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FAS NOS. 87 AND 88

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o A discussion of Financial Accounting Standard (FAS) 87 and FAS 88 including requirements for fiscal years beginning after December 15, 1988

MS. ELINOR V. BOWMAN: Scott Gildner is filling in for John Haley. He's a consulting actuary with the Wyatt Company in Washington, D.C. We are also very fortunate to have two people from the accounting firm of Touche Ross -- Gerald Searfoss, who is the Director of Accounting Standards, and Joseph Kelly who is Manager of the Actuarial and Technical Resources Group, both from the New York office.

MR. D. GERALD SEARFOSS: I had not been asked to speak on FAS 87 and 88 in a long time so I had to do some brushing up. I was told I'm the token accountant here. I'm not exactly sure what that meant, I guess that means I will turn it over primarily to the actuaries to deal with their particular areas in some depth from an actuarial perspective. Then I'd be glad to entertain questions as we go through, in terms of the accounting ramifications of some of these issues.

I am going to go back in time and try to give you a perspective from the accountant's point of view as to how we got where we are with respect to the specific items that we need your assistance on, and what your clients need your assistance on, in the development of the assumptions for complying with FAS 87 and 88. There are a couple things which actuaries may perceive as anomalies in trying to figure out how the accountants ever got there. So what I'm going to do is try to talk from the accountants' perspective and say, "This is how we got where we are, and I realize that creates some problems for you as actuaries." Then I'll turn it over to these other two fellows who are going to deal with FAS 87 and 88, respectively. As you have questions related to the accounting ramifications I'd be glad to spend more time on those. So my comments are going to be relatively brief. You know one thing you have to remember is that the accountants had an accounting standard for many years, known as Accounting Principles Board Opinion 8 that was superseded by FAS 87 and 88. When we finally got hold of that project it only took us 10 years to do it. That's relatively fast in accounting terms, at least in terms of standard setting. The project was started in 1974, and we finally had the standards out, as you know, in 1985.

Pension accounting is the primary focus of our session. What I'm going to deal with is FAS 87, first from the accounting perspective. Under Accounting Principles Board Opinion Number 8 that was in effect for many years, there were multiple actuarial methods that were allowed. Under FAS 87, the Board decided to move to a single family of methods known as the benefits methods. The whole concept was that there were benefits that were to be provided in the future, and to the extent that those benefits could be identified over a working lifetime, then cost related to those should be matched over that service period. Now unfortunately we are just finding out as we get into the other post-employment benefits area, that there was something in FAS 87 that we had not really realized was there. Had we known we probably would have responded vociferously and the Board may have changed it. However, we didn't and it didn't. And that is that there is a concept about eligibility which means that, if you have an eligibility arrangement such that there is a point at which all of your benefits are capped, then all of your liability should be accrued by that

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point. We as accountants really didn't pick up on that. We thought from an accounting perspective that for every year of service that an employee works for you, you should match a piece of the cost against that benefit that the company receives, i.e., the service from the employees. And we thought that went from the day the person was hired to the day he was expected to retire. Unfortunately we're learning that there is this subtle requirement in Statement 87 that says that you may have to end at an eligibility period which could significantly precede the expected retirement date. We're learning a lot about that right now, and we're being a lot more careful about the wording in the post-employment benefits project. I don't know how many of you are following that.

Pension accounting and FAS 87 have what I call the two rate approach: the settlement rate and the expected long-term rate of return on plan assets. When the FASB first started out with the project, it had to deal with this whole issue of the discount rate and the rate of return on plan assets. The concern, of course, that most people had was what degree of volatility that having current rates would add to their financial statements. The Board in terms of looking at the settlement rate said it could really be one of two things -- it could be an annuity rate or it could be a rate of return on long-term investments matched to the expected benefit payment stream. People didn't like that, because if you are going to determine a settlement rate at the end of each year and you are going to go through that process of measuring the liability (and your expense), then you are going to be introducing a great deal of volatility into that measurement process.

The Board's whole focus over the past five years has been moving away from what we had in accounting as an income statement focus, that is, trying to get the income statement right, and whatever falls out in the balance sheet, well, so be it. About five or six years ago the FASB flipped on that, and it is now operating on a balance sheet approach. That's really what we have in both 87 and 88, that is, get the balance sheet right and whatever happens to the income statement, we're not going to worry about that so much. There is an important ramification to that from the accountant's and the financial reporting perspective of the client. You introduce a great deal of volatility into the income statement because it gets whatever happens, but the balance sheet is measured correctly. Well, if you would talk to most of your clients, from a financial perspective and what they want analysts and rating agencies to see, they would like a fairly steady growth of earnings over time without a great deal of volatility, because that makes analysts nervous. So what the FASB said was, well, okay, we'll compromise on one side of this. Instead of having a current rate of return which would have also introduced volatility into the process, we'll go along with an expected long-term rate of return which actuaries are comfortable with. It helps offset some of the volatility that would be introduced in the settlement rate issue by using a current discount rate. That was the way the FASB was thinking at that point. So the selection of the expected long-term rate of return was really very much a compromise, and one which has created some concern and a perception of some inconsistency to actuaries. Looking at it from the asset liability approach the Board said, let's get the balance sheet right and then we'll worry about the income statement, but the problem is FASB couldn't even get the balance sheet right.

Let me back up a second, to say that accounting is really applied micro-economics, micro-economics being the economics of the firm. That is, we look at the marginal revenues, marginal costs and long term revenues and costs, and so on, and we try to quantify those in a very objective sense. We put those in black and white on a piece of paper, and we report the performance of a firm from the beginning of one period to the end of that period. Well, our problem is that from a micro-economic perspective we would look at the liability as being measured by that true future stream of benefits -- that entire future stream of benefits that is an implied or actual commitment by the company -- and present value that back and put the whole thing on the balance sheet. Politically that was impossible for the FASB to accomplish; what it had to do was go into a staged process. That is, you would have an asset on the balance sheet if in a particular year you had an excess of funding over the accrued pension cost. So if I put more in than I accrued as cost, I wind up with an increase in the asset. If, on the other hand, I have an excess of pension cost going through the income statement over what I'm funding for that year, then I would have either a decrease in the asset on the balance sheet or I'd have an increase in the liability. That means that over time you would build up piece by piece this liability on the balance sheet, assuming it's a liability. But then the Board asked, what if there is an even bigger liability out there that's not being recognized -- that is, that your projected benefit obligation (PBO) is large relative to your plan assets and therefore you have a shortfall? Well, if I look at it from the perspective of the micro-economist, I would say what I ought to do is take the PBO less the fair value of plan assets and that tells me what my liability ought to be. But that is such a big number that it was politically unacceptable to the reporting entities. Therefore the Board said, we're going to create the concept of this additional minimum liability that has just rolled in this year for your clients. Basically it was a compromise -- I can't get the whole liability up there so I'm going to get a piece of that liability, and the piece of that liability will be the accumulated benefit obligation (ABO) if it's greater than the fair value of plan assets. The FASB put the message out there and said, well this whole area is in transition and someday we might get all the way there, but we couldn't do it this time. There is some language to that effect up in front of the statement. So really where we are is that this additional minimum liability is now rolling in because of the deferral period, a grace period. And in some cases as you know that additional minimum liability is very large unless the company has made superhuman efforts to get in the funding levels necessary to so offset the ABO that you have no additional minimum liability to recognize. That's the current state of the art in terms of what's happening with respect to the balance sheet and the "quasi true-up" of the obligation.

