The Board also believes, and this is a fairly central item, that the cost of an employee's pension should be recognized to the extent possible during the period that the employee is working. It follows that the employer has an obligation for those benefits that have been earned but not funded or paid. The Board views employee service as the primary feature in terms of earning pension benefits. The Board also believes that the best possible method of measuring that obligation is based on the terms of the plan. I think the theory or notion that measurement can be based on the terms of the plan is another central element of this. The plan benefit formula provides the best basis that the accountant can possibly have for trying to make an objective measurement of the obligation at a point in time.

Finally, the Board believes that funding and accounting need not necessarily be the same. There are many other areas where funding or financing or cash flow information and accounting information differ. Indeed, reporting something in addition to the amount of cash disbursements and cash receipts is the essence of what we call accrual accounting. Pensions is a fairly unique area from an accounting point of view in that we have a tendency to get the funding confused with the accounting information that is provided. That is not to suggest that funding information is not to be part of the accounting. The proposal would certainly not eliminate the reporting of cash flow information as part of the package.

I would like to talk a little bit about how the Board got to where it is, why we believe this project is appropriate, and why we came to the kind of tentative conclusions we have. The Board has been quite explicit in defining its objectives. The notion that financial statements need to provide information that is useful, specifically to investors and creditors, has received quite wide acceptance. That idea transcends the question of pensions and it covers all of what the Board is involved in. The idea that pension information can be useful or that useful pension information can be included in financial statements has some interesting implications. We look first to people who are outside the financial statements but not exclusively. Financial statements provide information that is useful inside. Gaylen Larson will give us a little more of an inside view on accounting information. It also follows that if we change the information that is presented, some of the decisions that are made may change. That has been troublesome for some people but it is really fairly central to the idea of useful information. There are some who have suggested that any changes in the decisions that are made indicate flaws in the presentation and I do not think that we can start with that assumption. Information in order to be useful must have a certain level of understandability. That is, people trying to use it must be able to comprehend what it means. Comparability is also important. It contributes to that usefulness. Perhaps more important than either of those is the notion that we call, to use a little of our own jargon, representational faithfulness. Information in order to be useful needs to represent what it purports to represent. It needs to tell about the companies real situation. That has been one of the problems with pension information.

The information that we find is needed and is useful in the pension area relates primarily to the area of cost, the area of cash flow, and some information about the obligation that has been undertaken. That is the same kind of information that is provided by accounting statements in other areas. There is nothing unique about that in pensions. The difference is that we have not done as good a job in pensions in providing it in the past.

The Board is trying to separate those portions that are key parts of the problem from those portions which are implementational details. The latter are by their very nature more subject to change. You can come up with three underlying principles that are very difficult to refute and are independent. Any one of them could exist if the other two were to be eliminated. Any one of them would suggest significant changes in the way we account for pensions today. Let me give you those three underlying principles that I think are pretty firmly established. Then I will mention briefly a few of the less significant details that are part of this proposal.

First, cost should be recognized during the working life of the individual. That is fairly difficult to refute from an accounting point of view. The notion of matching costs and revenues as a part of accounting has a long history and I think it is difficult to argue in an accounting sense that we ought to defer the recognition of cost beyond the point where the individual retires. That is different from the funding notion. You all may very well be able to make excellent arguments that suggest that the pension obligation need not be funded until some period after that. But from an accounting point of view, this idea is central to the Board's argument and in my mind hard to refute.

Second, we should narrow the range of methods in order to provide information that the people who are using financial statements can cope with. I think that is about equally central to where the Board came out and, from an accounting point of view, also hard to refute. There has been a trend in accounting toward narrowing the range of alternatives in a number of different areas. Some of the areas that are often mentioned as future candidates for this treatment are inventory and depreciation. I think the Board may get to those in due time. But the different methods that are used in pensions really do render the information difficult to understand, difficult to use and probably impossible for most users of financial statements to really understand. They introduce differences that really do not have anything to do with the part of the company's existence that we are trying to report in financial statements. When I talk about the range of methods, I would include some of the differences which exist in amortization methods.

Third, I think the conclusion that the pension arrangement does have some impact on financial position is central. You can separate the notion that there is some impact from how you measure it. The way that I normally try to separate those two ideas is to think in terms of vested benefits. I think it is difficult to argue from an accounting point of view that there is not an obligation at least for unfunded vested benefits. It is also very difficult to argue that accounting can have any hope of presenting something that is described as financial position without some consideration of that liability. Those three central themes will obviously result in some very significant change if any one of them were to be sustained. Now I would like to talk about some of the details that are part of this package and are perhaps a lot easier to argue about.

First, is the idea of how to go about measuring what we are talking about. How we go about measuring the cost and the liability is an area where we have more room and a lot of work left to do. Measurement of the cost and liability are linked in the Preliminary Views and the same method is proposed for both. I think the most contentious part of that is the salary progression question. From an accounting point of view I can build a pretty good conceptual case on either side of the question of whether salary progression should be included. We had some long and fascinating arguments about that the first time around. There were several Board members who prefer the other answer. I would point out that there was an awful lot of commentary when Statement 35 was published that suggested that we should have put salary progression into that opinion. We are getting about the same amount of commentary that says we ought to take it out of this one. I am not sure that there is an answer that will satisfy everybody.

A second item that I think leaves a lot of room for further debate is the question of how much smoothing we need or how much volatility we can use in the financial statements. The Measurement Valuation Allowance I mentioned earlier is a device intended to reduce volatility. Similar devices are part of the actuarial procedures that are used today. A question of how fast we ought to amortize, how much volatility should be left in, or how much smoothing is required, is one where there really is no conceptual basis that I know of that bears on the question. It is essentially a pragmatic and a trade-off type of a question.

Third, the recognition of the intangible asset has been a subject of considerable controversy and I think there are some discussions that we could have down the road on the period over which that ought to be amortized or even whether that ought to be recognized.

Fourth, the whole subject of transition and what transition methods and transition periods are to be part of this is quite wide open in my mind. I can scarcely imagine an alternative for transition that the Board would not be at least willing to discuss and consider. I would leave out of that the idea of no transition or not transitioning at all.

Fifth, I think the subject of disclosure deserves and will receive more attention. You really cannot get fully into the question of what we should disclose in the footnotes or elsewhere in the financial reports until you have dealt with the question of what information is going to be part of the basic financial statements. I think that is the approach the Board has taken but it is time for us to focus more clearly on the disclosure question and some of the alternatives. We always get a trade-off in the area of disclosure between the quantity of information and the understandability and desirability of it. There are pressures in accounting to try to reduce the magnitude of required disclosures. This project is going to challenge those goals to an extent that many others do not. Finally, there is a whole list of issues in the Discussion Memorandum that was mentioned earlier that are, I am sure, open for further discussion. The Board, in fact, has not addressed any of those at all in the first part of this.

Looking ahead, we have public hearings scheduled in January (see Exhibit 3). Both the Discussion Memorandum and the Preliminary Views are currently out and we are requesting comments from you and other interested parties. Those comments have been requested by December 1st. We are working on a Field Test that I will give you a brief overview of in just a moment. It is intended to provide us with a lot of additional information. We do anticipate that that process will lead to an exposure draft by the end of 1984 and perhaps to a final statement by the end of 1985. In other words, Preliminary Views is just one step in trying to find a solution to what we think are some fairly significant problems. It is one step in a long process. It is intended primarily to generate some helpful input from you and many other people who are interested in the project. And I think there has been perhaps a bit too much emphasis on counting up who is for it and who is against it as a result. Nobody that I know of is necessarily for every aspect of the Preliminary Views. I would include the five Board members who voted for its issuance. None of them came out on the winning side of every individual decision that had to be made. The decision to issue a Preliminary Views document in the first place was made because, if we have a specific proposal, it makes it a lot easier for everybody to focus in on at least one potential solution to the problems and to respond. The response to the original Discussion Memorandum with its eight fairly abstract issues was much more difficult, I think, than the response to Preliminary Views. Those of you who were trying to respond to the current document may want to take issue with that, perhaps.

By the same token I think there are not many people who are really and truly against all aspects of the proposal. To be against all aspects of it I guess is to argue that absolutely no change in current accounting for pensions is necessary or desirable. I do not think there are very many people out there who hold that view and I know that neither of the two dissenting Board members has much sympathy for that view. Will the Preliminary Views be changed? I can say yes without too much fear of contradiction. When I get down to how much or where or which pieces of it are going to be changed or what it will be changed to, I have a lot more difficulty. But as long as much of the process remains to be done, I cannot imagine that we would proceed without some significant changes to the initial set of proposals. I hope that we can work together in trying to find solutions to these. I think the explicit objectives of the Board that I mentioned at the beginning of this may provide a little bit of a clue in how we can do that. I think it would be helpful if those who are proposing other alternatives and other solutions would focus in on the Board's explicitly explained objectives. If there are other objectives that should be considered, they could identify those as well.

Moving on to focus briefly on the Field Test, we found that the amount of effort involved in compiling and pulling together this test exceeded our expectations. We find frequently that the effort required to get to where we think we ought to go exceeds our expectations and this one is no exception. There is no way in the time available that I can even give you 1% of the amount of information that is in the forthcoming report. What I want to do instead is give you a very brief flavor for it and a few highlight statistics. Perhaps that will whet your appetite and cause you to decide to study the publication itself at some more length when it comes out.

The Field Test is a joint project of the FASB and the FEI (Financial Executives Institute). The Committee on Corporate Reporting of the FEI cooperated with the Board in setting this up. We are grateful to the FEI and to the participating companies for making this possible. Thirty-two companies participated and tested the proposal on forty-six different pension plans. They provided the Board with information on the many variables that can affect pension cost over a four year period from 1979 to 1982. You can think of the Field Test as a pro forma application of the Preliminary Views proposal to those periods.

