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FAS 88 (ADVANCED)

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What are the problems encountered in the application of FAS Statement 88?

- o Curtailments
- o Settlements
- o Measurement dates
- o Data requirements
- o Recognition of gains and losses

MR. WILLIAM TORRIE: The panel consists of Walter McLaughlin with Buck Consultants, John Grady with Coopers & Lybrand, and Leon Wilneff also with Coopers & Lybrand.

Mr. Wilneff has agreed to give some opening comments, and hopefully, this will give us a feel for what FAS 88 is about, and some of the thoughts that Leon has on it.

MR. LEON B. WILNEFF: Briefly I want to talk about what a curtailment is, and also give an example of an unusual curtailment we had done for a client a couple years ago. A curtailment is an event that either significantly reduces expected years of future service for your present employees, or eliminates for a significant number of employees, the accrual of benefits for future service. In simple terms, it reduces either employees or benefits. The timing of a curtailment is different if it's a gain or if it's a loss. If it's a gain, the curtailment is measured when the employees are terminated or when the plan termination or suspension is adopted. If it's a loss, the curtailment is measured when it is probable and amount of loss can be reasonably estimated. These are more of the accountants' calls rather than the actuaries' calls.

A curtailment is measured in two parts. The first part is the reduction in unamortized past service cost, which includes any unamortized net obligation at transition. You multiply this by the reduction in expected years of future service of the people who are being removed from the plan, over the expected years of future service prior to curtailment. According to strict interpretation of FAS 88, they want you to do this calculation based on the employees who are participating at the time of transition and the time of each amendment. The implementation guidelines let you do this at curtailment to make it a little easier, so you don't have to calculate different ratios for each different piece you're going to recognize. The second part is the change in the projected benefit obligation (PBO) which is reduced by any unrecognized gain or loss that's in the opposite direction. If the change in PBO is a gain, it is reduced by any loss, and if the change in PBO is a loss, it is reduced by any gain. An unamortized net asset at transition is treated as a gain in FAS 88.

One example I wanted to go through involved a client of mine, with about 300-400 employees, that ceased operations. The company went through a corporate reorganization and started closing facilities. The closings didn't all occur on the same date. Although, probably none of them was significant, there were 10 closings within a two-year period. What we ended up doing was very complicated and probably could have been done easier if we would have treated them all occurring as of a certain date, such as the date the corporate reorganization was announced. We prorated the net periodic pension cost (NPPC) from the beginning of fiscal year to the closing date for each plant. We brought the PBOs forward to each date. We then calculated the change in PBO due to the curtailment. We prorated the service cost based on the PBOs of each group to the total. Since we had a transition asset, not an obligation, we didn't have to reflect this in the prior service cost. Our NPPC for the year was the sum of the individual NPPC for the companies that closed plus the NPPC for the companies that remained for the entire year. Our total NPPC was added to the curtailment gain. Since there was an unrecognized gain, there was no offset. If there would have been an unrecognized loss, we would have had to offset the curtailment gain against this.

The situation could have been made easier if we had a concession on how to do this. FAS really wants you to do a remeasurement as of the curtailment which meant we would have had to collect new asset data, new employee census data, and new assumptions about 10 times for a client with 300 lives. It still was a lot of work.

MR. JOHN H. GRADY: I've thought of four situations that were a little bit interesting that I've dealt with in the last few years since FAS 88 came about. I thought what I would do is talk first about one or two of them, and then I'll talk about the other ones a little later. The first one has to do with selling a portion of a plan. There are two different conceptual bases for dealing with this. We had one case where we almost did it a particular way and found out that the accountants were looking at it the other way. Luckily, we got on the same wavelength in time. The first approach would be to split the plan, and then give the spun-off plan over to the buyer. In FAS 87, question 81 talks about spinning off a plan and how you do that. You take your three unrecognized buckets and two of them you prorate by PBO, and the other one, prior service costs, you base on the actual group going over. You then solve for the accrued cost on the balance sheet which will balance to your funded status and the net of the other three buckets. So one approach is to split your plan, turn the plan over, and then on your seller's balance sheet, just reverse the accrued cost that you ended up with.

The other approach is to actually do settlement and curtailment accounting under FAS 88. Question 39 in the Q&A book takes that approach. Conceptually, you would think that they would give you the same result, and I believe they do if you elect to do settlements first and then curtailments. If you do it in the other sequence, they can give quite different results. If you do a settlement first, you're accelerating a part of your unrecognized gain or loss plus any unrecognized transition asset, and this is based on the PBO that's being settled. If you did your curtailments first and you wrote your PBO down to an accumulated benefit obligation (ABO), that changes your denominator. Your PBO is now a different number, and the amount you're settling will be a different number.

My conclusion at the time, if my memory serves me right, is that the two approaches give the same result if you do them in the right order, but if you don't, they can give you quite different results. Which of the two you follow may depend on the facts and circumstances. Based on the language in the sale agreement, it might sound like you should do a spinoff, and split the plans. Sometimes the sale agreement just talks about transferring assets and obligations to the buyer. I'm not quite sure if there's anything from the accounting side that would tell us for sure that only one of the two approaches is correct. The fact that you get different results would make it a situation where you might want to evaluate the two if your client's interests were served better one way or the other.