Business combination is an issue that I think you need to think very carefully about, and your clients need to be concerned about this issue. In accounting when you acquire another company and it's what we call a purchase business combination, you have to value all of the assets and liabilities to get them up to the current value, and if you have a previously unrecognized liability or asset, you should true it up. If you have a situation where you are acquiring a company that is in an unfunded obligation position, you would then have to recognize a liability when the PBO exceeds the fair value of plan assets, or an asset when the plan assets exceed the PBO. Now prior to this statement, the rule was that you would take your vested benefit obligation and compare it to plan assets, and you would bring up any difference in the business combination -- in other words, on the balance sheet of the acquiring company. Now what that causes currently, because of now using the PBO, is a recognition of previously unrecognized amounts. Those amounts would not have been brought on the balance sheet of the acquiring company in the past, because you would have used vested benefit obligation (VBO) under the old standard. Now you will use PBO in terms of measuring that difference. Of course, there could be a substantial difference in those numbers, and therefore there could be recognition of a large liability in a purchase business combination. You would be called in to help your client measure the amount which would have to be booked in that business combination. We have heard of situations where this has not been done and should have been done. If it is missed that would be a serious accounting error, and there would have to be a restatement of the financial statements, which of course your clients would be extremely unhappy about. However, if they are being audited, there shouldn't be any question about that. That would have been caught hopefully.

MR. CHARLES BARRY H. WATSON: When you say "affects the allocation of the purchase price," could you explain the accounting implications of that for nonaccountants?

MR. SEARFOSS: This is going to be an interesting one. Let's see if I can do as good a job as Joe Kelly does explaining actuarial stuff to me, which is good. If in an acquisition you pay more than the fair value of the net assets, meaning assets minus liabilities, then you have a difference you have to account for. Now normally we call that goodwill; however, goodwill would only occur to the extent that you have already valued all of the other assets and liabilities properly and still wind up with a positive difference. So it affects the way I have to account. For example, let's say I've got an undervalued plant, I would fair value the plant, and if I still had some left over of that difference, then that would be goodwill. But here what I've got to do is to also fair value the pension liability or asset and then determine what my difference is, so that I can properly record the amount of goodwill. Then that goodwill is amortized over 40 years or less under the accounting rules.

MR. RUSSELL L. FERRANTE: One other thing here you could really have a problem with is overlooking unfunded nonqualified plans. They may be stuck off to the side somewhere and you have zero plan assets. So if they are subject to this accounting treatment that one can bite you.

MR. SEARFOSS: Exactly. Good point. Because at that point the whole PBO becomes a liability to be recorded in the business combination.

That pretty much does it on FAS 87, to just give you some of this accounting background and some of the issues, and introduce you to this particular issue that I'm not sure that a lot of people have focused on.

PANEL DISCUSSION

MS. BOWMAN: When you said previously unrecognized amounts, you mean previous combinations in previous years, where you only recognized the VBO over assets?

MR. SEARFOSS: That's right. In previous years you would have only recognized the difference between VBO and plan assets, and now this is going to cause you to recognize more in a new business combination.

MS. BOWMAN: It's only new, from now on.

MR. SEARFOSS: That's right. It's only prospective, that's correct.

MR. SCOTT B. GILDNER: I'd like to ask a question, too. I believe in the business combination situation there also is a provision that if amendments are anticipated as part of the purchase, then they should be included in the valuation of the PBO.

MR. SEARFOSS: That's correct.

MR. GILDNER: But of course, we all know that, when mergers and divestitures are made, they are done quickly, and it's very unclear what the final benefits will be. Those are often to be agreed upon, and I wonder if you could just comment from an accountant's perspective on how you look at that entire transaction. For instance, the company might intend to terminate the nonqualified plan, and yet it may not have been specifically included in the agreement.

MR. SEARFOSS: Well, there is a provision that you in essence have a year to true up in a business combination. In other words, if you discover something that indicates that your estimate was "light," you could true up. Now what I'd be careful about here, though, is a situation where it was just completely missed, as opposed to a missed estimate. If you had an estimate that was off, you generally have no problem going back and truing up. If you had decided in the combination agreement that there were specifically to be no modifications to pension benefits, then I'd have trouble truing that one up -- going back and saying, we changed our mind. I'd have a hard time with that one. Joe, have you run into that situation?

MR. JOSEPH W. KELLY: Typically, most of the mergers and acquisitions (M&A) things we've been running into lately say that you're going to keep the same benefits for up to two years. That's become very popular, and if that's the case, then you're not going to anticipate it. The other things discussed are if you anticipate plant closings or anything else like that. You have to take that into account in coming up with the amount you are going to recognize as part of the purchase as well, if you know you're going to close a plant in six months, and that's already part of the business plan you have in place for the post acquisition phase.

MR. SEARFOSS: That's right, that's a good point. Because if you were anticipating anything in that business combination -- it's already part of the plan of combination that you're going to close down a plant, all that's got to be wrapped up in this whole decision. When I get into FAS 88 and deal with curtailments, then I'll talk about nonbusiness combination situations where you're going to close a plant or whatever.

MR. VICTOR A. GALLO: If I understood right, in an ongoing business you compare the ABO to the assets. Now when you have a business combination, then all of a sudden you use the PBO. Number one, what's the logic for the difference, and what happens the next year when you've got one combined business? Do you use the ABO then?

MR. SEARFOSS: Yes. I think I used the words before, "political expediency" or "astuteness." The FASB felt that there was no way it could get enough support for this standard out in the business world if it didn't compromise on the additional minimum liability, so FASB settled for ABO minus plan assets. You are absolutely right, it's an inconsistency.

MR. GALLO: So does the excess liability then get erased the next year? In other words, when you initially combine, you set up a liability that's bigger because it's based on projected benefits.

MR. SEARFOSS: No, that becomes the additional minimum liability. It becomes your base.

MR. GALLO: In other words, next year you get to set up an asset equal to the difference between the PBO and ABO.

MR. KELLY: No. You're going to do the calculation next year of what you think your minimum liability should be and then compare it to the liability that's already on the balance sheet. Since you've got the PBO minus the assets already on the balance sheet, you're not going to end with an additional minimum liability, so there won't be an intangible asset that you're recognizing.

MR. SEARFOSS: The point is you don't go down, but you would go up. That's accounting conservatism.