We should start out with a bit of a disclaimer. The sample of companies who volunteered to participate in this test is in no way a random sample. Certainly not a random sample of all of the plans to which Preliminary Views would apply. The companies tended to be very large. They tended to be mature in some sense. With all of the potential shortcomings though, we are pleased with the results of the test and we think the experiment has been a success. We realize that we do not really know anything about all plans but we have a whole lot more quantified information about some actual situations than we have ever had before. The Field Test report has, at long last, passed out of my hands and has gone to those who will turn it from a manuscript into a publication. They took one look at what we were asking them to print and immediately doubled their estimate of how long it would take to get it out. That process has begun and we hope it will be out by about the 31st of October.

Just a brief overview of some of the information in the Field Test. The largest part of our analysis, and I think the most interesting part of this report, focuses on the individual situations of the individuals plans and tries to summarize how the Preliminary Views would have impacted those particular plans in their financial reporting information. I should mention there is another group working on a report based on essentially the same Field Test data -- the Financial Executives Research Foundation, a branch of FEI, has commissioned Coopers and Lybrand to do an analysis of much of the same data. Their report will be out about the same time as ours and will provide another viewpoint on this information. They have chosen to focus somewhat less on the individual plan situation.

Here is an example of some of the charts that are presented in the report for each of 20 of the plans (see Exhibit 4).

Basically, what it does is show the pension cost under Preliminary Views, and under APB 8, for this plan for the four year period. It also compares those costs to the IRS minimum and the ERISA maximum. This presentation is intended to give you a picture display of things like volatility and the relative level of cost. In this particular case, the Preliminary Views costs is below the APB 8 pension cost for each of the four years and even dips below the minimum for one of those periods.

Another presentation that is part of the charts summarizes the balance sheet numbers. The net liability under the Preliminary Views is shown. In this particular case, the last two years of the period the company had a net asset, that is, the asset exceeded the liability. The APB 8 liability is shown. In this particular case, as in many of the Field Test cases, it is essentially zero throughout the period. Another line is the designated pension benefit obligation, or PBO, which is the obligation including salary progression measured for each of the four years. Then, by subtracting the fair value of assets, you get the other line, which should be somewhat more volatile because it does not include the Measurement Valuation Allowance. There is a lot of data in these charts and I think studying each one of them would give everybody a better understanding, on a quantitative basis, of how this proposal really works.

A quick look at a few other situations -- Company G (see Exhibit 5) -- this is a situation where pension costs become, in effect, pension income in the last two years. This can happen under Preliminary Views because the return on assets overwhelms the rest of the cost factors. It can only happen in a situation where the plan is relatively well funded. If we look at the balance sheet on this one you can see that there is a net asset under Preliminary Views in all four years and it is growing.

For this third company the Preliminary Views cost turned out to be a little bit less volatile than the APB 8 cost (see Exhibit 6). Volatility is one of the fascinating aspects of this and it is an awfully hard thing to get a grip on, but I think the situations that are presented will give everybody a basis for looking at it that we have not had before.

I can really only scratch the surface on the things that we tried to analyze as part of this test. We found that we had an infinite variety of information and we were tempted to do an infinite number of analyses on how it was presented. However, we never would have gotten the book out had we done that so we had to make some hard decisions. One of the things we were sure we wanted to do is compare the cost for each of these plan situations with the cost which would have been reported under APB 8 (see Exhibit 7). The range was wide. There were quite a few differences. The 80 observations represent 20 plans for each of four years so that there are 80 individual plan years involved in this test. The cost, if you take the APB 8 cost as a percentage of the Preliminary Views costs, ranged all the way from 40% to a couple of situations in which there was income (and of course you cannot calculate a meaningful percentage when you get close to zero or go below the line). Of them, 29 showed APB 8 cost as being less than Preliminary Views cost and 51 showed APB 8 cost as more than Preliminary Views cost.

With regard to net liabilities or assets, we were trying to put this in perspective relative to the companies' financial statements. We had some difficulties with that because of the way the test was structured. Most of the companies that participated sponsor more than one pension plan. Some of them sponsor a great many pension plans and in some cases we had only a relatively small part of the total picture. We concluded that it did not make any sense to take the one pension plan we were looking at, which might constitute as little as 5% or 6% of the total, and compute the change in that plan as a percentage of the company's financial statement numbers. So we limited the part of the analysis that focused on financial statements to those companies that provided us with at least 90% of their total picture. For the 11 situations that fell into that category, the net liability or net asset that would have been recognized in 1982 ranged from almost 16% of total assets down to one company where the effect was essentially zero and from 33% of equity down to another company where the effect was approximately zero (see Exhibit 8). The averages were 5% and 9%. Included in those are two companies that had small net assets. Neither of the extremes are companies that were reporting net assets.

Amortization methods that are used in current practice have been quantified (see Exhibit 9). The most common amortization period for experience gains and losses was 15 years. Some other companies were using either 10 or 30. For assumption changes the most common was 30 years with 10 and 20 being other periods that were selected. For amendments, 30 years was most common with several different numbers between 10 and 20 also appearing. Plan initiation was treated separately in some cases. These numbers are only for those companies that have a specific amortization period for these items. There are some who are using variations of the aggregate method where the data was not available.

The average remaining service period is the basis for amortization under the Preliminary Views. One of the objectives was to contrast that with the amortization periods that are being used. We found that the 12-15 year range of average remaining service picked up the majority of our companies while the others varied from 6 to about 20.

One of the interesting aspects of the study was the ability to compare actuarial asset values for our companies with the fair value of assets, which is the beginning point for the computation under the Preliminary Views (see Exhibit 10). We found a significant number of them were within the 90% to 110% range but we also found some at the extremes that were a little bit surprising. They ranged all the way from 60% to 140% of fair value.

Assumptions have been a key subject. One of the issues in the 1983 Discussion Memorandum is whether the Board should say more about how the assumptions are selected. There are some powerful reasons not to, but we keep having the subject brought up because of the impact that different assumptions have on the comparability of the results. The assumptions that were used for the Preliminary Views are the subject of a considerable amount of our analysis. We compared the assumptions that are currently used for expense determinations with the assumptions that are used for disclosures under Statement 36 (see Exhibit 11).

We asked for some information on the sensitivity to assumptions. We asked the companies to compute the amount of change that would be expected in the pension benefit obligation for a 1% change in either the rate of return on assets or the rate of salary increase and then a 1% change in both. For a 1% change in the rate of return, the change in pension benefit obligation ranged from 17% to 8% with the average being about 13% (see Exhibit 12). Increasing the rate of return on assets decreases the pension benefit obligation. The salary numbers were a little bit less sensitive and the combined results are presented in the slide.

Let me close by restating my appreciation for the opportunity to be here. I look forward to the question and answer session and I also look forward to your help as we go forward in searching for a way to solve these problems. Whether it turns out to closely resemble the Preliminary Views or to require an all new approach, I think there is no way we can come to acceptable solutions to these problems without your help as a group.

MR. MILLER: Thank you, Tim. I think both Tim and Gaylen, with their accounting backgrounds, would tell us that accounting in theory is not supposed to effect the economic, operational and financial decisions made within organizations. On the other hand, in the real world executives are very aware of net income and how it influences the price of stock and executive stock options. So there are a lot of real world plan design issues that the FASB's pension accounting proposals could affect. Actuaries are probably as well qualified as any group - if not better qualified - to discuss the financial, operational and economic aspects of pension programs. I would like Gerry Wilson to share with us some of his thoughts from an actuary's perspective on FASB's Preliminary Views.

MR. GERALD I. WILSON: Good morning. The response on the proposals that lead to FASB Opinion 35 resulted in a certain amount of human cry that a salary scale should be included and some that it should not be included. We as actuaries, have come from both sides on a number of specific issues. Certainly the people who sit in the offices next to me and I do not agree on all these. I would think that in this room there is a wide range of opinion. So, my remarks reflect one actuary's opinion.

When I thought about meeting with all of you today on this subject, I wondered if I would even be here if there had been no ERISA. I thought probably not, and probably not even if they had issued ERISA without Title IV. Even if we were here to discuss new standards for employers' accounting of pensions, we would not be looking at the Preliminary Views as now presented.

Then I asked myself, what was changed in the nature of pension plans by ERISA? For an ongoing plan, I think there was very little. Plan benefits are still described about the same way in their fundamental sense. Employees still retire and receive benefits in about the same way. Employers still view their obligations in about the same way. At the time of a plan termination there is a difference -- at least if the assets fall short of some guaranteed benefit level.

Most of us would agree to talking about new standards for a terminating plan. Yet, here we are talking about a whole new set of accounting standards for an ongoing plan that suggest something is basically different about an employer's obligation to an ongoing plan. I think Tim would say we are not really saying something is basically different but that the difference was always there and we were not recognizing it. These are two different points of view on what is happening.

I do not think there is a difference which justifies the degree of change being proposed -- and if it were possible to buy insurance to cover the contingent plan termination liability, then we would truly address the ongoing plan accounting and find little reason for some of the Preliminary Views positions.

Together, the people attending this session could come up with several hundred points of concern about the Preliminary Views and related Discussion Memorandum. We certainly would not all agree on these points, we would put our priorities in different places and we would disagree strongly on some points. Recognizing this divergence of opinion, let me start the list by citing several points of concern with the direction of these documents from the perspective of a benefit consultant and actuary.

Major points of concern would include:

1. A single notion of "liability" is endorsed. This notion immediately raises the question about salary scales and now we have some disagreement. In the end, one has blessed a single notion of the statement of liability and that is a point of concern for some of us.

2. This "liability" is presented in the plan sponsor's balance sheet.

3. I believe that pension expense and income statement effects are more important than the presentation of this liability, but, in fact, are derived as a by-product of this notion of "liability". The pension expense is being affected by this notion of "liability" in a fairly direct way.

4. Pension expense is too volatile.

5. Pension expense is overly influenced by the fair value of assets on a single date in a year.

6. These standards will lead directly to different plan design to the ultimate detriment of employees.

7. The group nature and the prospective nature of compensation exchange are given too little weight. Much too much weight is given to the expression of individual benefit formulas as a function of service.

8. Conclusions are sought for single employer, non-insured plans before finding out whether comparable, consistent conclusions can be reached for multi-employer and insured plans.