Another observation has to do with settlement calculations when you're doing settlement accounting when you are selling off part of the plan compared to settlement accounting where you're just buying annuity products. If you recall, in the calculation of a settlement, you normally take into account the gain or loss measured at the time of the transaction, the unrecognized gains or losses through the prior measurement date, and the remaining unrecognized transition asset to get your maximum amount that could be accelerated. In a settlement that involves buying annuities, you would at this that point take into account the difference between the assets you pay for the annuity and the PBO actually being settled. That difference would also be included in the total gain to be accelerated and would be prorated based on the portion of the PBO that's being accelerated. That's not so where the settlement is a sale of a part of a plan. In that case, you're actually bringing it in dollar for dollar. In effect, 100% of any difference between assets and PBO comes into the accounting result and not a prorated piece. Question 39 in the Q&A book for FAS 88 specifically shows this in their example. If you use the other model of doing a plan spinoff, giving over the plan that you spun off, and then reversing the balance sheet item, you get it there dollar for dollar. However, if you're used to doing settlement calculations where you're buying annuities and having that gain or loss item go into your buckets and then prorating it, you can easily miss that where the transaction is a sale.

The second situation that I would like to discuss regards contractual as opposed to special termination benefits. Contractual termination benefits come up on plant shutdowns, things of that sort. They're in the plan language but are triggered by a specific event. My comment on this particular topic is just how I've applied that in a particular case. The language is clear on what you do, but how you actually apply it in a particular instance has to be developed. In one instance, a client had a kind of a restructuring period in its history going on. The treatment of contractual termination benefits is that you recognize them when they're probable that they will occur. What we did in this particular case is every year, as of the measurement date, the client would have a list of plants that they deemed probable to close in the next few years. For any plant on that list, we did the accounting that FAS 88 called for including the calculation of the cost of those special benefits. I have two thoughts about that. One is that there is no mention in FAS 88 of what to do if a "probable" doesn't happen. What we did in this particular case is we used offs to the list the same way we used ons to the list. If a plant was on the list as of the prior measurement and now it's off, we would calculate the impact of that plant, reverse those entries, and net it against the calculations for the new plants. So ons and offs were just opposites in the same process every year.

Another point about this is that depending on how precise or perfect you think you need to be, timing could be an issue for a curtailment. If you recall the timing of recognizing curtailments, if it's a loss, you recognize it when it's probable. If it's a gain, you're supposed to recognize it when the people have actually curtailed. So when you try to come up with a practical approach to doing these calculations, the one I just described to you for termination benefits where we have a list of probables every year and we're taking ons and offs to that every year, technically that works fine when the curtailment would result in a loss, because the timing is the same as the contractual termination benefits. However, if the curtailment happened to be a gain, you could argue that you shouldn't recognize them under this "simplistic" approach of just looking at it at the end of every year. In this case, in working with the client in setting up a mechanism which was practical to implement, the approach we took was to do the accounting for curtailment and termination benefits at the same time.

MR. TORRIE: Walter McLaughlin is next. He has prepared a numerical example which he's going to go over.

MR. WALTER J. MCLAUGHLIN: I'd like to give you some background on Chart 1. This chart presents two special windows, one occurred on 12-31-89, the other occurred 5-31-89, along with the sale of a division. The second window was given to just the people that belonged to the division being sold off.

The figures on the chart were originally to the dollar. I have rounded them to thousand so you will find that if you would do some of the additions, they're going to be off by a thousand due to the rounding. The same assumptions were retained in this situation throughout the whole year. You'll notice the expected rate of return is equal to the discount rate. As an aside, I'll tell you from a rough recollection, that in most cases I have seen, the expected return rates were roughly about .5-1% higher than the discount rate. It's very seldom I see the same rate used.

The funding valuation is as of 1-1 and the fiscal year is running from 10-1 through 9-30. The valuation was done as of the 1-1 valuation date. That's when the first window was recognized. The same data were used as of 10-1 for the fiscal year to get those figures, and a remeasurement was done for the second window as of 5-31.

As I mentioned before, the 5-31 curtailment involved the sale of a division, but the vested accrued benefits remained payable from this plan. Throughout the illustration, the assets at every point are always greater than the PBO, so naturally they're greater than the ABO, so we had no problem with additional liability. Please note that the 10-1-89 values show a $556,000 credit as an unrecognized past service liability (line 5). It's an oddity that an amendment produced a credit rather than a liability.