We'll now discuss FAS 88 -- curtailments, settlements and termination benefits. I'll be talking a little bit as well about something I just heard of as we get toward the end of our discussion on this particular issue which is the criteria for a settlement (again I'm going from the accountant's perspective). When you use the term settlement, the accounting says it's got to be a done deal and the definition of done deal has three attributes: 1) It has to be an irrevocable action; then you first define what irrevocable means. Is there such a thing as irrevocable, because anything could be irrevocable? There might be a penalty attached, but anything might be revocable. 2) It relieves the employer or the plan of primary responsibility for the PBO. 3) It eliminates significant risk. Well, the definition immediately raises two issues. What does irrevocable mean, as I mentioned. By and large the FASB essentially says the cash must have changed hands to purchase the annuities to get a done deal. Because up until that point the FASB has believed it is not irrevocable. So to recognize the impact of a settlement the position has generally been the money must have changed hands -- the company must have paid for the annuities. And that's the period in which any settlement gain would be recognized.

Eliminating significant risk leads me into the issue of participating annuities. The Board found that to be a very sensitive issue -- how much risk have you transferred and what is significant risk? That has become very much a judgment call, but by and large what I've seen is not a great demand for participating annuities simply because of the uncertainty as to whether you had transferred significant risk. I don't know what you've seen, Joe, I just have not seen a lot of participating annuities being purchased. So I think again you want to structure the thing such that there is a significant transfer; in essence I think that people are going to a total transfer of risk by going the straight annuity route. Again the gain recognition takes place at the time that you make the transfer of cash. Criteria for a curtailment is different -- curtailment basically says you either reduce the people or you significantly reduce future benefits, and therefore you would have to recognize either a curtailment gain or a curtailment loss. If it's a loss on a curtailment, the concept is you would recognize the loss when the decision is made to curtail -- when there is a firm decision to curtail. If on the other hand it's a gain, it should be recognized when the curtailment has been completed, the actions have been taken. Again a very conservative accounting perspective basically says, "Recognize all losses as soon as possible and defer all gains until you're absolutely sure." That's the concept that was built into that.

Now one question that I've had is how do you actually measure the impact of the curtailment gain? Do you look to number of years of future service that have been eliminated and use a ratio on that basis? The FASB happened to use the example in FAS 88 using the years of service reduction basis. Recently we had an example where a client had a situation where the curtailment related primarily to the younger group, and therefore what you had was a significant percentage reduction in future years of service over which accruals would take place. But you had a very small proportion of the PBO reduced. So of course if you followed the percentage of years of service, you could have a significant loss, but if you use the percentage reduction of PBO, it would be much less. Well, I talked to the FASB about that, and the basic guidance was whatever makes sense. What you ought to be looking at is what makes most sense under the circumstances, and that's why FASB uses reduction of expected years of future service or eliminates accrual of defined benefits. Therefore, you would look to the reduction in the projected benefit obligation. So in this particular circumstance we relied on the reduction in the PBO as the basis for the loss recognition. The FASB's example was not a clear-cut answer because everybody thought that because FASB uses years of service as the basis for its example that's what you had to do. And it is not. So it is pretty much situation specific.

With respect to termination benefits, you'd recognize the expense when it is accepted for a special termination benefit. For a contractual benefit you'd recognize it when the decision is made to offer that, then you would make an estimate of the loss or the expense that would be incurred. Now one question that has come up is what is a short period? And I said, "What do you mean what is a short period?" I think that is an unfortunate use of words by the FASB, because maybe it should have been for a limited period, or anything that's not a contractual termination benefit is a special termination benefit. Well, let me tell you why the question is being asked. Apparently some companies are setting up two-year or five-year windows, and they are saying that's not a termination benefit, that's a plan amendment. Therefore they get to spread the effect of that over the future remaining service life. I think we better be very careful about that; I understand that in two circumstances companies have accounted for it that way. I have a real concern because to me as soon as I put a term on the period over which I can exercise or accept that offer, it becomes a special termination benefit. If this is an SEC client, I would have a significant concern about spreading a termination benefit over the remaining service period by calling it a plan amendment. You better be very clear as to what it is, or is not. So that's a question, and I think it's a pretty significant one given some of the benefits that are being offered. These are being offered by companies that want to do a downsizing over an extended period so that they don't have to take all the hit in one year, which is fine, but you also have to be careful. The accounting for a termination benefit typically is that you recognize the expense when the employee accepts the offer. So you may have a certain number of employees accept the offer each year over two years or five years, and that's how you'd recognize your expense. But to recognize it over 15 or 17 years of expected service, I have a real problem with that. Some firms are expressing a great deal of concern about that, and others have already accepted it. So right now we have mixed practice, or the potential for mixed practice because this is the first I've heard of it.

Now one other thing I would mention to you with respect to FAS 88. You know when a company goes though a major downsizing or restructuring, what you often have is a combination of settlements, curtailments, and termination benefits. And because you have different points of recognition from an accounting perspective, that means that one of the things that you have to do, you meaning the actuary working with your client, is to disaggregate the impact of these things. Because remember what I said, a settlement is not recognized for accounting purposes until the money changes hands between the company and the annuity provider. From the perspective of a curtailment, if it's a gain, it's recognized when the curtailment is finished, if it's a loss, it's recognized when the decision is made to curtail. And if it's a termination benefit, the expense is recognized when the employee accepts the offer. So you have different recognition points. Therefore, what you have got to do is disaggregate the effect of that downsizing into its pieces so they can be properly recorded into the various accounting periods. And again, the reason I'm bringing this up is, if it all happens in one year, no problem. But if some things happen over a year-end or over a period of years, that means you will recognize the effect of some of this in one year and some of it in another year. For example, if it's a curtailment loss and I make the decision to curtail, that should be recognized this year, as soon as I make that decision. But if it's a settlement involved and the cash isn't going to change hands until next year, then that's to be recognized in the next year. So all I'm saying is be careful about that, we've seen some situations where it either has not been disaggregated and all recognized in one period, or where it had been improperly disaggregated and we had some real questions about the numbers.

MR. KELLY: Now that Jerry has had a chance to give you FAS 87 and 88 from an accountant's perspective, I'm going to endeavor to give you a perspective from an actuary who works for a Big 8 accounting firm, and then Scott is going to speak about FAS 88 with you, and I think go through a settlement example. The first area I'm going to talk about are the relative responsibilities of the client, the audit partner, and the actuary in determining what our assumptions are for calculating FAS 87 pension expense. Unlike regular actuarial valuations, the ultimate responsibility for selecting the assumptions lies with the client. The audit partner then will have to sign off on whether or not the assumptions and estimates being used are reasonable for the client at hand. As actuaries we're going to act more as plumbers. That's one of my favorite little terms for this whole area. We will consult with clients on coming up with what reasonable estimates are, to give them some idea of some ranges, and talk with them about their particular situation. But as I said, ultimately it is their responsibility to set the assumptions, and then Jerry or one of his fellow partners will have to sign off on whatever the assumptions are.