9. There is a hint at further guidance on actuarial assumptions.

Now after looking at these concerns and others it would seem that we have a number of choices in our response to the FASB:

1. Accept the views -- make some minor suggestions.

2. Fix the views -- accept the basic premises, such as the notion of the liability on the balance sheet tied directly to expenses. Suggest major changes in implementation, e.g. change the amortization rules, eliminate the salary scale.

3. Redo the Views -- do not accept the basic premises or at least not all of them. Suggest major changes. For example, (and I am not necessarily suggesting these), the liability definition is inappropriate, the liability should not be on the balance sheet, pension expense should be separated from the liability notion, and plan sponsors should have more choices in establishing pension expense.

4. Forget any major changes -- restate the standards of APB Opinion Number 8 and FAS Statement Number 36 with only minor changes.

If I were on a committee with the responsibility for working this out, which response would I choose? At this time, I would suggest we redo the Views.

What would I hope we would accomplish and what should we try to avoid? I would suggest a number of things.

1. We would propose a shift in the emphasis in the accounting standards for an ongoing plan from the balance sheet to the determination of the pension expense charge. Liability definition and presentation for an ongoing plan would be a secondary consideration. Separate standards should be stated for liability recognition associated with plan terminations.

2. We would seek a treatment of pension assets so that the pension asset presentation and the effect on the income statement would not significantly influence decisions on the investment of the pension assets of an ongoing plan. The income charges should not be greatly affected by the fair value of assets on a single date. And, there is no need to have last quarter adjustments to income because of last quarter investment experience.

3. We would reject the notion that the anticipation of future salary increases meets the definition of liability -- the salary increase impact disappears too easily through plan amendment or termination of service.

Effects of salary increases or other anticipation of future events (e.g., inflation, COLA adjustments) could be an optional or required footnote disclosure.

4. We would be concerned that the net result of all of our decisions does not leave plan design as the major source of flexibility regarding accounting appearance and impact. Altering plan design because of accounting treatment will ultimately be to the detriment of the employees. I listened to Tim's statement of some of the fundamentals and the foundations that are the basis for the discussion that is going to take place. Any discussion that is going to be meaningful will have to address these foundations and these key underlying principles that he has outlined. However, we can all think of examples where we begin to have problems. For example, if you look at an increase in benefits for a retiree group, the first two foundations view this as a form of compensation where the cost should be recognized during the working period and I immediately have a problem. It is not clearly a form of compensation which can be expensed over the working period of the group getting the benefits. If we play with this too much we begin to think about things -- we will promise the increase only one year at a time instead of making an amendment that promises to increase all the benefits by 3% a year. If we get into plan design we are going to change the benefits dramatically for some people. If plan design is the way we are to work our way around some of the issues of flexibility, we only have to step back one step from the retiree example to look at the increase for those who are a few months from retirement. There is not much future working period there and, on an individual basis, we begin to have problems. If we follow through all of these notions as they are now presented and look at the results, I think that many of us would share concerns that the net results of all of our decisions in coming up with some final accounting standards does not leave plan design as a major source of flexibility. I think we have a lot of experts in this room who know a lot of ways to use that flexibility. I suggest that in the long run that would be to the detriment of a lot of employees.

5. We would seek accounting standards which would not prejudice the choice between insurance contracts and trust funds as a funding vehicle. Some flexibility in handling insurance contracts will be needed because it will not be possible to provide an up-front definition that fairly and consistently handles the accounting under all types of contracts which are, or will, become available. (I suspect unwise accounting standards will lead to the "universal insured pension funding contract" under which amounts could become allocated or unallocated, par or non-par, etc., based on whatever presentation the plan sponsor and the actuary want to make. I do not think we need that.)

6. We would prefer standards which would not force plan sponsors to have the confusion and additional administrative expenses of two sets of pension costs -- one for ERISA cash funding and another to meet pension accounting standards. For most plans, it should not be necessary to have accounting practice differ from ERISA; conversely, it should not be necessary that they be the same.

7. We would seek a treatment of single and multi-employer plans which was reasonably consistent -- in a way that accounting treatment would not

prejudice the use of one vehicle versus the other. It would not appear that multi-employer plans could (or should) be brought into plan sponsor financial statements under the Preliminary Views proposed standards. Can you imagine Pabst taking an income statement hit because Schlitz closed a brewery?

This Committee would have a tough task. I know going in that this committee could not accomplish all of the objectives that I set forth and certainly any committee would have more objectives than I just stated. But my list of discomfort with the present proposals is too long. I am sure your list would include some additional items and I believe it is too soon to concede that we cannot find some better answers that accomplish some more of these goals.

MR. MILLER: Thank you Gerry. Last week I spent some time thinking about whether I could design a pension footnote that was comprehensive, under a page long and understandable to some distant financial analyst. I called up an accounting database on a terminal and searched for the words, "accumulated plan benefits". The computer played back a list of 1900 pension footnotes. I looked at the first three or four and started to think I might possibly be able to do it. Then I came to a plan sponsor that had multiple pension plans. I came to the conclusion that once you have multiple pension plans, be it 60 like Gaylen Larson at Household Finance, or even 3 or 4, and information for one plan is offset against information for other plans, it simply cannot be understandable. On the other hand, if you have a page or page and a half of footnotes for each plan, the pension information becomes out of proportion to other things affecting the financial statements. Each individual plan has its own employee group and depending upon the location in the country and the type of business, it will have different salary increase patterns. Different investment policies will dictate different investment return assumptions. It is very hard to argue that the same set of assumptions be used. I do not think FASB can come to that conclusion either, that certainly remains to be seen. And if different assumptions are used for different plans, understandability becomes a less attainable goal for the layman.

Just as Gerry provided us with an actuary's perspective, Gaylen Larson will provide us with a plan sponsor's perspective. Gaylen's opinion may very well be different from that of other plan sponsors. Gaylen will provide us with some interesting insights from the perspective of somebody with responsibility for 60 defined benefit plans and a very good understanding of pension accounting issues.

MR. GAYLEN I. LARSON: Thanks Chuck. I thought it might be helpful to try to talk just a little bit about what our scene is. It might be a little bit easier to understand our company's perspective before we get into my feeling about the Preliminary Views. As Chuck pointed out, my opinion may not be representative of all plan sponsors.

Household is a conglomerate, multi-industry enterprise with $7 billion in revenues and $8 billion in assets. That does not tell you a lot except that there is a fair amount of money flowing through the financial statements. We have 40 business units which, for financial statement purposes, we summarize into 13 segments and 4 overall business groups. In financial services, some of the names you might know are Household Finance Corporation, Alexander Hamilton Life Insurance Company, and we have a number of deposit taking institutions. In merchandising we have Bonds, TG&Y, Coast-to-coast and Ben Franklin. In manufacturing, the list is too long to really cover but I will mention two or three: Switzer, Scotsman and Thermos. In transportation we have National Car Rental and Lend/Lease. Household International plans, as we had indicated before, include 60 company-sponsored defined benefit plans and it is really more than 60. We do not even know how many there are out there. We would guess there's either 12 or 15 that are unaudited. The 60 is merely an audited group. Additionally, we contribute to over 30 multi-employer plans and we have 10 profit sharing plans and 3 TRASOP plans. Approximately 32,000 employees are covered by company sponsored plans; 19,000 are covered by multi-employer plans. The value of the assets underlying our company sponsored plans exceeds one-half billion dollars (see Exhibit A).

The 1982 pension expense to the Company was over $60 million dollars of which approximately two-thirds related to company sponsored plans. As you can see by Exhibit B, expenses increased under APB 8 in a relatively controlled manner. When you get below this however, it is interesting to know that not only do I have to deal with 7 or 8 actuarial firms, but I have to deal with a variety of actuarial cost methods. We have 16 plans using Entry Age Normal, 23 using Frozen Initial Liability, 11 using Unit Credit Service Prorate, 10 using Unit Credit and 2 using Attained Age Normal. I will tell you quite frankly that the actuarial reports looking at this wide variety of assumptions do not help me at all. There is no way I can look at 60 or more actuarial reports and tell my management whether or not we have adequate funding, or whether or not one of our businesses is more conservative or less conservative than another.

As a result, in 1982 we worked with Gerry's firm and a group of our management to develop an internal funding policy. What we decided to do was to ignore what we have right here and try to go down a different direction to see if we could determine whether or not our pension plans were adequately funded. Our focus was to try to be conservative but not overly conservative. We have set assumptions that we decided should not be limited by generally accepted accounting principles and should not be limited by generally accepted actuarial convention. For our 1982 evaluations we used interest rates for all plans of 11%. We used an inflation rate for all plans of 6%. We started with a basic wage increase rate of 7% and adjusted upward depending upon the plan populations. In one case it was up to 9-1/2%. The asset valuations for all plans were market value. Our actuarial method for all plans was Unit Credit Service Prorate. The estimates include, interestingly, estimates of anticipated enrichment of benefits and anticipated post-retirement benefit increases (see Exhibit C). Obviously we are going down a different path than what we were reporting and obviously I have Gerry to thank for giving a little bit of help going down this path. I would never have been able to figure it out without his help. But it does say that you can use more than one method in trying to determine where you are at.

Our present goal is to maintain a funding ratio of approximately 100% to 120%. Corporate wide, using this internal basis, the funding ratio is actually 140% at the end of 1982. This compares to a 153% ratio using the external basis as required by FASB Statement No. 36. We believe the difference between the Statement 36 basis and the internal basis will widen as we become familiar with using the internal basis and as we start to include more projections for benefits not yet actually granted. Establishment of the corporate funding policy was one of the first steps in Household's corporate effort to better manage this wide variety of plans that we have inherited through an acquisition process over the past 20 years (see Exhibit D).

Turning to the Preliminary Views, as I said, our position obviously will not agree with all companies. One of the reasons, that should be very clearly stated, is that our high funding ratios give us more room to address the issue than companies who have severe underfunding situations. In general, we clearly and strongly support the FASB in their efforts to improve the accounting and the disclosure. We support the general concept of the Preliminary Views. We believe that the pension obligation is, indeed, a liability. At least in the broad sense, we believe that the assets put aside for funding those plans are corporate assets. If we choose to terminate a plan we can, in those cases, recover those assets and I think that has been demonstrated by a number of companies in the past year or two. Present accounting ignores reality and has weakened funding in troubled industries and has lead to overfunding in strong, conservative or regulated companies. Our shareholders should expect conservatism, but they should not expect us to be overly conservative. It is not in their best interests or our employees.