Now let's go through the illustration. There are nine columns across at the top. That first column is based on 1-1-90 data, valued as of 10-1-89. The second column does a remeasurement of that same data as of 12-31-89, actually at 1-1-90. The third column is the result of the first window that took place here, which produced a liability of $630,000. This is a final pay plan. There is not a credit there for the release of future salary levels. I think that we should have had a figure in there, that should have been

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CHART 1

	Values at 10/1/89 9.0%	Values at 12/31/89 9.0%	Effects of Window	12/31/89 Values After Window	Value at 5/31/90	Effects of Window	Effects of Curtailment	5/31/90 Values After Curtailment & Window	Projected Values at 9/30/90
1. PBO									
a. ABO									
Vested	(15,543)	(15,497)	(630)	(16,127)	(16,072)	(618)	0	(16,690)	(16,657)
Nonvested	(710)	(742)	0	(742)	(796)	0	96	(699)	(739)
Total	(16,253)	(16,239)	(630)	(16,869)	(16,868)	(618)	96	(17,389)	(17,396)
b. Addt'l. based on Future Salary Levels	(1,978)	(2,065)	0	(2,065)	(2,215)	0	236	(1,980)	(2,090)
c. PBO	(18,231)	(18,304)	(630)	(18,934)	(19,083)	(618)	332	(19,369)	(19,486)
2. Fair Value of Assets	20,668	20,678	0	20,678	19,863	0	0	19,863	19,899
3. Funded Status (1c) + (2)	2,437	2,374	(630)	1,744	780	(618)	332	494	413
4. Unrec. Nat Trans. Asset	(6,068)	(5,914)	0	(5,914)	(5,656)	0	0	(5,656)	(5,450)
5. Unrec. P.S. Liab.	(556)	(544)	0	(544)	(524)	0	87	(437)	(425)
6. Unrec. Nat (G)/L	1,992	2,009	0	1,009	2,870	0	0	2,870	2,870
7. Addt'l. Liab.	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
(Acc'd./Prepaid Liab.	(2,195)	(2,075)	(630)	(2,705)	(2,530)	(618)	419	(2,729)	(2,592)

Expenses	Rate at 10/1/89 9.0%	Rate at 01/01/90 9.0%	Rate at 06/01/90 9.0%	Expense 10/01/89 12/31/89	Expense 01/01/90 05/31/90	Expense 06/01/90 09/30/90	Total Expense
Service cost	370	370	331	92	154	110	357
Interest cost	1,599	1,662	1,698	400	693	566	1,658
Expected return on assets	(1,785)	(1,785)	(1,785)	(446)	(744)	(595)	(1,785)
Amortization							
Net transition asset	(618)	(618)	(618)	(154)	(257)	(206)	(618)
Prior service	(49)	(49)	(35)	(12)	(21)	(12)	(44)
Net gain above 10%	0	0	0	0	0	0	0
Curtailment	0	0	(419)	0	0	(419)	(419)
Window	0	630	618	0	630	618	1,248
Net charge for the period	(483)	210	(210)	(210)	455	62	397

included. So we're overstating somewhat that loss of $630,000. Recognizing this liability as a loss is in accordance with paragraph 15 of FAS 88. The fourth column merely brings in the effect of that window on the figures as of 12-31-89. A remeasurement was done as of 5-31-90, which is shown in column five, prior to the effect of the second window, and the curtailment involved with the selling of the division. The second window once again produces a loss ($618,000). This is the additional liability due to the benefits for the window, for those who took advantage of the window. Once again on line 1B, we have a zero. We should have shown a figure being released there for the liabilities due to the future salary increases. In the seventh column we look at the liabilities that are being released due to the sale of this division. They're retaining in the plan the liability for the value of the vested accrued benefits. We released the value of nonvested benefits of $96,000, and $236,000 for the future salary increases showing a gain on the curtailment of $332,000. The past service liability has to be recognized for the release of the expected future service, attributable to those people who were transferred due to the sale of this division. Instead of getting a loss here though, we wind up with a credit because this line was originally credit. So there is an additional gain of $87,000, giving us a total gain of $419,000 due to the curtailment. Column eight adjusts the 5-31 values for the curtailment and the window. The last column is our regular projection through the end of the fiscal year as of 9-30.

The bottom part of the sheet shows the expenses during the year. The three columns on the left side are the annualized rates of the expenses for each of the periods involved, whereas on the right side, we have the proration of these expenses that is allotted to the various periods. The final column is a total of the three periods. There are two things I'd like to bring out about these annualized expenses during the year. The first two columns for 10-1 and 1-1, we're showing the same service cost, $370,000. Now a window occurred during that period. I was told there that they took those people out that were taking the window as of 1-1. I feel they should have had some charge in for them so that the service cost should have been slightly higher for the 1-1 date. The second thing I noticed is in the amortization under the heading, the "net gain above 10%." We have, in line six above, an unrecognized net loss not a gain. It doesn't really make any difference at 10-1-89 since it's a zero, but I think the heading should have read, "net loss above 10%." At the 5-31 remeasurement (line six above under column five), we increased that unrealized net loss considerably due to asset losses during the period 1-1 to 5-31. It increased to $2,870,000 which is in excess of 10% of the fair value which is done on a market value basis, and we now should be amortizing a piece of net loss above that 10% as of 6-1. These are the items that I found in going over this much more thoroughly when I was in preparing for this presentation.

Now this was a very complicated presentation, and in doing review work, I have seen a couple of others where they've had multiple events occurring during a year, and where the actuaries had to be very innovative in making their presentations. I think these are challenging situations for us to be handling, but it is very tough to decide just how you should be doing it, and I think it's hard to pin down just how you should be doing it. Does anyone have any comments, or anybody else find something else that they feel wasn't handled correctly here? Or do any of you disagree with these observations I've made on this?