The first major assumption, the one that comes up most in conversations that I have with either my clients or in dealing with Jerry's group in National Accounting & Auditing, or with all the people out in the field, is the deciding of the discount rate. As Jerry spoke about briefly, it's a settlement concept. It should be based on what we can settle the liabilities for in the marketplace; in a lot of ways it is based around an insurance concept, the going out and purchasing of annuities. Many different firms are using many different ways to come up with what their discount rate is. One of the alternatives that I've seen used many times by large companies is to have a cash-flow analysis done by their actuaries, project out what annual cash flow is going to be necessary to pay out all benefits; then they either work with their internal financial people or they work with a banking firm or some investment firm to come up with a discounted cash-flow analysis, and determine the discount rate that would be implicit in that calculation. This tends to come up, especially for large corporations, with some pretty high discount rates, but it does seem to be defensible, and audit partners are willing to sign off on this as long as there is plenty of documentation that is backing all of this up.

FROM THE FLOOR: I don't see how that gets a rate?

MR. KELLY: Companies go out and do a projected cash flow analysis, and then basically set up some kind of portfolio where they know what the returns are going to be -- a bond type portfolio that is going to match those cash flows in future years. They then come up with, "What rate am I going to get on a discounted basis on that portfolio so I can pay off all my liabilities as they come due?"

Another alternative that is being used by some of the smaller to medium size firms who can't be that sophisticated, don't want to pay us a lot of money to do this, or pay any investment banking firm, is to look at what the PBGC rates are. Some firms will look at the immediate rate; they might use some deferral periods, or they may use PBGC plus half a point or PBGC plus one point. There is a wide variety of rates being used, it's an easily available rate that can be used and understood by a lot of the clients. Others take a look every year at two or three different bond rates and try to come up with a blend of what those bond rates are. I've seen a wide variety of miscellaneous things, some that seem reasonable to me, some that don't seem reasonable. I'm sure you guys have seen just as wide or wider a variety, and I know Jerry has run into several different areas.

Just for some information Slide 1 shows a history of the rates that have been out in the marketplace since 1987 for 30-year T-bills, Moody's triple A rated bonds and the PBGC immediate rates. As you can see the 30-year T-bills and the Moody's triple A have been a little more volatile than the PBGC immediate, but it would tend to point toward the fact that the rates should be moving year to year.

SLIDE 1
DISCOUNT RATE -- HISTORY OF RATES

Date	30 Year T-Bill	Moody's AAA	PBGC Immediate
6/89	8.27%	9.10%	7.75%
12/88	9.10	9.57	7.75
6/88	9.00	9.86	8.00
12/87	9.12	10.11	8.25
6/87	8.57	9.32	7.50
1/87	7.37	8.36	7.50

Based on an annual study done by Buck Consultants, Slide 2 shows what the average discount rates are for a large group of companies. As of January 1, 1987, you'll note that it was 8.36%; by the end of the year most of the rates had gone up. You can see there is about .4 of a percent increase in the average discount rate, with not much of a change from the end of 1987-1988. There are wide variations in these rates, the general ranges were anywhere from 6 to 12% for discount rates that are being used. As you can see not everybody agrees as to what the same general rates are that should be used.

SLIDE 2
DISCOUNT RATE

Averages -- Buck Study
01/01/87-8.36%
12/31/87-8.73%
12/31/88-8.80%

Let's look a little bit at some of the problems that we have run into. Probably the biggest problem I think I run into in the discount rate is the fact that there is no change from year to year. Unless a company's demographics have changed dramatically, at least in two of the three years that FASB has been out here, we need to have some kind of change in the rates. I've run into discussions with people where the rates had moved 1.75 points on 30-year T-bills and triple As in a one-year period of time, and they said it's not substantial enough to cause them to want to make the change in the discount rate. To me 1.75 points is a substantial change, and I think Jerry would have a real difficult time. It's one of his pet peeves, I know, not changing your discount rates from year to year, unless you're consistently applying some methodology that would fairly well document the fact you don't need to change the discount rate. The other thing we have run into is an inconsistent methodology from year to year. Clients one year will use a PBGC rate and then the next year they'll want to use the triple A bond rate as a basis for their discount rates. In those situations it seems to me they are changing their method of estimation, and that would need to be disclosed, because they are trying to get discount rates that probably would fit most closely with what they want their expense to be for that year. And that doesn't appear to meet the requirements of the statement itself.

Long-term rate of return on assets is meant to be the average rate of earnings on the funds that are currently invested or will be invested in the future, to pay off all benefits inherent in the calculation of our projected benefit obligation. Once again (Slide 3) from the Buck Study you'll note that the rates have maintained a relatively stable rate. They were a little bit higher in 1986 for those companies that did adopt early, about 9.2%. I think we will tend to see this more often, because it is meant to be more of a long-term look at rates and have less volatility, as Jerry explained earlier. As far as the relationship to the discount rate goes, we spent much time within our own firm and also having discussions with other people as to what the relationship should be. Our own firm position is that the long-term rate of return on assets should in almost all cases be higher than the discount rate. That is because in the discount rate is an inherent assumption of risk by the insurance company or whatever is going to settle the liability, where it is going to charge you in order to get those returns. Unless there is good documentation as to why your long-term rate of return should be less -- if you have it invested in an extremely conservative manner and you are only going to get 7.5 or 8%, but your settlement rate based on your population is 9% -- I think a lot of the audit partners that I know are going to be hard-pressed to sign off on anything where the long-term rate of return would be less than the discount rate.

SLIDE 3
LONG TERM RATE OF RETURN ON ASSETS

- Definition
- Averages -- Buck Study
  1987-9.03%
  1988-9.10%
- Relationship to Discount Rate
- Few Problems Encountered

Salary increases should be the best estimate of your population expected future salary increases and should incorporate the same inflation assumption as other assumptions that you are using -- the discount rate, the long-term rate of return on assets. Once again from the Buck Study, a little over 6% in 1987 was the average rate being assumed, dropping to about 5.9% in 1988.

I just want to get into purchase accounting a little bit more than Jerry did with some of the problems and issues we have run into. Oftentimes as Jerry mentioned there is a nonrecognition of the difference between PBO and assets. I run into it a lot, because I do a lot of reviews of financial statements and accounting that is being done for mergers and acquisitions, as part of due diligence. We also review a lot of financial statements within Touche, where audit partners will send the statements to the actuarial group to review. I've run into several cases where there was a nonrecognition, and as a result goodwill was either under or overstated, and that affected the overall statement of financial position for the company. The date of calculation should be the date that the purchase goes through, and the assumptions that should be used are assumptions as of the date of purchase. A lot of companies want to use the same assumptions or data as of the beginning of the year. The assumptions that are being used should be the assumptions of the acquiring employer. The remaining fiscal year expense for FAS 87 should be based on those same assumptions and should be based on a census as of that date of sale, and also should not include any more recognition of our transition asset or obligation in that calculation, because that's all already on the balance sheet of the company. In addition, if you had any prior service cost, that should also not be recognized. Future expense calculations are the same as I just mentioned; they are going to be service cost, interest cost, and expected return on assets until such time as you have gains or losses that fall outside of the corridor, or until such time as you amend the plan to either increase or decrease benefits, in which case there will be adjustments to the expense calculation for those.