We are one of the companies who participated in the FASB Field Test and one of the companies that will be included in the published document by the FASB. We chose our largest plan, The Household Retirement Income Plan, only because there is no way we could summarize 60 or more plans for this purpose. This plan is a final pay type of plan. It has assets of $140 million which represent 30% of the total for all the company sponsored plans. It has a present value of accumulated benefits of $90 million which is 25% of the total for all the company sponsored plans. In other words it is better funded than the average plan. Our 1982 expense was $7 million for this plan -- only 10% of the total. Obviously, we are funding this one slower than the others because of its overfunded status. It includes 4,800 active participants which is 15% of the total for all the company sponsors plans (see Exhibit E).

The results of the Field Test show that in 1979 our balance sheet would have a net pension asset because of the excess funding position. The intangible asset balances differ due to the different treatment under the prospective and retroactive methods (see Exhibit F).

We have tried to study whether or not we should go prospective or retroactive. Given the difficulties of trying to go back and redo our financial statements for prior years for so many plans, and the difficulties in many significantly underfunded companies in dealing with the equity issue, we are increasingly leaning towards recommending that everybody go prospective. I do not believe that having a choice will lead to a desirable amount of comparability amongst employers.

Our 1979 pension costs, although they appear similar, are different, as APB #8 has driven both the income statement and funding, while the balance sheet, under the Preliminary Views, is driving the income statement (see Exhibit G). What the Preliminary Views is recognizing in this plan is that it is overfunded and APB 8 does not suggest that, unless you go digging in the footnotes.

To deviate here, I am also a member of the Committee on Corporate Reporting and involved in an Financial Executives Research Foundation project trying to condense financial statements. We know that most readers spend less than 10 minutes looking at our annual report. We believe that the added page and a half of footnotes would not improve the readability. We do not think many people would read it and in fact we do not know how we would even start describing 60 plus plans except to say that they are all funded in one manner or another. I would like to have you look a little bit at the two lines in Exhibit H which kind of indicate where our expense would go from 1978 through 1982.

The net pension assets under the Preliminary Views starts out with an asset of \$3.3 million in 1978 and grows to \$16.5 million in 1982. This is primarily due to the very strong increase in the market values experienced in this plan during that period. Assets grew from \$53 million to \$111 million dollars. Obviously, other periods and other economic cycles would not have caused that growth to have occurred. The APB 8 liability declines strictly because we elected in 1981 to postpone making our contributions to the plan until we filed the tax return. Strictly because of that funding decision, therefore, we ended up with a liability on our balance sheet. The balance sheet in no way suggests the overfunding.

Turning to the pension expenses for 1979 through 1982 - the APB 8 expense is relatively constant (see Exhibit I). It changes only because we changed our assumptions in the middle of this period to start the move towards a slowing of the funding. The pension cost under the Preliminary Views changes from a \$2 million expense in 1979 to a \$2 million dollar gain in 1982. Once again, this swing is due primarily to the 110% increase in the market value of the plan assets during the period. The difference between the retroactive method and the prospective method, the two bottom lines, is the amortization of the initial and tangible assets. Obviously, even this difference is not very significant to our financial statements. The same basic thing is happening -- it is going from a debit to a credit on our income statement.

We do have some concerns, although I have indicated that we support the Preliminary Views. The primary concern is understanding earnings per share volatility. Management, shareholders and analysts all tend to focus on earnings per share and none relishes surprises. The use of market values for plan assets and a very short or relatively short amortization period, in our case 11 years, cannot help but generate unexpected fluctuations in pension expense. Further, the use of market value for pension assets is not consistent with the historical cost basis model that we are presently using to prepare financial statements. How can we focus on a current value of this liability in our balance sheet when it is the same balance sheet that has LIFO for inventories and historical costs for fixed assets? How can we move from that historical basis to a current value basis step by step as the FASB addresses each of these accounting items on a line by line basis? It is not, as far as we are concerned, a very easy way to have changes made in your financial statements and deal with managements or the public.

Let us take a look at Exhibit J and try to show what is happening under the Preliminary Views. The use of market value for plan asset valuations in our situation does have a relatively dramatic impact on pension costs. Our pension cost based upon the Field Test is a \$2 million gain for 1982. The gain and the reason for the trend is that our investment experience for the period 1979 to 1982 included a 13% gain in '79, a 20% gain in '82, to 3% gain in '81 and then a 21% gain in '82. We asked what happens if we use a different period of time?

The top line reflects what would have happened if we would have used experience from 1972 to 1975. Instead of having a 1982 gain of \$2 million we end up with a 1982 expense of \$5.4 million. The reason is that in 1972, we have a gain of 14% of our portfolio followed by a 16% loss in '73, a 19% loss in 1974, and a 21% gain in 1975. The middle line is an attempt to look at it if we used the ten year average of 5.7% for the return on plan assets. The 1982 expense would have been $2.3 million. Obviously, if you just look at the differences, there is no way you can avoid the fact that investment return is very volatile under the Preliminary Views. And I am not convinced that that reflects the long term nature of providing for these benefits.

We do have other concerns with the Preliminary Views but I think they are relatively modest. I think that the point raised by Gerry regarding multi-employer plans is a good one. We have a lot of multi-employer plans, as I indicated, although only a couple of them are significant in size. I have some difficulty accepting the fact that we would record the liability for the company sponsored plans and decide not to record them for the multi-employer plans. Logic tells me it should be recorded but as I study it further, it is very difficult for me to conclude that we should have an asset or a liability in our balance sheet that we do not control. Therefore, I think the multi-employer plan is going to be especially troubling.

I think Gerry's point about having some symmetry in the accounting makes sense but I am not sure that it is going to be a practical conclusion. I think it is important to not lose track of the fact that the accounting methods being proposed do not necessarily impact funding. Although, as a practical matter, I believe there will be pressure on underfunded plans using the accounting disclosure to improve funding and on overfunded plans to back off.

One idea that I would like to have tried out, and I am going to talk to Gerry and see if he can help me do it, is to look at removing some of this volatility. A couple of thoughts have come to my mind. One concern is using an 11 year period, the average service period, for amortization of benefits. Why could we not use a much longer period focused on the average period of payout of these funds to our employees for amortizing the market value gains and losses? Another idea would be to carry the liability and the assets on our balance sheet at market value but to take the MVA, the deferred asset or liability direct to equity. Treat it as an equity item much as we do now with marketable equity securities under FASB Statement 12 and with Foreign Exchange gains and losses under Statement 52. These are options which I think need to be explored. What this leads us to is a situation where we can begin to have the current value balance sheet, which at least the FASB and some people in the public seem to prefer, but we can still have an income statement that management, analysts and even creditors are looking for where we use historical values and a reasonable amount of predictability. What that leads to is a non-articulation situation where the old dirty surplus idea comes up but I think as we study it we feel it is a practical answer. I would like to encourage each of you and the FASB especially to consider this. I appreciate your attention.

MR. MILLER: Thank you Gaylen. We have about half an hour for questions.

MR. MURRAY BECKER: I would like to focus on one area which I believe has gotten insufficient attention. That is the notion that pension expense be based essentially on a difference in liabilities. This means that actuarial assumptions which lead to pension expense also lead to balance sheet liabilities.

Currently, unfunded liabilities are disclosed in a footnote. First of all, they do not even exist unless the plan is terminated. If it is terminated you can buy annuities at prevailing interest rates. Therefore, we should use a higher interest rate in our footnote for liability purposes.

As I see living with the Preliminary Views, the actuary would wonder what to do. One employer might say he wants his balance sheet liabilities not to be overstated. Therefore, you use as high an interest rate as you can tolerate. That makes pension expense come out rather low. If we work on the idea of making pension expense come out right, then some of our clients might feel that we have overstated their balance sheet liabilities. It is part of actuarial theory to say that the appropriateness of an assumption should be influenced by the purpose of the project. I would contend that it may be appropriate to use one interest rate for pension expense and another interest rate for balance sheet liabilities. I would be interested in Tim Lucas' reaction to that.

MR. LUCAS: There is a fairly fundamental relationship in accounting between expenses on the one hand and liabilities on the other. We will normally see a situation where if you have measured one of them right, at least conceptually you have gotten the other one right as well. Gaylen and some others have suggested that in the area of pensions we might need to take another look at that. The idea of a "non-articulating" solution was one that he mentioned and certainly the approach that you were discussing would be a form of non-articulation. Part of the problem is that we want to get the liability right and we want to get the expense right. Part of the problem is trying to decide what is right.

MR. LARSON: The only thing I can say is that you are close to the heart of the concern that I have had as a user of the information within my company. Dealing with many actuaries and many plans, I can sit down with them and try to understand why they are using the various assumptions, but I come away with "tell me what you want to do and we'll do it." I guess if I put my management hat on and I focus on earnings per share, that is great. But if I put my management hat on and try to focus on whether or not I have meaningful information from my business units, it is not so great. I think if it is not so great for me to compare my own business units then it very likely is not so great for analysts to compare one company to another. I really and truly believe there is too much flexibility under the present accounting.

MR. LUCAS: One other factor that may need to be discussed in connection with that idea is using two sets of interest rates. We have heard from many different directions the call to minimize the complexity and the variety of different computations that are involved. The current proposal includes disclosure of the economic assumptions on the theory that if we do not, and if everybody does not use the same assumptions, the person who is trying to understand the information being presented needs to know whether a 10% rate or a 5% rate was used. If you were using different rates for expense and for liability information, I think you would further complicate that understandability question.

MR. EDWARD FRIEND: Tim, during your comments you observed that there are powerful reasons for the Financial Accounting Standards Board not stipulating the investment return or salary scale assumptions in determining costs or liabilities for pension plans. In spite of this observation, you showed a chart, a sensitivity chart, which demonstrated that 1% changes in these assumptions produce significant modifications in financial results. Can you comment on the seeming conflict in these two observations?