MR. TORRIE: Before I do that, I just want to do a survey. By raising your hand, how many people have been involved in some sort of settlement accounting? I'd say a good 75% or 80%. Curtailment? About the same, 80%. Termination benefit? More like 10-15%. With regard to settlement accounting, how many were involved where it was the gain from the settlement accounting that drove the annuity purchase? There's two or three responses out of about 50 in the room. I think that was pretty prevalent when FAS 88 was first passed, and there was an opportunity to pick up a gain. We don't see much of that anymore, and I gather that settlement accounting was driven by the circumstances. That is when there was a spinoff termination or there was a sale of a unit or some other situation like that. Let me ask another question. Settlements also include payment of the lump sums. How many of you are involved in that, and I imagine that would be an ongoing process? Small response, maybe 5%.

Opening it up to another area, that is who's really interested in these numbers? How many people would reflect this kind of accounting to the client, maybe as requested by the accountant, on a quarterly basis? The response is none, and that's basically my experience. With regard to the notification to the actuary, is it the client that notifies you that this incident has occurred and that he needs the results? Two or three responses in the room. How many find that is it that the accountant notifies you that something's happened and that he needs these numbers? How many find that is it the actuary who is asking did something occur and whether we have to calculate these numbers for it? I'd say 50-60% of the people in the room are responding to that. That's my experience, too. I happen to have a client that has maybe 40 plans, and the only way to get this information is to actually have a little newsletter about the plans. These are the things that we know occurred during the year. Is there anything else? To me, it's just a form of disclosure. This is what I intend to reflect, if there's anything else you'd like us to reflect, let us know. I think you're all just supporting my impressions, that generally the accountants are not aggressive about asking for this kind of information. Generally, the client's not aggressive about it, and generally, we're pretty responsible citizens about asking has something occurred and do we have to respond to it. With that, I'll open up the floor to any questions.

MR. ROBERT J. LAMONTAGNE: Two questions that actually may be fairly simple, but I'd like the opinion of the panel as well as anyone else.

First of all, with respect to a significant reduction in future service, what do you feel is a measurement of significance in terms of either percentage of dollar amounts? The second question is with respect to a curtailment situation where there is a gain, and that situation involves a layoff which crosses a couple of years. Is it reasonable to do a straight pro rata over that two-year period based on the number of employees who have left?

MR. GRADY: Would you repeat the first one?

MR. LAMONTAGNE: What do you consider a significant reduction in future service?

MR. GRADY: Seems to me like I've heard around 5-10%, although I don't know of anything formal in accounting literature that addresses that.

MR. LAMONTAGNE: The situation I ran across was where I had a reduction in future service that was relatively small percentagewise, but the gain that it produced was large dollarwise since it was a very large client. In that situation, the accountant said that even though the percentage was small, the dollar amount of the gain was significant enough to recognize it as curtailment.

MR. GRADY: Would you repeat your second question again?

MR. LAMONTAGNE: The second question involves a situation where there was a curtailment gain as a result of a layoff, and the people didn't leave right away, but over a two-year period. Is it reasonable to just reflect the gain based on the percentage of employees leaving, so if a third of the people left in the first year and two-thirds in the second year, you just reflect the gain at that percentage, or do you do something a little more scientific?

MR. GRADY: The entire two-year period is all related to one business event, correct?

MR. LAMONTAGNE: That's correct.

MR. GRADY: The Q&As talk about how you can have a sequence of curtailments that are not related, and the question is asked as to whether you aggregate all of those to come up with something that's significant and treat it as a curtailment. The answer to that is no. If they're unrelated events that just happen to add up to something significant, it's not a curtailment. However, in your case, where it is related to a business event, you are supposed to look at it all together. Then there is the question of timing. I don't think there's guidance on exactly how to do that, but it gets to something that I think is just worth talking about a little bit, and that's being practical with these calculations. I'm speaking just as an actuary. As you know, the controller's department of your client would normally be the one who would have to be comfortable with the mechanics that you establish. In my experience, they will really look to the actuary to decide if a particular approach is not only practical but acceptable.

There was a similar question earlier about timing of lump sums where lump sums are normal payment form, and how do you handle that? We did, in fact, start out in one particular case where we aggregated them quarter by quarter and went through the settlement accounting quarter by quarter. We did that for about a year, maybe two, and then we quit that. After that, we just collapsed it all once a year, and we did it at the end of the year, and that's our pattern now. In fact, within the theme of being practical, what has actually evolved is to estimate the lump sums, and add an adjustment for the prior year estimate. For example, if in 1989, we estimated $10,000,000 and it came out to be $9,000,000, we would carry that $1 million into the following year, and the next year (1990), we would estimate what we expect and adjust it by that million from the prior year. It's always kind of a catch up type of thing. You won't find anything like that in the guidelines. I've really been impressed with the reasonableness of the accountants and the controllers in companies to be practical with these things. They know that you can run up a lot of hours and pay a lot of fees for these things, and they seem to want you to be practical.

MR. LAMONTAGNE: The only other comment I would like to make is that I agree with your sentiment with respect to everyone looking to the actuary for how these things should be done, and as long as the approach is reasonable, they seem to buy it.

MR. THOMAS F. CHES: If you have a measurement date that is other than your fiscal year end, and there is an event (curtailment or settlement) that occurs between your measurement date and your fiscal year end, are there any adjustments that are done to the numbers that are developed?