Another problem I have run into, or have had questions from many people on, is that the prepaid asset or accrued liability that is on the balance sheet of the company is not going to be amortized as a separate component of expense each year. The only way that prepaid asset or accrued liability will change from year to year is to the extent that there is a difference between the amount of cash contribution you put into the plan and the amount of expense you charge to the income statement during any one year.

Additional minimum liability comes up as Jerry mentioned for the end of this fiscal year. The main companies that are going to be affected by this are any companies that have collectively bargained plans where there has been a series of regular plan amendment increases and funding not being able to keep up with that -- typically with utility companies or big steel companies. There are certain other strange situations you can run into that you don't see very often that might lead you to an additional minimum liability. As we talked about earlier, anybody who has gone through a purchase accounting on a plan probably will not have to worry about additional minimum liability because he will have already recognized the full extent of the difference between the PBO and the assets.

MS. BOWMAN: You said the remaining fiscal year expense is based on a census as of the date of acquisition?

MR. KELLY: Preferably everything should be redone unless the actuary can make the auditor comfortable that there has not been a significant change in the population that is being covered as a result of the purchase itself. The acquiring company should have had its expense done for the whole year already. This recalculation is for the plan that you are picking up for the expense for the rest of the year. You are going to calculate that particular piece for the rest of this year. You are adding it in to the acquiring company, and then you'll put them all together for the following year.

MS. BOWMAN: And when you said there is no more amortization of the transition asset, that's in the acquired company?

MR. KELLY: Yes. I just wanted to bring up one interesting issue that FASB has backed off from its original position. I don't think Jerry spoke of this earlier. Originally FASB wanted anybody who had a history of regular benefit increases to have to recognize some level of increase in all future years when valuing FAS 87, for example, if you increase your benefits from $10 per month per year of service to $11 or $12 and you kept those increases going over a period of several contracts, FASB had wanted you to project that out as some level of increase for all future years. It came out in the questions and answers -- I believe it was question 52, and backed off that by saying that a history of regular benefit increases in itself is not enough to require this to be done. We ran into a situation where we went back, as an example, and looked over the last 30 years or the past 10 negotiations for a very large firm to see how often the benefit increases had been given. They had been given in 4 or 5 of those 10 prior negotiations. The FASB backing off on question 52 and the fact that 5 or 6 of the prior negotiations had not resulted in benefit increases led the audit partner not to require projection of future increases. I don't know that there's been much talk about this recently; this was about a year and a half ago that this whole issue came up on this one particular client. I think everybody kind of stepped back from that because there was quite a big uproar about it from a lot of companies that are highly unionized and always going through contract negotiations.

MR. GILDNER: Joe, I have an interesting question on this particular point. If you have a client perhaps that has a collective bargaining agreement, and every three years it bargains essentially special termination benefits for the next bargaining cycle, which provision prevails? Can you treat it as a history of plan amendments, treat it as an amendment, or do you need to treat it as termination benefits each cycle?

MR. KELLY: I'm going to defer to Jerry, I haven't run into that one yet.

MR. GILDNER: The client doesn't want to treat it as a series of amendments, because then it has essentially put on the books that it will continue to do this and it is in a bargaining situation, and yet it does not seem appropriate necessarily to treat it as termination benefits.

MR. SEARFOSS: I'm a little confused. Do you mean in the collective bargaining process a special termination benefit is negotiated in?

MR. GILDNER: Special termination supplements.

MR. SEARFOSS: Oh, that's contractual?

MR. GILDNER: Contractual termination benefits.

MR. SEARFOSS: Oh, it's not a special termination benefit. But a contractual termination benefit under FAS 88 is only recognized at the time you make the decision to open it up. So I'm not sure why it would be built into the calculations, maybe there is something about the actuarial stuff here that I don't understand? It's a contractual benefit but only available at the time you decide to make it available. Right? Or if the firm decides to exercise it.

MR. GILDNER: But in many ways it's just like exercising the right of retirement.

MR. SEARFOSS: I don't know.

MR. GILDNER: That's the same answer I had.

MR. KELLY: This is one issue we have run into a couple of times, too, and that is where you decide in March 1988, for example, to adopt a plan amendment increasing benefits effective January 1989. Do you, or do you not, have to alter your calculation of expense for the remainder of 1988? The answer is yes, you are supposed to do the calculation and alter your expensing for the remainder of 1988, because you know that there is an ultimate benefit level that you have to pay to people leaving after January 1, 1989. I know I've run into this personally a couple different times and this is the correct answer. I saw one other presentation at one time where someone talked about the fact that it turned out not to be material in the audit partner's estimation, so the company didn't have to do it for that year and just did it for future years.

The last kind of arcane little issue here is one that Jerry cringes at every time we bring it up. The reason I bring it up is that it came up again in a recent acquisition we were working on. That is, how do we account for a floor plan? FASB has danced around this whole issue. To my knowledge and Jerry's knowledge FASB still doesn't have a final answer on what we should do in the case where we have a defined benefit plan that identifies a targeted benefit, but it's going to be offset by whatever the account balance in a defined contribution plan will purchase as an annuity. We sent three approaches to FASB and asked it to come up with some kind of opinion as to whether or not they were reasonable approaches. They all seemed to make sense and each have their own advantages and disadvantages, and I just want to run briefly through those, to give you an idea of some of the thoughts that we have on this.

The first one is a combined plan approach, where we would project the total benefit to be payable from both plans, including for those people who would have a larger defined contribution plan account balance than what would be necessary to pay off the defined benefit plan, excess benefits that would be attributed to that defined contribution plan. Then we would allocate that pro rata, with everything allocated to prior service being PBO and everything for the current year's worth of service being the service cost. Plan assets would then include the defined contribution account balances with future projections of contributions, based upon what we expect for the level of contributions, whether it's a profit sharing plan, or standard deferrals under a 401(k) plan, so we know how much of a match is going in, etc., etc. The advantages of this methodology are that it provides a stable expense where our defined contribution plan future contributions are reasonably estimated. Disadvantages are that the calculation of that defined contribution plan excess benefit, for those people who are going to get a larger accrual through that than through the defined benefit plan, is highly dependent on those estimates of our future defined contribution plan contributions.

The second way to do this is to calculate the plans separately, whereby the defined contribution plan contribution expense every year is just whatever money you put into it. For the defined benefit plan we would calculate what our ultimate defined benefit plan benefit would be, net out what was going to be provided by the defined contribution account balances, plus future contributions projected, and then subtract those out and then allocate pro rata over the future. Plan assets would not be included in this calculation of our expense.