MR. LUCAS: Let me say what I think the powerful reasons are. There has been the suggestion that the range of interest rates under Statement 36 is too wide, that it impairs comparability, and the Board ought to stipulate that everyone ought to use the same rate. One of the problems with the Board going down that road, is that we would have to figure out which same rate everyone ought to use. One problem with that is at least some of the differences in those assumptions presumably represent real differences in people's expected experience. The same is true on the salary progression side. There are going to be differences in the rate of return experienced on assets to some extent. If the Board required a single rate we would have an artificial sort of comparability. My own belief is that, while we have a difficult trade-off, the notion of allowing some flexibility to allow those assumptions to reflect the best expectations of experience, and mitigating the impact of that by requiring disclosure of assumptions, is about as workable a compromise as the Board is likely to be able to come up with. I feel that disclosure of some sensitivity information would be an additional help to the user who wants to, for example, adjust two companies to put them approximately on the same rate. That is not part of the current package. The Board considered that and decided it was too complex. It is probably something that will come up again. Really, what we are finding here, not entirely unexpectedly, is that there are no perfect answers.

MS. ANDREA FASHBACH: I would like to ask Mr. Wilson and Mr. Lucas whether they have heard anything from plan sponsors that would indicate that they will be making plan design decisions based on the new accounting standards if they go through. For example, switching final pay by amendment rather than final pay plans or not improving benefits because of the effect on the financial statements?

MR. WILSON: I do not think that we know what people are going to do if this happens because I do not think we have been discussing these things with those people yet. The implementation date is out there far enough that I do not think people have gotten really serious about this. We have heard some conjecture that if final standards were like this, we would consider doing some things differently. I am sure there are lots of people in the room who have already thought of some of the things you would do differently. You mentioned one of those things. I think that there is a background level or knowledge that if things were finally implemented in exactly the same form, there are some suggestions that many of us would feel we would have to make for the consideration of those plan sponsors. So I think the subject will get out on the table whether it comes from plan sponsors or from their consultants.

MR. LUCAS: I think conjecture is probably a reasonable word to describe what we have heard so far. Certainly I cannot point to any particular company that has announced a plan amendment contingent on all of this. There is a long way for us to go and there may well be some significant changes in this. It would probably be premature for somebody to react to it in terms of making changes in their situation. I would like also to suggest that perhaps we should not jump to the conclusion that even if we could demonstrate that a company would change its plan design, or a decision maker would undertake some other decision because of this information, that we should not do it. That may be the reason that we should do it. Certainly it is not our objective to induce people to change their plan design in any way. But if a particular management group, board of directors, or shareholder group looks at the information that is presented as a result of this proposal and as a result understands more about the obligations they have undertaken, their cost or the impact of their pension decisions on their financial status and results of operations, and if based on understanding that information, they choose to change those arrangements, to some extent that is what accounting information is all about. I would submit that if we turn it around and we could prove, which is equally unlikely, that there would be absolutely no changes in anybody's decisions as a result of whatever the final proposal was, that would be proof that we were all wasting our time.

MR. LARSON: I could make one other comment Andrea, and it relates to other post-employment retirement benefits and a specific experience I had. On the CCR, a few companies had indicated that to record those benefits would wipe out a very significant part, if not all, of their equity. I discussed this accounting issue with a chief executive officer. He was somewhat surprised that companies had this magnitude of what he very clearly concluded was unrecorded liability. He expected that the ultimate recognition of this would, in fact, cause them to step up to the problem that they themselves had created. A couple of days later, one of our human resources persons, talking about increasing their benefits in this area, quickly concluded that there is no reason to get approval of financial management in the company because it was going to be recorded on the pay-as-you-go basis. It did not have any effect on the financial statements. When you look at the way you decide how you might refine or change benefit plans, it is common to focus mostly on the impact on earnings and ignore the balance sheet. As a result, some of these very substantial liabilities have crept up on management without them realizing it.

MR. MILLER: One example that most of us are familiar with of people taking action based on accounting treatment is in the area of non-qualified retirement programs funded by whole life insurance. Creative accounting approaches can be used which make it appear that there is little, if any, immediate impact on the income statement. In many cases, these programs probably would not have been adopted if it was not for the accounting treatment.

One area that may not have been discussed sufficiently today is the measurability of the obligation amount. It is my understanding from talking to Tim and Gaylen, that accountants look at a couple of things to determine whether or not liabilities should be recognized on financial statements. One of those is whether or not the information is relevant. Another one is whether or not the information is measurable. Reflecting on most of the corporate clients I deal with, one of their main arguments against putting the obligation on the balance sheet is that they do not believe the obligation is measurable. They think it is too volatile, it is a wishy washy number. This argument is interesting because it is based on this same lack of understandability we discussed earlier. I think Tim would comment that the relevance of the information may be important enough to offset any deficiency in measurability -- suggesting that the pension obligation belongs on the balance sheet regardless of measurability problems.

MR. LARSON: We have discussed this on CCR in developing our position. Many people do believe that it is not measurable. But we are measuring it right now using the present concepts, we are just not recording it. In fact, if you turn to a different area of accounting that I think most of you are familiar with - that is, accounting for property and liability company claims, I think it is much more difficult to measure those obligations than it is to measure pension obligations.

MR. MILLER: One of our audit partners made a comment to me about how a recently proposed RRA method of accounting for oil and gas companies was abandoned on the grounds that the estimates required were too unreliable to go on to the financial statements. I do not know if that is a good analogy of a measurability problem.

MR. LUCAS: There are a number of aspects of measurability. Certainly the measurement of any pension amount presents some difficulties that are not present in measuring cash. As a result, we are not going to have the same precision in the measurement of either the pension cost or the pension liability that we have on cash. But Gaylen's point is extremely well taken on the current method of measurement. The current pension expense number and the resulting liability or asset is not one bit more measurable than the numbers that are proposed. We are measuring it now. The choice when you get to oil and gas or the RRA accounting was not a choice between putting something on the books or not putting it on the books. There was not a decision made that those assets should not appear. It was a decision made that we ought to use another measurement for those assets.

MR. TOM BLEAKNEY: I have another question for Mr. Lucas. I was bothered, when Statement 35 came out of the potential articulation, with what you are now doing. I would really like to hear your comment on what I consider to be a similar potential problem to what Gerry mentioned in the multiple employer section. I am interested in your comments.

MR. LUCAS: I think you are using articulation in a sense other than the technical accounting sense in which it was introduced here. I will try to stay out of the debits and credits. Maybe a better term for what you are suggesting is symmetry or some kind of consistency between statements. Certainly the multi-employer question is going to give the Board fits. The legal situation is unsettled and may change even while we are considering it. One of my hopes is that it will get clarified a bit before we start. But that may turn out to be a forlorn dream. I think a case can be made for presenting at least the withdrawal liability as a measure of the pension obligation in that case on the theory that if you continue the plan,you are going to pay it as contributions and if you terminate the plan, you are going to pay it as withdrawal liability. There is no contingency on whether you are going to pay it. The only contingency is what you are going to call it when you do pay it. But there are some very significant difficulties with getting the information on that amount, and there is a fundamental difference in terms of the relationship between the employer and the plan for a single employer case or a multi-employer case. I do not know what the answers to those are. We will certainly consider the notion of symmetry or the appropriateness of having conceptually consistent solutions to those problems and the impact, the economic impact among other things, of possible differences that result. I cannot speculate on where the Board might come out on the multi-employer case. While in concept symmetry or applying the same concepts in related situations is desirable, in practice we frequently find that does not work out to be the best answer. This may be one case where we trade those off and try and find a solution that is partially symmetrical.

MR. MARTY ZIEGLER: I have two questions. The first is directed to the whole panel and the second directly to Tim Lucas. It is clear in APB 8 that pension accounting and pension funding are intended to be separate and distinct items, although in practice to a great degree they have become one and the same. I have seen some but not many plans that have been accounting on a different basis than they have been funding. I think the new proposal comes a long way in reemphasizing that distinction. However, I guess my fear is that in practice many plan sponsors will depend on funding what they expense, since that is what they are used to doing and they do not want to clutter their balance sheets anymore with prepaid pension items and those sorts of things. That may or may not be a good thing. In many cases, the projected unit credit method may not be the best course for funding purposes yet that is what will be used. The second question to Tim is, with this whole idea of salary increase in the liability, what is the rationale relative to a career average plan?

MR. MILLER: In response to the first question, my sense is that there are a portion of the plan sponsors -- perhaps the more sophisticated ones -- that have become more sensitive to the fact that you can accrue an expense different from a funding amount. Certainly some people have been doing it for years. I think more people will expense and fund different amounts in the future. They will probably carry this only to a certain point because there would be some pressure to have the accounting and funding follow a similar progression since a funding policy different from the accounting policy would have to be disclosed.

MR. WILSON: I have a perspective on that that is obviously not an accountant's perspective. I think under the Preliminary Views the issue goes away. The piece of the issue that has to do with whether your cash funding matches your expenses is a non-issue. For example, whether you have got an accrual to put cash in the fund or an asset in the fund, it is all part of the same balance sheet.

MR. MILLER: I think actuaries will be forced now to explain any discrepancies to a client whereas in the past many clients never asked and the explanations often were not given.

MR. LARSON: In general, I agree with Gerry but let us say that it did cause some convergence. Is it necessarily bad to have a significantly underfunded plan lead to pressure on managements to increase the funding and is it necessarily bad to have your local utility, that has been building that overfunding into your rate bill, start to back off now that this asset is hanging out on their balance sheet?