MR. GRADY: I did go back and go through the Q&A book in preparation for this, and I think one of the Q&As does talk about that. As I recall, they say that in normal circumstances, you would not make an adjustment. You would reflect the special events the next year because it's after the measurement date, but they did have a couple of exceptions. I don't recall what they were off hand.

MR. WILNEFF: This is covered in question 28. If a gain or loss from a settlement or curtailment that occurs after the pension plan's measurement date but prior to the employer's fiscal year end should the employer include that gain or loss in determining that fiscal year end's results of operation. It says generally no. Gain or loss should be recognized in the financial statements for the subsequent fiscal year. The exceptions are if the gain or loss results from the employer's terminating the pension plan and not establishing a successor plan, then the effect of the settlement should be recognized in the current fiscal year; if the gain or loss is directly related to an event of the current fiscal year for which paragraph 16 of FAS 88 applies, the gain or loss should be recognized in the current fiscal year. So the two examples are if you terminate the plan, and no successor plan and disposal of a segment.

MR. GRADY: Looks like the exceptions they make have to do with things being very final, a complete termination without a successor plan, then you'd want to recognize that in the actual fiscal year.

MR. WILNEFF: I guess that's another good reason not to use a measurement date other than the fiscal year.

MR. MARIO S. GALIZIA: I actually find that quite interesting because in Canada, the auditors always write a letter to the actuary asking if he's aware of any significant event which has occurred subsequent to the measurement date which may impact on the PBO or the assets that have been reported. So in our case, we would have to indicate what the adjustment is in order to identify whether it's material or not, and if it's material, they will make an adjustment to the books. So I find it interesting that the answer is no unless it's one of those two events.

MR. GRADY: That is interesting because I think in many ways, your Canadian rules mirror these, don't they? Aren't they very similar?

MR. GALIZIA: They are, but I think we're a little more practical. For example, we don't make a distinction between the initial net asset and the initial net obligation. The Americans look at an asset as an accumulation of gains prior to the imposition of these rules. Whereas if it's a net obligation, it's accumulated prior service costs, and of course, you deal with those things differently in a curtailment or a settlement. However, we look at it as all one number. Gains and losses and accumulated prior gains are all prorated on an event occurring such as a settlement or a curtailment. The other difference is you use settlement rates which change from year to year, whereas we use management's best long-term estimate of what these economic assumptions are. So effectively, management picks the assumptions. The actuary has nothing to do with them, but obviously the actuary can influence the final numbers. We tend to have a much broader range of assumptions as a result, whereas the Americans would have a narrower band. The other difference is that you have a 10% corridor which we don't have. Gains and losses are amortized from year to year, and I think that's tied to the fact that we do use long-term assumptions as opposed to settlement rates which change from year to year. Also, you would lump gains and losses together and reamortize them every period, whereas we have a layered approach so gains and losses for this year are amortized for the next umpteen years, and then next year's gains and losses are amortized, so we end up with a layered approach. Now that's where we're a little less practical than you are.

MR. GRADY: I think your comment on assumptions may not be a difference between us though. I don't regard the discount rate as being assumption that the actuary picks with the legal responsibility like we do for minimum funding or max tax.

MR. GALIZIA: I'm sorry, I didn't mean to imply that. Your settlement rates do vary from year to year, right?

MR. GRADY: Oh yes, right.

MR. GALIZIA: Whereas in our case, management picks the assumptions, and the auditor generally questions any change. There has to be a significant reason such as a change in the expected economic future in order to change. They'll ask you to justify a change in the assumptions.

MR. ANTHONY P. CUNNINGHAM: A couple of people have mentioned lump sums, in the U.S. context, but from the U.K. plan viewpoint, the majority of plans are final salary plans, but there is ability to take part of your benefit as a commuted lump sum at retirement, a substantial part of your benefit and it's tax free. Therefore, everybody does it. I know that we recently had a U.K. Association of Consulting Actuaries meeting where we were discussing FAS 87 and 88, and said that since lump sums were promised under the plan rules, it was not FAS 88 issue. Could you confirm that it wouldn't be a FAS 88 issue if it's in the plan and not an unusual event. It is actually the benefit that we're very often funding for.

MR. GRADY: Well, you do have an option with lump sums as long as the amount of the lump sum payment is less than a couple of the components of expense, the service cost and interest cost. If the total volume of lump sums in the year is less than those two components of the FAS 87 expense, you can choose to use settlement accounting, or at your option, you can just let it go into gains and losses. However, if it's above that level, then you don't have a choice. Under FAS 88, you do have to use settlement accounting.

MR. CUNNINGHAM: So if we have a block of retirements in a particular year, we would have to use FAS 88.

MR. GRADY: That's correct.

MR. CUNNINGHAM: The other thing that surprised me was that until Mr. Galizia from Canada stood up, I hadn't heard the word materiality, and I wondered about the practicalities of whether you usually do these numbers and then discuss materiality. Certainly from our perspective in the U.K. when we have to do FAS 87 or FAS 88 numbers, we try to say everything's immaterial, and then only when we feel that we've lost do we start doing the calculations. Is this very different from the approach in the U.S.?