The third and hybrid approach is where we would calculate the ultimate benefits to be paid from the plan, which would be both the defined benefit plan benefits and the excess defined contribution plan benefits. However, this would not include projections of defined contributions in future years, and we would only project the existing account balances to the extent that there would be excess over the defined benefit plan, and those would be the excess benefits. When you get the excess benefit, that would be added to the PBO. To come up with the additional service cost for the year, you would only add in the current year's expected contribution for the defined contribution plan, and then project out to see if there is any excess, and that incremental difference would then be the service cost addition. Defined contribution plan assets are treated as assets, and you would do the calculation pro rata over the service lifetime, and that would be the cost for both plans combined.

MR. GILDNER: I have been asked to speak on FAS 88, and in particular I'm going to concentrate on settlements because I think there are some interesting actuarial aspects of settlements. And just to review, a settlement, of course, is a transaction that is irrevocable, relieves the employer of primary responsibility for a projected benefit obligation, and eliminates significant risks related to both the assets that were settled and the liabilities. The two most obvious examples are lump-sum payments or the purchase of nonparticipating annuity contracts.

We have set up a sample settlement calculation (Slide 4). The data before the settlement would essentially be what you might have projected your PBO and your assets to be at the date of the measurement, the date the settlement occurred. On that basis we have set up a projected benefit obligation of $1,811, assets of $1,560, an unrecognized net loss of $107 and an unrecognized net transition asset of $231. After remeasurement at the settlement date, the PBO under the new assumptions that are applicable on that date is $1,765. I think the key point is that it's completely reasonable, and not only reasonable but also expected, that you would look at and review your assumptions again at the date the settlement occurred, to see if the assumptions you picked at the beginning of the year for expense purposes were still applicable. With the remeasured assets, you could easily have an asset gain or loss during the year. Then we also looked at the amount settled versus the cost of the settlement. Even after remeasuring your PBO using what you consider applicable assumptions for that date, the fact that the settlement may cost more or less than the PBO being settled is in some ways an additional adjustment to your PBO.

SLIDE 4
SAMPLE SETTLEMENT CALCULATION

<u>Data before Settlement</u>

PBO	$1,811
Plan Assets	1,560
Unrecognized Net Loss	107
Unrecognized Net Transition Asset	231

<u>Settlement Data</u>

Remeasured PBO	$1,765
Remeasured Assets	1,540
Amount Settled	385
Cost of Settlement	340

I think Slide 5 gives you an example of each of the calculations you might do. The first gain or loss component you might look at is the difference between your projected PBO and the PBO you calculated using your new assumptions at the settlement date. And in our example that's $46. The asset gain at the settlement is the difference between your projected assets and your fair value at the settlement date, in this case negative $20. The negative $20 we specifically picked could just be because of poor investment performance. We actually had one interesting situation where a client had participating annuity contracts which it was holding at some type of book, supposedly at market value. Turns out when the time comes to try and convert it to nonparticipating contracts from participating contracts, that contract had a different value. So there can actually be adjustments to your asset values at the time of settlement. And then I'm not sure this is a very good term but we say the gain from the settlement. This is defined as the difference in what the PBO is valued at, for instance by the insurance company, and what your valuation of the PBO would be for the same participants being settled. I would really consider that an additional PBO gain. I would see a PBO gain of $91 and an asset loss of $20. Then in the calculation of the actual FAS 88 settlement gain, the first step is to determine the maximum gain that could be recognized in earnings at this particular point in time. That maximum amount is the sum of several amounts. It is the sum of the prior unrecognized gains or losses, in this case $107 in losses; plus the gains or losses that you recognize at the time of settlement, so our differences at the time of settlement; plus any unrecognized transition asset. And the sum of those elements in our example is $195. There is one key distinction: if you have an unrecognized transition obligation, that is not included in this calculation of the maximum gain. That's excluded. Unrecognized prior service cost is also excluded. Once you have determined the maximum gain, the next step is to determine what portion of that gain will be recognized at the settlement date. And that portion is the proportion of the PBO that is being settled. In our case, we use $385 divided by $1,765 or 22%, so 22% of the maximum gain is $43.

SLIDE 5
SAMPLE SETTLEMENT CALCULATION

1.	PBO Gain at Settlement $1,811 - $1,765 =	 $46
2.	Asset Gain at Settlement $1,540 - $1,560 =	 (20)
3.	Gaim from Settlement $395 - $340 =	 45
4.	Maximum Gain	
	a. Prior Unrecognized Gain	$(107)
	b. PBO Gain	46
	c. Asset Gain	(20)
	d. Settlement Gain	45
	e. Unrecognized Transition Asset	231
	f. Maximum Gain	195
5.	Portion of PBO Settled $385 ÷ $1,765 =	 22%
6.	Recognized Settlement Gain $195 X 22% =	 $43

Take a look at the impact of this settlement gain on the statement of financial position (Slide 6). We see that the status before the settlement, the PBO as remeasured on the settlement date, was $1,720. The assets were $1,540. We were settling $340 of the PBO and purchasing that settlement with $340 of the assets, leaving post-settlement calculations of $1,380 and $1,200. For the items not yet recognized in earnings, we can see that essentially we had the $231 in the net unrecognized transition asset, 22% of that is recognized immediately in earnings, leaving $180 after the settlement. For unrecognized net cumulative losses or gains we have $36; if we go back to Slide 5 and you subtract out unrecognized transition asset, the difference is $36. Some 22% of that is immediately recognized, leaving us with $28. Unrecognized net prior service cost is unaffected. The settlement gain in this case of $43 falls immediately to the bottom line, and is added to prepaid pension cost.

A settlement has some other implications, and Joe already touched on this. The fact that you settled an obligation during the year, if you settled it on other than a measurement date, would affect your net periodic pension cost for the remainder of the year (Slide 7). In this case we've

CALCULATION OF SETTLEMENT GAIN

	Before Settlement	Effect of Settlement	After Settlement
Assets and Obligations			
PBO	$ (1,720)	$ 340	$ (1,380)
Assets	1,540	(340)	1,200
Items not yet Recognized in Earnings			
Unrecognized Net Obligation (Asset) at Transition	(231)	51	(180)
Unrecognized Net Cumulative Loss (Gain)	36	(8)	28
Unrecognized Net Prior Service Cost	521	0	521
(Accrued)/Prepaid Pension Cost on the Statement of Financial Position	$ 146	$ 43*	$ 189

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* Settlement Gain.

