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**ACCOUNTING STANDARDS FOR PENSION AND
EMPLOYEE BENEFITS AROUND THE WORLD**

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Different practices in Europe, Latin America and the Far East.

MR. ROBERT E. HEITZMAN, JR.: We'll talk about Latin America, Canada, the U.K. and just about anywhere in the world where we know of an accounting standard. We're going to at least refer to it.

I want to give an overview of accounting standards around the world. I will try to step back and take a look at where we were ten years ago, and where we might be ten years from now. Obviously, we're talking today about accounting standards for postretirement benefits and not for insurance companies or not really even for other postemployment benefits. We can talk about medical benefits and other severance arrangements if you want to, but primarily we will talk about retirement plans.

Ten years ago, only one country in the world, the U.S., had any meaningful or specific requirements for accounting for retirement benefit costs. And in the U.S., that standard was APB Opinion Number 8. It was a rather permissive document. It put few constraints on key actuarial decisions, such as the choice of funding method or assumptions, valuation of assets, and so on. There was a lot of leeway under APB Number 8 to do just about anything that was actuarially acceptable. In most cases, for most companies, the expense was equal to the contribution to the fund in the U.S. and elsewhere around the world, and unfunded plans were usually accounted for on a pay-as-you-go basis. So when benefits were paid, that was when the cost was expensed.

Now ten years later, we have very specific accounting standards in the U.S., Canada, the U.K., and Ireland. Canada, the U.K., and Ireland are going to be discussed by Gareth Williams in detail. We have more rudimentary requirements in countries such as Germany and Spain. And Mexico has just adopted a new standard, which I think is called D3, and David is going to discuss that. An exposure draft, ED 53, was issued by the accounting profession in Australia about two years ago, and I believe it's still being considered.

About 11 years ago, the International Accounting Standards Committee (IASC) promulgated IAS/19. Like APB8, it was a rather permissive document, and to date it has not had a great impact on our work. However, in 1990 the IASC issued a statement of intent that proposed specific changes to IAS/19 to toughen it up and make it more meaningful. I think an exposure draft of that new statement has just been issued. David has a copy of it and is going to discuss it when he makes his presentation. The result is that nowadays there's unlikely to be an identity among the three major gauges the cost of a retirement plan (the amount contributed to the fund, the amount that's tax deductible, and the amount that's expensed on the books of

the company). For multinational companies, the plot thickens even beyond that, because in many situations, a plan may have to comply with more than one accounting standard; the standard of its own country as well as the standard of the parent company's country. Compounding the confusion, if the plan sponsor is a subsidiary or branch of a U.S. parent company, another version of its cost, which is its cost under Section 404(a) of the Internal Revenue Code, has to be determined and calculated. So we have many different numbers floating around now.

What will the future bring? There will probably be a proliferation of accounting standards around the world as more and more countries kind of jump on the bandwagon. And there are a couple of questions that this probable development raises. First of all, will the various standards that a multinational is required to adhere to be consistent among themselves, so that one cost calculation could conceivably comply with all the relevant standards? The second question is to what degree will accounting standards influence the behavior such as plan design, the funding approach and so on, that they're intended only to measure? The manner in which the questions are phrased hints at the preferred answers. It would be nice if there were consistency among the accounting standards in an ideal world. Accounting standards theoretically should not influence behavior, they should measure it.

Will these ideals ever materialize? Well, let's take a look a little more closely at the experience to date and see if that gives us any hints. Is there a consistency among standards? Let's look at the issue of actuarial funding method. We're going to look at the three major standards that exist now: *FAS 87*, Canadian Institute of Chartered Accounts (CICA), and Statement of Standard Accounting Practice (SSAP). CICA is the Canadian standard and SSAP is the U.K. standard. With respect to the actuarial funding method, we find that there is not inconsistency in the area. *FAS 87* and CICA require the use of a projected unit-credit method. SSAP allows the projected unit-credit method, but it also allows a variety of alternative methods.

ACTUARIAL ASSUMPTIONS

The three major standards are generally consistent, but they do not match perfectly. *FAS 87* and CICA require that each assumption be the best estimate or an explicit approach, and SSAP allows for an implicit or explicit approach. In this regard I guess you could say that is consistent, because what's required under *FAS 87* and CICA is permitted under SSAP. However, *FAS 87* does require a short-term, market-driven approach to the selection of certain assumptions, and SSAP and CICA generally mandate a longer-term approach. So, theoretically, assumptions that are acceptable under SSAP and CICA may not be so under *FAS 87*.

With respect to the asset-valuation method, *FAS 87* and CICA require a market-related approach. SSAP allows a broader range of asset-valuation methods. The discounted cash-flow method, which is pretty popular in the U.K. and is not particularly market related, is an acceptable method under the British standard, but is not accepted under the Canadian and the U.S. standards.

AMORTIZATION OF DEFICITS

FAS 87 prescribes a very specific type of amortization. CICA and SSAP are more permissive. A wide variety of approaches is acceptable. And the *FAS 87* approach is one acceptable alternative.