MR. WILNEFF: I would think so because it seems like we let the accountants decide whether it's material or not. Sometimes we would go through the whole work, and then the accountants would say that's not material and ignore the whole thing.

MR. CUNNINGHAM: Obviously, we let the accountants decide, but the very first meeting each year to consider these issues is a materiality meeting before we do anything else, and I just wondered whether that was a different approach from what you would do. We basically try and get out of doing all the calculations we can get out of, and when they are deemed to be material, we start doing them.

MR. WILNEFF: The problem is that until you do the numbers, they can't assess the materiality.

MR. CUNNINGHAM: We give them orders of magnitude, and they're very practical.

MR. WILNEFF: Well, we would discuss it with accountants when the event occurs whether to recognize or not. That's like the case I mentioned before, if they close three operations, it's not material. If they close 30 operations, it's material, so then we would sit down with them and talk about the materiality of that.

MR. CUNNINGHAM: Before the calculations?

MR. WILNEFF: Right.

MR. MCLAUGHLIN: I have seen in our firm that sometimes the actuaries have made the decisions where they felt it's fairly obvious, and they say it's immaterial. They've done it on their own initiative, and it's up to the accountant then to question it.

MR. GALIZIA: My experience has been that most accountants haven't got a clue what the impact of any of these rules is, and that it's only the actuary that can decide what's material and what's not material. So the question I always ask is what are your bounds for materiality, and then I tell them whether or not it's material or not. I haven't found an accountant yet who understands these rules. They're not specialists in pension accounting, and as a result, they don't really understand what these changes really mean, any kind of changes, whether it be an early retirement program, change the plan itself, etc.

MR. GRADY: My perspective as an actuary in an accounting firm might be a little different. If we are the actuaries and the accountants for the same company, we have close communications. Although I agree with the idea that the accountants are not knowledgeable about the mechanics of FAS 88 or even 87 very much, they are the experts with respect to generally accepted accounting principles. As you know, materiality doesn't appear in FAS 88. You don't decide whether to do settlement accounting on whether it's material or not, you just decide whether the three criteria are met that defines it as a settlement. Now I'm sure we all know that overriding that is GAAP where you always have a materiality issue. If it's immaterial, then you can compromise GAAP, and so from that point of view, you wouldn't have to do a settlement transaction if it was small enough, even if all three criteria were met. But it's only at that level of an overview of GAAP as to whether a generally accepted accounting principle is material or not. I've had a number of cases where the accountants were quite knowledgeable about fine points. One of the examples I gave earlier about the two conceptual approaches of when you're selling off something and you do the measurement, and you come up with one result from the sale one way and another result the other way. The accountants were right on top of that. It depends on the particular situation and the magnitude of it. If it's a key thing to the client, they're likely to dig in more.

MR. TORRIE: I have a question with regard to that example. As you were discussing it, two questions came to mind. Typically when there's a spinoff of assets and liabilities as a result of a sale, while the plan may be curtailed with respect to those participants at the date of sale, the actual spinoff of the assets may not occur for several months, maybe even a year, after that sale date. So it strikes me in that particular situation, the order of the curtailment and settlement may have been set. That's one thought. The other thought was if they're considered to be coincidental, that is the curtailment and settlement occur at the same time, you're allowed to pick the order but once you've picked it in theory, it's set for some period of time. Do those questions generate any thoughts in your mind or any responses?

MR. GRADY: I do recall the order is kind of an accounting method then and you don't change that method?

MR. TORRIE: Right.

MR. GRADY: Probably, it would be like a change in accounting method to change, which has ramifications. So once you have an order, you're supposed to stick with it until you go through that process to change it. One topic that I had on my list to talk about if we had time relates to this. It is still in the sale area, but it's where the sale is to a joint venture where the seller is a joint venturer in the transaction, but not a large enough ownership. I guess it would take 80% for the joint venturer to be part of the controlled group. Let's say that it's less than that, 30% or whatever it might be. We had an interesting thing come up in that regard. If you remember when I was talking before about when you have a sale, and if you look at it under the model of doing a plan split, and coming up with the separate plan that's going away and you have the balance sheet number that results from that for that plan that's going away. The seller just reverses that, and that's the accounting result from the sale. The twist that came out of this situation with the joint venture was that they did not regard that as being the end of the calculation since they were a joint venture but not a controlled group member. They prorated that sale number. Let's say they came up with an accrued cost for this plan that was going away of $100. They didn't book the entire $100 in this case. If the ownership percentage was 30% and they were selling 70%, they would have prorated that $100 by 70% and only brought $70 back into the financial statements. The other $30 would have gone on to the balance sheet as a deferred gain rather than an immediate recognition, and they amortized that over a period of years. I think it was 10 years that they picked for this purpose. Again, there is not anything that's in the Q&As or in the statements themselves. If they had sold 100%, they would have brought the $100 back into the financial statements, but because they still owned 30% of it, they didn't want to recognize that 30% now. It wasn't appropriate under GAAP, so they just booked it as a deferred gain and brought it in over a period of time.

MR. TORRIE: Any other questions from the floor?

MR. JOSEPH P. STRAZEMSKI: Joe Strazemski, Kwasha Lipton. I have a question about the recognition of a transition obligation, if you're doing a plan spinoff, a curtailment or a settlement.