SLIDE 7

EFFECT OF SETTLEMENT ON NET PERIODIC PENSION COST

	Before Settlement	Effect of Settlement	After Settlement
Service Cost	$ 90	$ 0	$ 90
Interest Cost	152	(19)	133
Expected Return on Plan Assets	(134)	16	(118)
Amortization of Unrecognized Prior Service Cost	32	0	32
Amortization of Unrecognized Net Loss (Gain)	9	(6)	3
Amortization of Unrecognized Net Transition Asset	(33)	7	(26)
Net Periodic Pension Cost	$ 116	$ (2)	$ 114

put no effect on service costs for the settlement, we're assuming that we were buying nonparticipating contracts for inactives, let's say. The interest cost went down, since part of the PBO was settled; you could even have a different interest rate following the settlement date, so that number could change. The expected return on plan assets component went down leading to a higher expense, and again that could be reevaluated at that time as well. I think there is a key point in FAS 87 which says that you may use the assumptions in effect on the measurement date to determine net periodic pension cost for the entire year, but you could change those, and in fact you should if any significant event occurs. In this case a settlement would typically be a significant event and would require you to revalue everything as Joe indicated, which means you could, for the portion of the year following the settlement, have an expense calculation on a different set of assumptions, and you'd have to marry the two. That is in fact the only way that the calculation will balance. Amortization of unrecognized prior service costs is unaffected by a settlement. In our case the amortization that was going on of the unrecognized net loss was affected, and the amortization of the unrecognized net transition asset was also reduced by the amount that was recognized immediately. Now these two calculations here are not necessarily 22% of the annual component because they are 22% adjusted for how much of the period is remaining. For example, if this occurred in the middle of the year, your remaining transition asset at that point might go down 22%, but you would have half a year with the full transition asset, half a year with the 22% lower transition asset.

One thing we think is very important to point out, when you have a settlement situation, is that there is a third value, which is the real economic value of the transaction. And this may be very different from the accounting costs. It seems that the best way to look at the true economic cost is to compare the expected rates of return -- in our example the annuity contracts versus what the trust might have earned.

I think we look at settlements as ways companies try to recognize their transition asset early. They want to settle part of their obligation, they want to pull part of that transition asset, take it from a deferred status and an amortization status and recognize it immediately. Typically they do what economically seems like a bad decision in order to accomplish this accounting objective. One exception we found that was very interesting was we had a client with some participating annuity contracts and it was looking to settle those. In that particular case it actually made a lot of sense to settle those and convert to nonparticipating because there did not appear to be any real economic cost. The client was actually probably earning the same amount on a participating basis that it would earn on a nonparticipating basis. If you have participating annuity contracts for your clients, probably really have a good opportunity to recognize a settlement gain without incurring a true economic cost.

The other thing that happens is once you recognize a settlement the company may want you to look at when this will reverse. If I recognize this gain today, it must increase my expense tomorrow. We often provide the long run impact, and that's easy enough for certain components; it's easy enough to determine how the amortization of your net transition obligation or asset has been affected. What's not so easy is how the amortization of your net gain or loss has been affected when you have a corridor. If you don't have a corridor, it is a very simple calculation. If you do have a corridor you have a certain part of the settlement gain or loss that is deferred indefinitely if you're within the corridor.

Then finally as part of this projection of the accounting costs, you may want to point out that there may be residual effects on earnings. To the extent you have incurred a real economic loss to accomplish an accounting gain, in the long run you will have lower return on your assets.

MR. SEARFOSS: Scott, under what conditions would you have no economic cost of converting from a participating annuity to a nonparticipating?

MR. GILDNER: Well, there is an interesting paradox that nonparticipating annuity contracts are typically cheaper than participating contracts, including contracts where participating means the employer still has an obligation to put up more money if it needs to. You would think that the reverse should be true. But, in general I think what you see is that, since both types of contracts may reside in the insurer's general account, there is really no reason to believe one type of contract will earn a better return that the other, and yet in the one case you actually have to have more money with the insurer instead of less.

PANEL DISCUSSION

MR. WATSON: Having been a panel participant on some occasions I hate to raise a question which might put the panelists perhaps a little on the defensive, but in reading through the description of the session here, it states that part of it is to include a discussion of requirements for fiscal years beginning after December 15, 1988. Now would anyone care to comment on how those requirements might differ as compared to the requirements for fiscal years beginning prior to December 15, 1988?

MR. SEARFOSS: Apparently I didn't clearly indicate it, but I did speak about the additional minimum liability, which is the new requirement subsequent to December 15, 1988. That's the one that is rolling in now, plus the nonpublic smaller companies. Nonpublic companies with less than 100 participants in the plan also now have to apply the standard for the first time.

FROM THE FLOOR: I believe the requirements for foreign pension plans, also, were deferred.

MR. GILDNER: I have a question for my co-panelists. The statement specifically, or at least the questions and answers to FAS 87, specifically addressed the question of adopting a methodology for determining the discount rate, and explicitly say, no, you don't have to do such a thing because that would be contrary to using your best estimate approach. And yet you seem to imply that you thought a consistent methodology should be adopted. I would like to hear your comments on that.

MR. SEARFOSS: I'm not sure what you are asking, except the FAS 87 also would indicate that you select a basis, and once you select a basis you would be expected to use that same basis from year to year. The position the accounting profession has been taking is that it is a change in estimate, which would be a prospective effect, if you change your basis. But typically we would expect that you would select a basis and use that basis; now each year you change your rate to be consistent with that basis because something is happening in the marketplace. That's why we would expect the rate would differ but not the basis.

MS. BOWMAN: I have heard it suggested at previous meetings, that you should not select a basis, so you don't have to justify any change.

MR. SEARFOSS: I've not heard that one before. Our feeling has been that there has to be some justification for how you are coming up with your discount rate, and you would do that by laying out your basis for determination and that typically is linked to some particular approach. Each year you should be able to use that approach to make the determination of the current year's discount rate. Variations within that basis are fine, because that is what you expect would happen over time. But as far as accepting no basis, I don't know how I as an auditor would understand how you have arrived at your rate by saying there is no basis for it. I have a hard time with that, I don't understand how you could do that.

MR. GILDNER: I understood Joe as indicating a little differently that you should have a particular methodology that you use each year.

MR. SEARFOSS: Basis, methodology, we are really saying the same thing.

MS. BOWMAN: Is it stated in the financial statement footnotes what the basis is for selecting the discount rate?

MR. KELLY: Not typically, but a company will say each year what its basis is for determining how it is coming up with its discount rate, and that's what Jerry audits as an audit partner. He has something that ends up going into the audit work papers that says, this is how the company came up with what its discount rates are, and when the company brings its information to us to have us review it, we look at it and say, OK, is the company using the basis, is it being consistent from year to year or are we jumping around. If the company's rate doesn't change, is there a reason for why it hasn't, and does it fit in with what the company's basis is?

MR. SEARFOSS: As I said, I'd be concerned if there was not a good explanation of the basis, and if in one year it is a good explanation for the basis, I'd be concerned why it wouldn't be a good rationale for the basis the next year. Now again you are going to have variations over time in the number that you come up with using that basis. So as Joe said, we are also very concerned if we see no change in the discount rate from year to year, that would be unusual, we would think.

MS. BOWMAN: Are you looking for a mathematical formula based on some index?

MR. SEARFOSS: A rationale. You can have the formula, just give me the rationale for how you got there. If it is based on a formula, we will generally have that in our work papers and an explanation of the rationale underlying that formula.