MR. LUCAS: I do not have too much to add to the first question but I will take a shot at the second question. The second question was, "How do you justify salary progression on a career average plan?" We had some difficulty with the salary progression question. It was one of the more controversial issues among Board members and one of the last major issues to finally fall to a 4 to 3 vote among the Board members. The notion that we are working with is following the plan formula. That is, the plan formula gives you a basis for measuring your obligation and, where that plan formula is a function of future salary, you should consider future salary in making the measurement. We found that there are two ways that you can think of, describe, or write the plan benefit formula under what is called a career average plan. One of them would say the pension benefit is going to be a function, say 1%, of your average salary over your whole career, and would take all of your salaries, including the ones in the future, average them, and then take 1% of that for each year. The other formula would say that your pension benefit, for each year, will be 1% of that year's salary. Those two reduce to exactly the same formula. I think the Board was correct in saying that we ought not have the way the formula is expressed produce completely different answers when it is really just two different ways of saying the same thing. So it was a question of choosing between the "career average" version of a career average plan, if you will, and the "each year of service times its own salary" version. The initial vote, the initial pass that the Board made at the issues in Preliminary Views, excluded salary progression for career average plans. In other words, we were taking the approach that it is each year times its salary. It was comments and discussions from the task force members who reviewed that initial draft and a few other discussions that came from other quarters that caused the Board to make a change in that at the last minute. One of the arguments that was brought up was that the typical final pay plan is, say, a five year final average plan. So the question was asked, assuming you are going to include salary progression for that plan, and you are not going to have it for career average, then what do you do with a ten year career average plan? How about a 20 year final average plan? Suppose you had a final pay plan that was the average of the last 30 years and you only expected this guy to work 25 years. The argument was that there was no way to draw a clear line between career average and final pay.

MR. JUAN KELLEY: I have several very short comments. First, I agree with Mr. Lucas that this is an accounting issue. Personally, I have met very few accountants who understand it. You use the word simple. I think if we took a vote here as to how many of us thought this was simple, it would be unanimous. My own straw poll of the big eight accounting firms indicates that the reception to the Preliminary Views is lukewarm to say the least. The reaction ranges from total vehement opposition to the whole exercise to putting it on the back burner for a couple of years.

The corporate controller on the panel said that he had no trouble at all with the notion of putting any overfunded portion of deferred compensation employee type assets on the corporate balance sheet. What will happen if we do that is that this overfunding is going to result in CFO's terminating the plans as a prelude to terminating operations. We are going to have the tail wagging the dog. Any company at any point in time may terminate its plan without regard to its financial situation. It is embodied in the plan document, unless we are talking about a collective bargaining agreement which is a separate issue.

As far as putting liabilities on the balance sheet, APB 16 has worked very well in a plant shutdown situation. If you shut down the plant, you have got to book to plant shutdown liabilities. It works, and I have never seen any problem with it. As far as an alternative to this whole exercise, I was thinking of one during our discussion. Namely, on the asset side of the corporate balance sheet put the credit balance in the Funding Standard Account. On the liability side of the corporate balance sheet, put the funding deficiency. If the plan sponsors and the accountants do not like those numbers, then challenge the actuary. The actuaries, since ERISA, have been living in a grace period because the IRS does not have the funding or the staff to challenge the assumptions. But Ira Cohen has promised us that before too long we are going to have our assumptions challenged.

STATEMENT OF FINANCIAL POSITION

Assets		Liabilities	
Cash	$ X	Accounts and Notes Payable	$ X
Receivables	X	**Net Pension Liability (See Note)**	NL
Inventories	X	Long-Term Debt	X
Deferred Pension Plan Amendment & Initiation Cost	**IA**	Deferred Taxes	X
		Stockholder's Equity	X
Property, Plant & Equipment	X		
Total	$ XXX	Total	$XXX

Note to Financial Statement:	
Pension benefit obligation	$ L
Pension plan assets	-A
Measurement valuation allowance	±MVA
Net pension liability	NL

EXHIBIT 1

EXAMPLE
FOOTNOTE DISCLOSURE

Pension Benefit Obligation: Actuarial present value of accumulated plan benefits	L_1
Effect of estimated future salary increases*	$+ L_2$
Fair value of plan assets	$- A$
Measurement valuation allowance	$\pm$ MVA
Net pension liability (asset)	NL

*For final pay and career average pay plans

EXHIBIT 2

FASB PENSIONS PROJECTS

1974	ERISA and Agenda Decision
1975 Oct.	Plan DM
1976 Feb.	Public Hearing
1977 April	ED on Plan Accounting
1979 July	Revised ED on Plan Accounting
1979 July	ED on Disclosure
1980 March	Statement 35—Plan Accounting
1980 May	Statement 36—Disclosure
1981 Feb.	1981 DM on Employers' Accounting
1981 July	Public Hearing
1982 Nov.	**Preliminary Views**
1983 April	**1983 DM on Employers' Accounting**
1983	Field Test
1984 Jan.	Public Hearing
1984	Exposure Draft
1985	Statement