Let's say I have a transition obligation, and I'm doing a plan spinoff, how would I treat my transition obligation?

MR. GRADY: If it's a spinoff, you prorate that transition obligation the same way as if there were a transition asset, based on the PBO. So that one is clear, and if you're doing a settlement or a curtailment, you treat transition obligation as prior service cost, don't we?

MR. TORRIE: If it were unrecognized transitional asset, you treat it as a gain.

MR. GRADY: Okay, so if it's an obligation, then you do include it in prior service cost with respect to the FAS 88 calculations. If it's an asset, it's treated as a gain in two places if you're doing curtailment or if you're doing settlement calculations.

MR. STRAZEMSKI: And what if I'm doing a settlement calculation, and I have a transition obligation?

MR. GRADY: Ignore it.

MR. TORRIE: My next question is whether anybody had any questions raised by accountants with regard to their results or the processes that they've followed in developing the numbers? Are pretty much free to do whatever we want? My first experience with this was when we were setting up a process for a large client with many plans. This was when the client was first adopting FAS 87. We had some procedures we intended to follow, and the way we arranged it with the accountant was we detailed, in a five page memo, all the procedures, all the administrative changes we were going to go through to get the numbers. At a meeting, they agreed to everything that we had said and we've been using that process for the last five years now.

MR. WILNEFF: I have a question, too. Has anybody had the case where benefits were frozen, and where you have to recognize the prior service costs and transition obligation, but vesting service continues to accrue? I guess the board felt that there was no future economic benefit to the employees, that vesting wasn't an economic benefit.

MR. GRADY: I recall that is the case if you freeze accruals, but you let the vesting service run. It doesn't take it outside of being a curtailment. Vesting service continuing to run was not sufficient in FASB's view.

MR. TORRIE: Any other questions from the audience? It's an opportune time to make an informal survey if you will.

MR. GRADY: It would be interesting to hear about people's experiences on FAS 87 assumptions with respect to setting a discount rate, for example. Do you find in your practices as consultants, that the client really sets that assumption through some kind of well defined process? Do you have input into it or are there specific indices that they look to? I'd just be interested in anyone's comments in that area as to the process that is used each year to set the discount rate assumption.

MR. GALIZIA: I'll give you the Canadian perspective on American plans because I have the distinction of having plans which I have to identify with the FAS expense or pension costs, with the Canadian Institute of Chartered Accountants (CICA) expense and also comment on the materiality of the difference. I get a sort of North American perspective on these accounting numbers. What I have found with the FAS numbers is that the Canadian companies are almost universally tying it to an index. They tie it to a long-term government of Canada bond or something like that, plus one or two percentage points depending on how aggressive they want to be, and they will not vary from that unless there's some very significant reason.

MR. GRADY: Most companies that I deal with are using an approach that is within an established procedure, but with flexibility. In other words, they'll look at a certain set of indices every measurement date, and see how they change from the prior measurement date. However, they won't define specifically, such as if the PBGC immediate rate changes then we change by the same amount. They like a little flexibility. They'll look at the PBGC immediate rate, they'll look to long-term corporate bonds, maybe long-term government bonds. Those all move quite differently as you may know if you follow that approach yourself. From one year to the next, some may go down .25% and some may go down 100 basis points. They'll look at that movement and then pick what to use within that movement. It depends on the nature of the company. Utilities, which tend to be conservative, gravitate towards the lower end, to something like PBGC rates. Some companies will follow that quite closely, whereas some other types of corporations will use a couple hundred basis points higher, perhaps looking more at corporate bonds as opposed to the PBGC rate. There's quite a bit of latitude, but I would be interested to know more about how other consulting firms have educated their clients to go through this process. I'm sure you'd find quite a different process at different companies.

MR. MCLAUGHLIN: I find in my firm our consultants don't seem to want to be pinned down on these rates, and they'll just put in the assumption what the rate is, but they won't state on what basis that rate was determined.

MR. TORRIE: I have two major clients with two different processes. For one client, we put a letter together with the same kind of logic each year and come out with a number and asking them is this what you want to use, and every year it's been yes. For the other major client, we go though and give them a history of three or four indices, and they can pick and choose what they want. We also show them all the valuation results. That is, we actually do all the FASB results on the various interest rates so they actually know what their NPPC and the reconciliation will be. By looking at these sets of results and the indices, they will sit there and pick what interest rate they want to use for the results. There hasn't been a lot of discussion so far, and last year was the first year we had to consider the additional liability. However, I think at the end of this coming fiscal year will be the first time that there will be a lot more sensitivity as to what rate they use, especially with the market value of the assets probably going down, making the interest rate much more sensitive. Their selection of the interest rate will be more tied to results that they would like to see. This is their choice. We make that very clear, and whatever rate they pick, we go with it thereafter.

MR. MCLAUGHLIN: I have noticed somewhat of a trend recently where several of the actuaries have been using the current liability interest rate for Schedule B purposes as a discount rate. It saves some of the calculations. It's a small percentage, but I've noticed recently that quite a few of them have started to do that. I guess they would have to get the client's permission to use the same rate as they're using on the current liability. Sometimes they may use the discount rate as the current liability rate if it falls within the permissible range.