MR. ARTHUR TEILER: This is probably more basic a question than should be in a Society meeting. But it seems to me that FASB requires you to choose a discount rate different from the long-term rate of return on assets. Aren't you building in an automatic gain in that you're comparing two items that are equal, and you are bringing them forward a year? When your discount rate is a lower rate than your return on assets, don't you have an automatic gain that you are building in, where you use unequal rates to compare equal items?

MR. KELLY: I think that gets back a little bit to my discussion earlier of why the relationship is the way it is. If your long-term rate of return is less than your discount rate, it's not a good business decision to keep the plan around and continue funding it, because you're saying you can't get at least as good a rate of return by funding it as opposed to selling it off. If you can sell it off for a better deal, it makes more business sense. The way the accountants have always explained it to me is that it makes business sense that it should be greater, because you ought to be able to get a better return managing it yourself, and you're not paying for that risk then.

MR. TEILER: What I'm questioning is having two different rates. I certainly would not say that the rate on assets should be less than the discount rate.

MR. GILDNER: I think what we are used to as actuaries is, when we calculate a gain or loss, we compare two years' unfundeds. In a FAS 87 calculation you do the liability gain or loss separately from the asset gain or loss, and then you combine the two. That way they are completely separate, and therefore the procedure does not develop an anticipated gain or loss. Your expected asset return takes into account your expected return on assets, and expected liability value takes into account your discount rate.

MR. SEARFOSS: And this also relates to the issue of the Board's requirement that you have explicit assumptions. They stand alone. They should not necessarily be combined.

MS. BOWMAN: But is your question the fact that, if your asset return is higher, you are expecting your assets to jump ahead faster than your liabilities do, in your carry forward?

MR. SEARFOSS: Well, part of that will be captured in the corridor. As I was trying to explain earlier, the FASB has looked at these things very discretely. It has looked at the balance sheet impact and the income statement impact, and it wanted a good measurement of the balance sheet liability, totally independent of anything else. And therefore you zero in on a discount rate to measure that liability, because in accounting terms a liability should generally always be reported at its settlement amount. There was a distinction in the Board's mind as to what you should be using for which elements, and they had to be explicit and separable.

MS. BOWMAN: And the use of market-related value was a compromise, right?

MR. SEARFOSS: That's right, as was the corridor.

FROM THE FLOOR: I have a question about the recognition of liabilities for early retirement windows. I have a client who wishes to downsize and wants to introduce this program right away, but it doesn't want to recognize the liability in 1989. What it plans to do is to send out the material, make the program effective February 1, 1990, and ask that nobody reply to it until January 1, 1991. The question is, will this work and a second question, what happens if maybe one or two people send in their replies early?

MR. SEARFOSS: That's what happens when you try to do those things. They backfire. Reading the letter of the law in FAS 88 you have the expense when it has been accepted. That's it. So in this particular situation where the company hopes to accomplish the objective by making it so clear as to how to avoid it, it backfired a little bit I guess, and some people have accepted it. Now if that is material from an accounting perspective, then theoretically the company should be reporting that in the period in which the offer was accepted. I doubt if it's just been a couple of them, it's that material, but I don't know. It's according to who are the executives, if there are lots of benefits involved. I don't know. But it could very well have backfired on them.

MR. JAMES F. VERLAUTZ: If you structure the program in such a way that you don't accept an answer until January 1, or in other words it is totally revocable by the employee until January 1, the fact that the respondents turned in the piece of paper, doesn't necessarily mean anything yet.

MR. SEARFOSS: The point is you have to be careful structuring.

MR. FERRANTE: Trying to combine the FAS 87 expense rules with some of the transition rules under the integration requirements, model amendment 88-131, let me throw out a purely hypothetical situation. Calendar year plan year, calendar year sponsors fiscal year, sponsor adopts model amendment whatever that freezes all accrued benefits December 31, 1988. Then still here we are in October, they have not made up their mind. We don't have enough notice, we have rumors that they are going to maybe extend the remedial amendment period. They have done nothing, made no commitments. How are we going to expense for calendar 1989 fiscal year?

MR. KELLY: I want to bring Jerry in on this. This is one we haven't had a chance to discuss yet. Tax Reform Act required that probably the vast majority of pension plan formulas have to be amended to comply with the new regulations. It gave you an amendment where you could freeze all accruals as of December 31, 1988 for calendar year 1989 plans, until such time as regulations came out, when you are going to be required to come up with the new plan formula meeting those regulations. Many companies are doing a wide variety of things, but until all the regulations come out and they are not all out yet, you can't fully determine what your benefit formula is going to be. What should we be expensing for that year -- should it be the same as before, should it be our best estimate of where they are going to be, or what, from an accounting standpoint?

MR. SEARFOSS: From an accounting standpoint I will give you an off the record answer. Typically in accounting we deal with what we know now, unless we can reasonably estimate and predict what we expect to happen. In this case it sounds to me that, unless the company has a plan that you are aware of, that it had made you aware of, you would still deal with what you have. And we have run into this in a number of areas totally unrelated to pensions. Let me give you an example, in accounting for income taxes you would never anticipate a change in tax rate unless you know it has already been approved -- it's a regulation that has already been approved, a law that has been passed. You don't anticipate things like that, you lock in with what you know today. So my answer is going to be a fairly stock answer based on precedent in the accounting profession. But again I would have put it with a proviso that, if the company is already thinking about what it is going to do and it pretty much has put in a plan that in all probability it will implement, the conceptual answer is that you ought to anticipate that.

MR. GILDNER: I'll give you an alternative. I have several clients in the same position. We are going to take the approach with one of them that basically it has budgeted that it is going to fix the problem for X percent increase in the PBO. That's what is in this company's budget. We are going to come up with a solution that's 6% of the PBO, so we are going to put $12 million in for the cost of the amendment and begin to amortize it. When we actually get around to amending the plan, there will be a gain or a loss. It will cost a little more or a little less. I think that approach is very defensible because we often have plan amendments that, face it, we do some type of an estimate to get their cost anyway. And it's true here, we don't really know what the benefits will end up being, but especially if you have a company that does sophisticated budgeting, you have a good idea of what its tolerance is going to be for fixing the problem.

MR. SEARFOSS: I think that would be acceptable in terms that the company has given the situation a reasoned approach; it has a plan. Even if it is an intermediate plan, it is better than ignoring the situation completely. I think it's a good approach.

MR. FERRANTE: I think, by the way, in this hypothetical situation the client was hoping it could recognize a curtailment gain because it had frozen accrued benefits. But anyway, I agree. I think we are taking the approach of what is the company's intent? If its intent is that it is going to comply somehow with the law and if we can make some reasonable estimates, it would probably go ahead and expense for the calendar 1989 fiscal year under what would come out under the company's current formula, or our best estimate, or its actuary's best estimate on an ongoing basis, if the company's intent was to keep the plan comparable to what it has now.