EXHIBIT 3

Chart 3A-1

Statement of Financial Position

Plan A

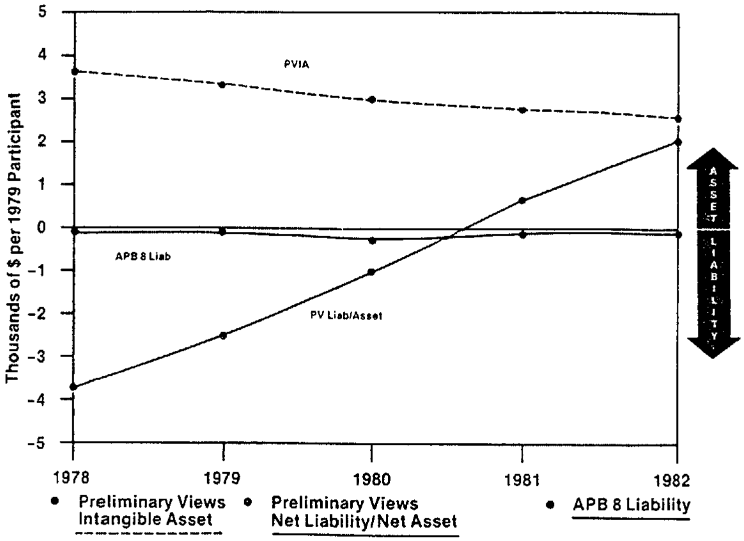


Chart 3A-2

Components of Net Pension Liability/Asset

Plan A

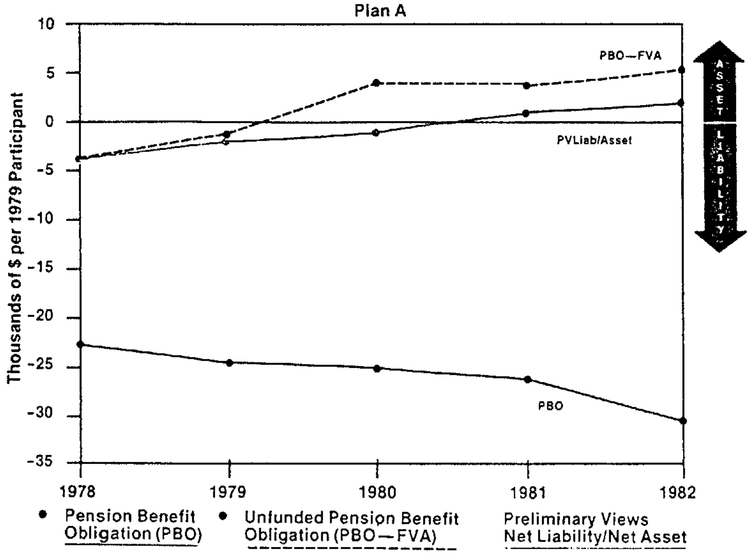


EXHIBIT 4

Chart 3A-3
Measurement Valuation Allowance
Plan A

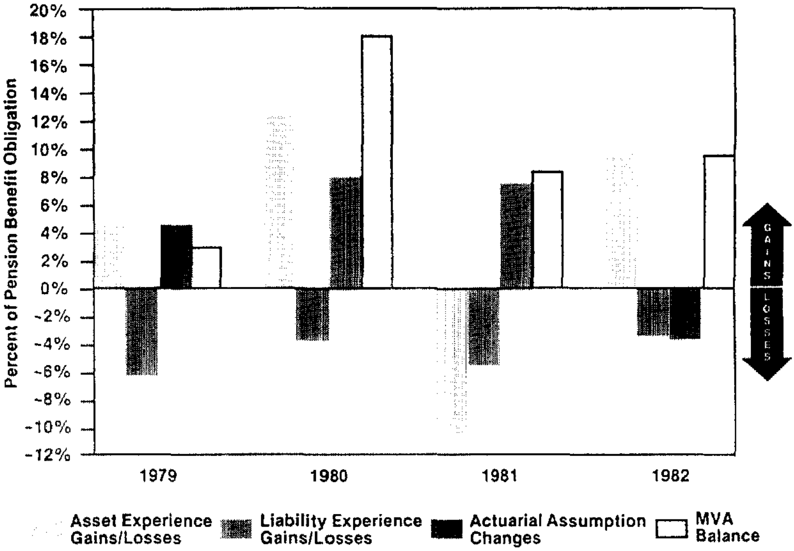


Chart 3A-4
Pension Cost
Plan A

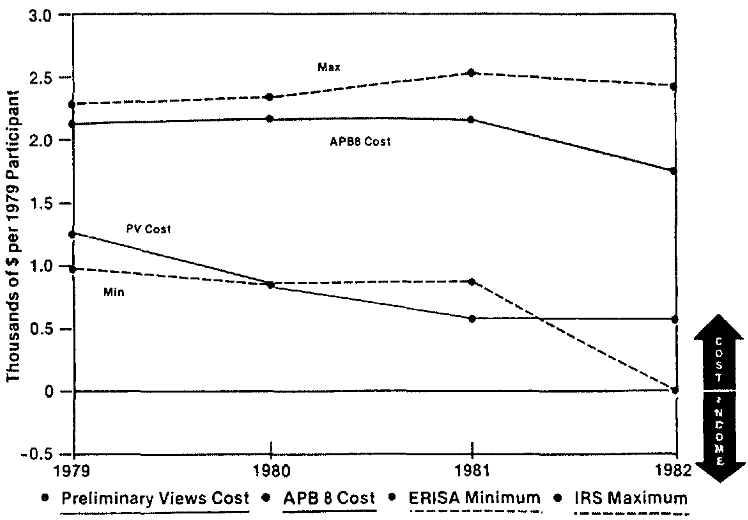


Chart 3G-1

Statement of Financial Position

Plan G

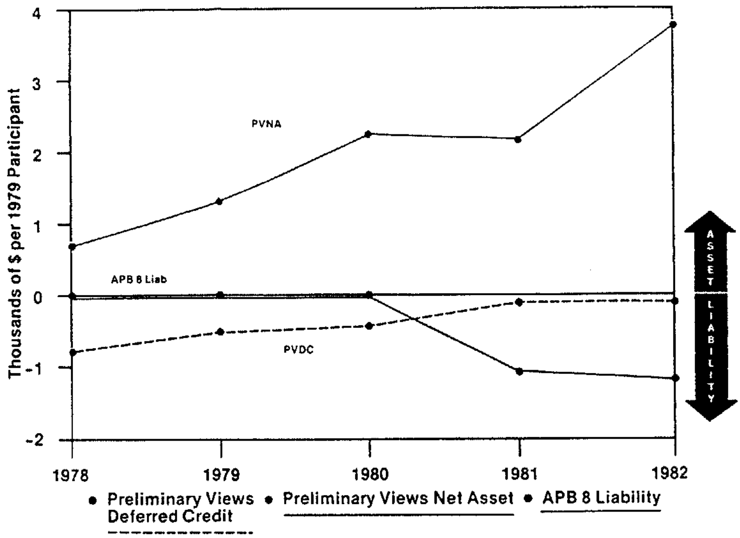


Chart 3G-2

Components of Net Pension Asset

Plan G

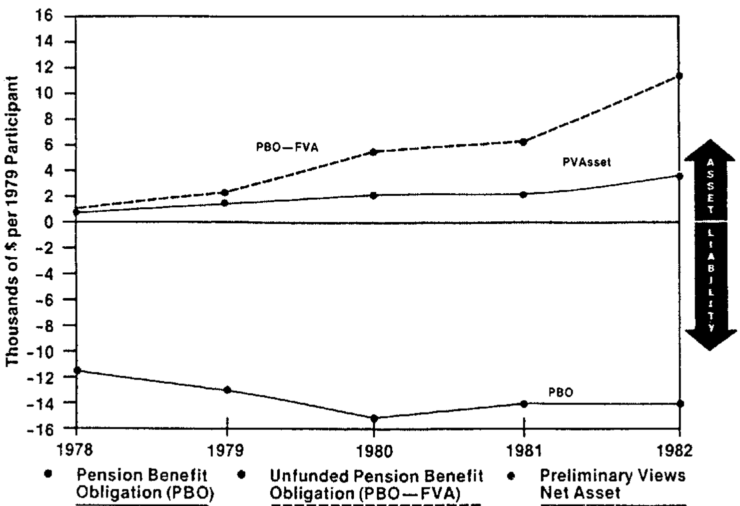


Chart 3G-3

Measurement Valuation Allowance

Plan G

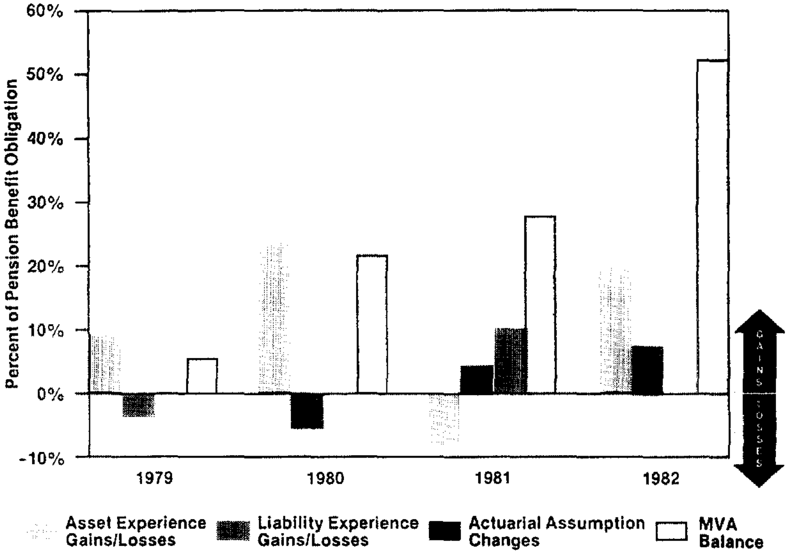


Chart 3G-4

Pension Cost/Income

Plan G

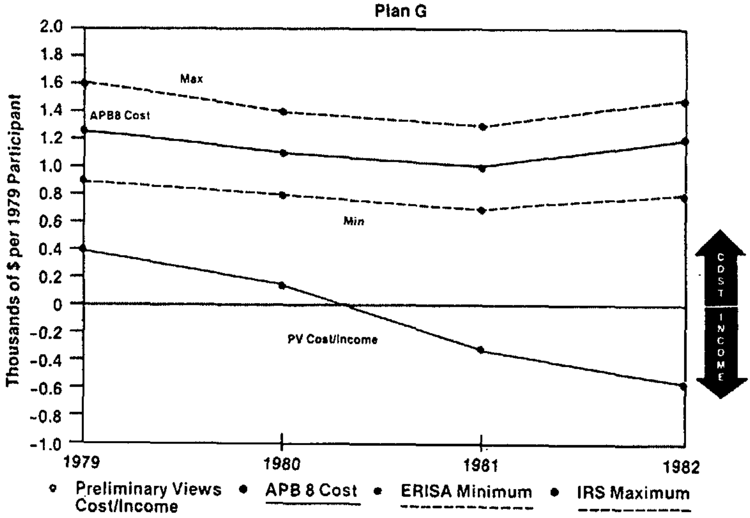


Chart 3D-1

Statement of Financial Position

Plan D

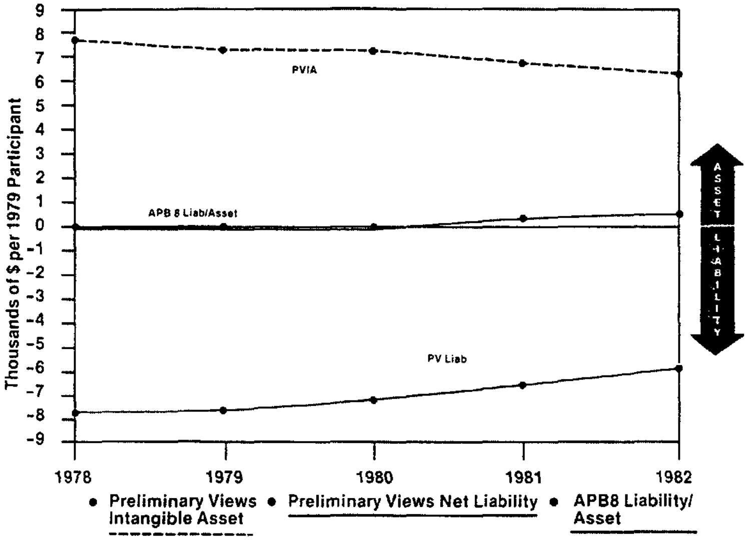


Chart 3D-2

Components of Net Pension Liability

Plan D

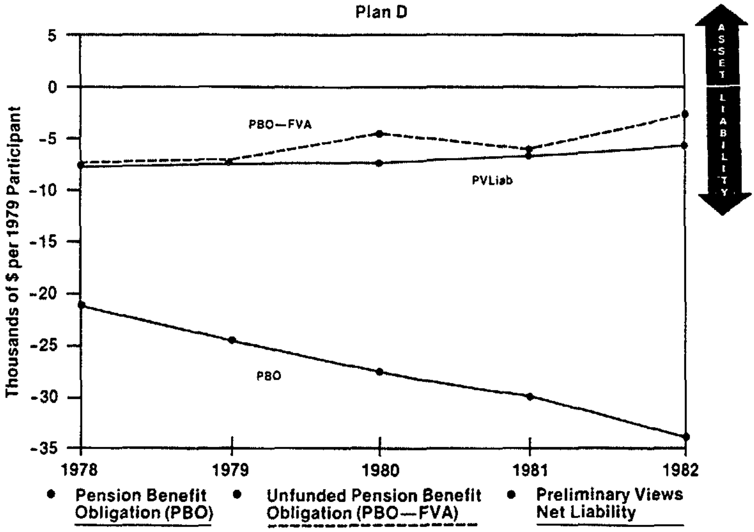


EXHIBIT 6

Chart 3D-3

Measurement Valuation Allowance

Plan D

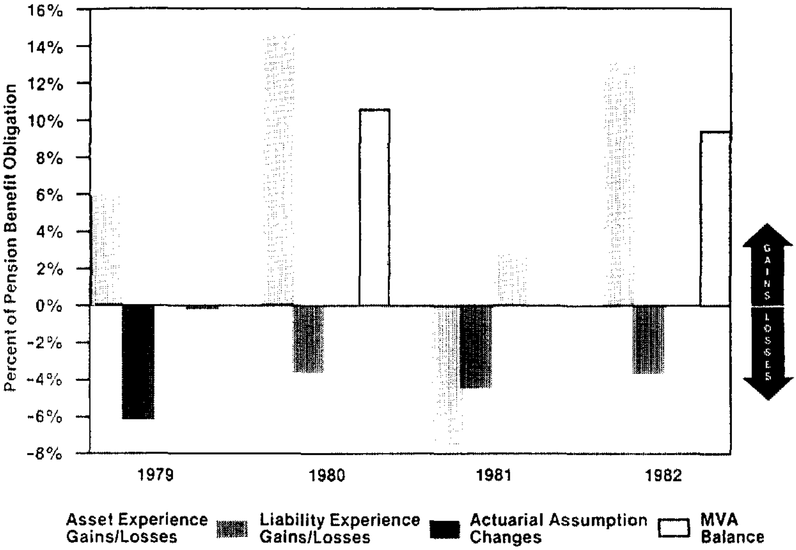
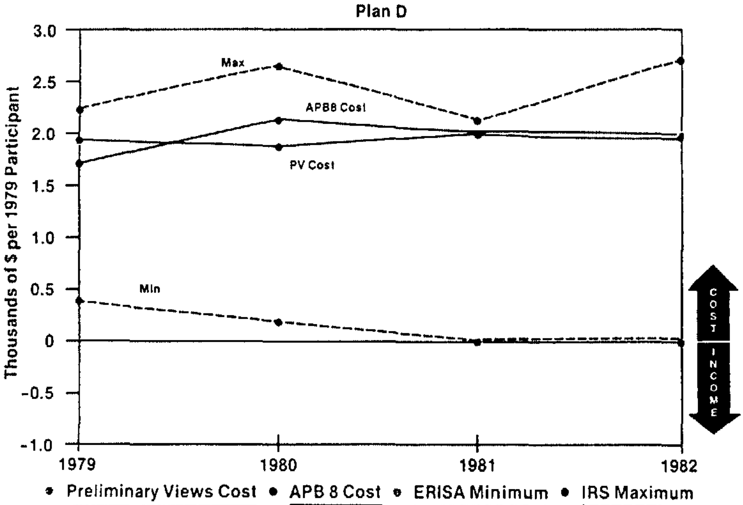