MR. TORRIE: Your comments made me also consider some changes I've noticed over the last four or five years. There was a time when actuaries were very concerned about having a uniform or relatively stable contribution rate to the pension plan. That's pretty much out the door right now, but that usually had something to do with the actuarial cost method that was used for determining the basic actuarial liabilities and annual costs. With FASB, however, in order to limit the number of valuations and the expense involved, we've suggested to our clients that perhaps we could use the same actuarial cost method for both funding and determining FASB expense, which means most of our valuations are going to be on a projected unit credit method. That's been my experience with my clients. Does anybody have anything to offer?

MR. MCLAUGHLIN: When I first started with my company, I'd say roughly 90% of the cases were done on the frozen initial liability method, and I'd say well over half of them now use the projected unit credit method. We are being pushed into using the same method. Otherwise, you have to explain to the client how come you're using two different methods, one for accounting and one for funding. I guess some of them find it easy to explain one method.

MR. GRADY: That's been my experience as well. A lot of them have changed to the projected unit credit method.

OPEN FORUM

MR. TORRIE: Any other questions, comments?

MR. GRADY: I've got one more of these kind of special topics. It has to do with how to recognize your FAS 88 calculations during the year. You're accelerating these buckets as we talked about, either unrecognized gain or loss, or the transition asset or obligation or prior service cost, and a lot of times it's a situation where we're collapsing events that occurred during the year to a point in time. Obviously, if it's something major like in our numerical example, there's a specific point in time that would be appropriate, but in other situations, lump sums, for example, or a window that is over a long period of time, and there's no one period within it that's major, you collapse them until the end of the year, or to some specific point within the year. If you're going to accelerate based on a 30% reduction in PBO for a settlement for example, are you going to apply that 30% to the beginning of the year buckets, or if you decide to use 9-30 as the date that is appropriate for this, do you roll forward? Of course, if it's a major type of thing you're supposed to remeasure everything if a remeasurement is appropriate. However, in the interest of being practical, I have not been remeasuring the entire plan in many cases for these settlement and curtailment calculations. I've been rolling forward with the components of FAS 87 expense. Do you think that we have the flexibility to roll forward the funded status and all of these unrecognized buckets to that date, 9-30 in this case, and then apply the 30% against those buckets to do your settlement accounting? Or do you even have more flexibility so that you can ignore that partial year roll forward and just accelerate the buckets at the beginning of the year. Has anybody been faced with that approach?

MR. TORRIE: My solution has been if it incurred in the first six months of the year, I treat it as though it occurred on the first of the year. If it's in the last six months of the year, it's on the last day of the year, and by agreement with the accountant we use, the same discount rate up until the end of the year when we will change it on the measurement date. So basically we're keeping everything as simple as possible, certainly not following the letter of the statement, but keeping things where they're manageable and can be done with a reasonable effort. As I said, we've done this for a number of plans of a major client and haven't had any questions come back on it so far. That's not to say that some young, smart accountant isn't going to come along who has just learned FAS 87 and 88, and say you've done it incorrectly. But right now, I think we've got the regular auditors rolled into the practice that we've followed for the last four or five years.

I hate to sound cynical about it, but I think based on your responses earlier, I don't think I'm experiencing anything that's much different from the norm. We do have one more question.

MR. CHES: Has anybody had any experience with plans that have opened up extremely long windows? We had one case where the client informed us that they had opened up an early retirement window, and the window period was going to be two years, and I was wondering what kind of modifications would be done as you go through your first accounting period and you're half way through this window before you get into the next portion of it?

MR. GRADY: Well, it seems that the fiscal year would be an important concept. I would think that the accountants would probably prefer to see recognition within the fiscal year because I think the timing criteria would be satisfied. Again for curtailments if it's a loss, you're supposed to recognize it when it's probable and can be estimated. If it's a gain, you're supposed to recognize it when they've actually made the election and terminated. Those things would be satisfied within the first year of the two years. So I suspect you would want to follow Mr. Torrie's approach and collapse things to the end of the first year, and then the rest of the people maybe the end of the second year. If it's a loss and they tell you that they can estimate it, the entire thing should be recognized in the first year. Special termination benefits are to be recognized when they're estimable, so you may end up concluding that the first year is the time to do it. If your actual experience is different than that, you have the issue of what to do. I think, unless it's really misstated, you'd let it flow through gains and losses.

Things like windows can be so major because you're recognizing the entire termination benefit all at once and the accountant sometimes get into the act more firmly because it's a major financial statement issue. That's been my experience, and if they do, you can work it out together before you actually do calculations.

MR. GALIZIA: I'd just like to echo Mr. Grady's comments. I did have a situation like that a couple years ago, and it was bounced off of the FASB people, as well as the auditors for the client in Chicago. They asked us to do an estimate of the individuals that we expected to take the retirement program, and that any subsequent change to that would be recognized as gains or losses because all you're doing is making an accelerated early retirement assumption, if you will. The client preferred it that way because they had a budget which was all being recognized in that year, and they would prefer to have it all flow into one fiscal year as opposed to spreading it out over several. In other words, take the hit today, and let's get on with our lives next year.