Chart 3D-4

Pension Cost

Plan D



COST
(20 Plans)

APB 8 as % of PV	Observations	
41 – 60	4	
61 – 80	6	
81 – 100	19	
Total		29
101 – 120	20	
121 – 140	7	
141 – 170	11	
Over 170	11	
Income	2	
Total		51

EXHIBIT 7

NET LIABILITIES/ASSETS 1982
(11 Situations That Tested 90% or More)

As % of:	High	Low	Average
Total Assets	15.9	0	5.0
Equity	33.6	0	9.8

Two of the 11 had net assets and
one had a negligible (<0.01%) liability.

EXHIBIT 8

AMORTIZATION
(46 Plans)

APB 8 AMORTIZATION (years)

	Mode	Other
Experience Gains/Losses	15	10, 30
Assumption Changes	30	10, 20
Amendments	30	10–20
Plan Initiation	40	10–30

AVERAGE REMAINING SERVICE (years)

Years	Number of Plans
6– 9	3
10–11	9
12–15	26
16–18	7
19–20	1

EXHIBIT 9

ACTUARIAL ASSET VALUES AS % OF FAIR VALUE (46 Plans)

%	Observations
130–139	1
120–129	4
110–119	8
100–109	25
90– 99	47
80– 89	61
70– 79	21
60– 69	2

EXHIBIT 10

ASSUMPTIONS 1982
(20 Plans)

	Return on Assets		Salary Progression	
	High	Low	High	Low
PV	10.0	5.5	8.5	4.2
APB 8	9.0	5.5	8.0	2.5

EXHIBIT 11

SENSITIVITY
(20 Plans)

	High	Low	Average
Return	(17)	(8)	(12.9)
Salary	13.3	3.8	6.8
Combined	(14)	(5.9)	(8.0)

EXHIBIT 12

EXHIBIT A

HOUSEHOLD INTERNATIONAL

	COMPANY SPONSORED	MULTIEMPLOYER
NUMBER OF PLANS	60	30
EMPLOYEES COVERED	32,000	19,000
PENSION PLAN ASSETS	$500 MILLION	UNKNOWN

EXHIBIT B

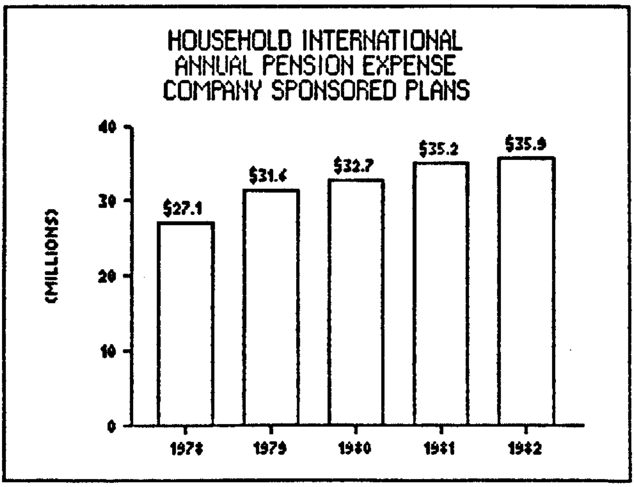


EXHIBIT C

CORPORATE FUNDING POLICY

MAINTAIN A FUNDING RATIO OF 100-120% USING REALISTIC ASSUMPTIONS

MAJOR ASSUMPTIONS

- INTEREST RATE - 11%
- INFLATION RATE - 6%
- WAGE INCREASE RATE - 7%
- ASSET VALUATION - MARKET VALUE
- ACTUARIAL METHOD - UNIT CREDIT SERVICE PRORATE
- INCLUDES ESTIMATES FOR THE IMPACT OF:
  - -ANTICIPATED BENEFIT INCREASES
  - -ANTICIPATED PLAN AMENDMENTS

EXHIBIT D

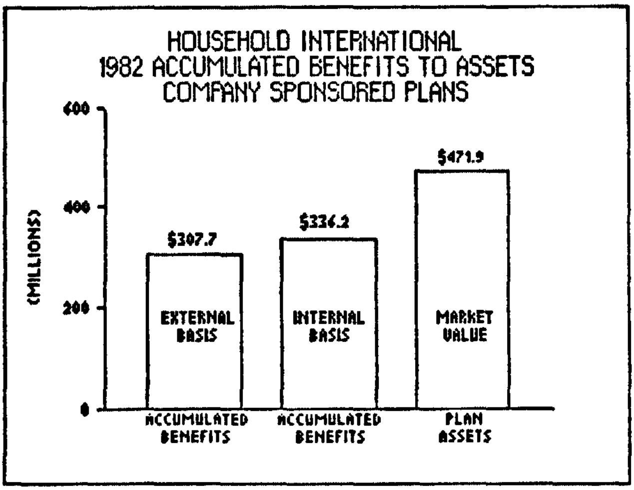


EXHIBIT E

HOUSEHOLD RETIREMENT INCOME PLAN

PLAN ASSETS	$140 MILLION
PRESENT VALUE OF ACCUMULATED PENSION BENEFITS	$90 MILLION
PENSION COST	$7 MILLION
ACTIVE PARTICIPANTS	4,800

EXHIBIT F

HOUSEHOLD RETIREMENT INCOME PLAN
1979 BALANCE SHEET ACCOUNTS
(DOLLARS IN THOUSANDS)

		FASB PRELIMINARY VIEWS	
	APB 8**	PROSPECTIVE METHOD	RETROACTIVE METHOD
PENSION CONTRIBUTION PAYABLE	$ -0-		
PENSION BENEFIT OBLIGATION		$ (57,073)	$ (57,073)
PLAN ASSETS		66,179	66,179
MEASUREMENT VALUATION ALLOWANCE		(3,302)	(3,302)
NET PENSION ASSET		$ 5,804	$ 5,804
INTANGIBLE ASSET (DEFERRED CREDIT)		$ (2,181)	$ 3,429

EXHIBIT G

HOUSEHOLD RETIREMENT INCOME PLAN
1979 PENSION COST
(DOLLARS IN THOUSANDS)

		FASB PRELIMINARY VIEWS	
	APBO#8	PROSPECTIVE METHOD	RETROACTIVE METHOD
SERVICE ACCRUAL	$3,430	$2,443	$2,443
AMORTIZATION OF:			
UNFUNDED LIABILITY	1,654		
MEASUREMENT VALUATION ALLOWANCE		(330)	(330)
INTANGIBLE ASSET		(262)	299
INTEREST ON:			
PENSION COST	331		
PENSION OBLIGATION		3,376	3,376
PLAN ASSETS		(3,434)	(3,434)
TOTAL	$5,415	$1,793	$2,354

EXHIBIT H

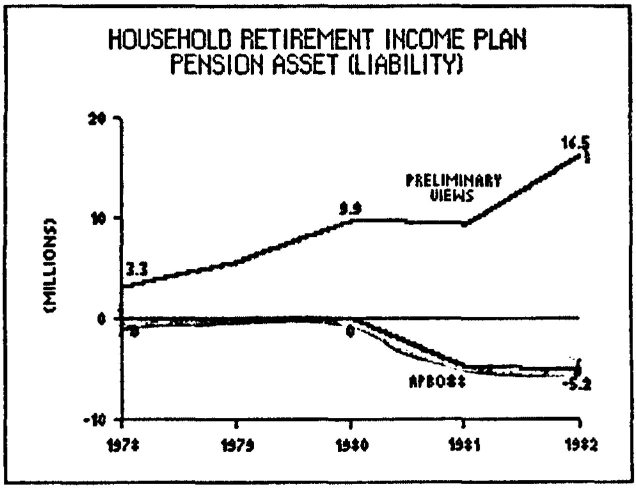


EXHIBIT I

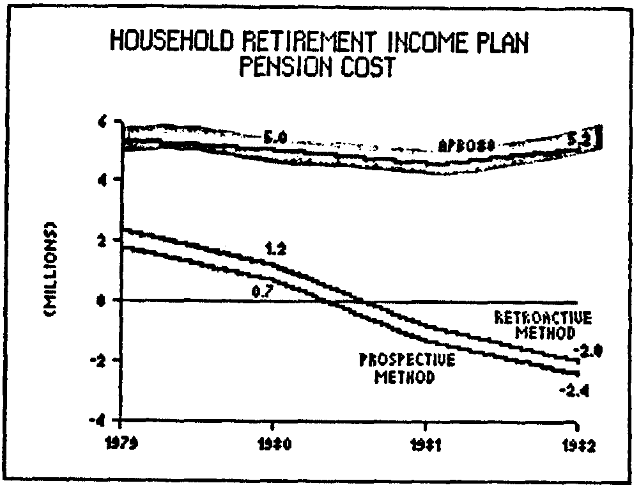


EXHIBIT J