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DISCRETIONARY PENSION INCREASES

As in most areas, *FAS 87* is the most prescriptive statement of the three that we're looking at here in this general discussion. Advanced recognition of increases is allowed only if there's a substantive commitment to make the increases. SSAP prefers advance recognition of discretionary pension increases, whether or not there's a substantive commitment, but it does permit the *FAS 87* approach. CICA doesn't really address this issue specifically.

With respect to disclosure *FAS 87* is the most prescriptive of the three standards. CICA is the next most prescriptive and SSAP is the most permissive. There's a general consistency in the disclosures to satisfy the most prescriptive standard; in most respects it satisfies the other two. So if you comply with *FAS 87* with respect to disclosure, you probably comply with SSAP and CICA as well.

So, in summary, there's general consistency, but not perfect consistency, among the major accounting standards that now exist. The general rule is that the calculations that comply with *FAS 87* probably comply with or are acceptable under the other standards. Calculations that comply with CICA are probably acceptable under SSAP, but may not be acceptable under *FAS 87*. So we have a spectrum of permissiveness, with *FAS 87* being the most prescriptive and SSAP being the most flexible.

That's not a bad state of affairs, but there are some nagging problems, such as the criteria for selecting assumptions that we discussed a little bit earlier that interfere with perfect cross-compliance. And, also, these relationships are not reversible, so that if something complies with *FAS 87*, it probably complies with CICA and SSAP, but you can't say the reverse of that. If it complies with SSAP or CICA, that doesn't necessarily mean it complies with *FAS 87*.

What does this bode for the future? Is there hope for a uniform, worldwide standard, and if so, what is it likely to look like? There's a lot of pressure from multinational companies that there be a uniform, worldwide standard. The most appropriate source for such a standard would be the IASC. However, the IASC exposure draft was a very permissive document and would probably allow calculations under any of the three major standards that exist now to be acceptable. And that doesn't really help much with respect to the cause of uniformity. The more permissive the IASC is, the less uniformity we have as far as our compliance requirements. What's more likely to happen is that *FAS 87* will become the dominant standard worldwide. Why is this? Well, there are a couple of reasons. One reason is the dominance of the U.S. in the world economy and another, maybe more significant, reason is the fact that *FAS 87* is so prescriptive. It is so specific as to what it requires. Just by virtue of that, it may dominate the others and drive them into meaninglessness in the future.

Now, the second issue that I want to discuss is whether accounting standards influence the behavior they are designed to measure. Ideally, they shouldn't influence the behavior, they should measure it. But in the real world, accounting standards do have a major impact on behavior, and I can give you a few examples of that.

One general trend is that there's a desire among those who deal with retirement plans, particularly those for whom it's just part of their job (i.e., they have other

responsibilities as well) to eliminate the need for different gauges of the cost of a plan. It's cumbersome and annoying to many that the recommended contribution, the tax-deductible contribution, the accounting expense, are all different numbers. It complicates any discussion in retirement plans and some would say that it enriches actuaries at the expense of plan sponsors and the beneficiaries under plans. Already I think we see that one of the measures of a plan's cost, the recommended funding contribution, is becoming extinct.

There's a growing tendency to focus purely on compliance, at the expense perhaps of sound funding principles, whether that compliance is for tax purposes or for accounting purposes. Therefore, there's really less and less attention nowadays paid to principles of sound funding. In general, the focus on accounting expense has the effect of decreasing the funding levels of plans around the world, particularly in countries like the U.K., where actuaries have traditionally seen their role as protectors of plan participants and have generally taken a very conservative approach with respect to funding.

Now there's a lot of pressure on them to take what we might call a more realistic approach with respect to the funding of any assumptions used in evaluating retirement plans. The increased focus on accounting standards has very subtly changed the role that financial officers in a company play with respect to retirement plans. The responsibility to conform with the standards has made those people more aware of the existence of plans and aware of the different ways in which costs can be manipulated to control the financial results of the company. The result is generally more aggressive assumptions and probably less soundly funded plans.

There may be also pressure now to hold back on plan improvements that might not have existed, say ten years ago, when there wasn't so much focus on accounting. I don't think anyone would deny that *FAS 106* has influenced the design of postretirement medical benefits in the U.S. The fact that companies had to account for those postretirement medical benefits has had a profound effect on the design of the benefits that companies provide to their retirees.

The complicated nature of accounting standards as they apply to defined-benefit plans is just one of the compliance burdens that have been piled on the backs of defined-benefit plans. A long-term result of these burdens has been the increasing predominance of defined-contribution arrangements at the expense of defined-benefit arrangements, which probably is to the detriment of future retirees, because defined-benefit plans probably do a better job of delivering the desired replacement ratio to retirees.

There have been some other effects that accounting standards have had on behavior. For instance, the way the *FAS 87* assumptions have to be picked often leads to increased volatility in pension costs from year to year. To mitigate that volatility, there's an incentive to invest in fixed-income investments, because the investment return assumption is geared to the yield on long-term bonds in many cases. If you have long-term bonds in your fund, there's going to be a better correlation between what happens to the fund and what happens to the liabilities, and that can dampen the volatility that results under *FAS 87*. So here again we have situations in which the accounting policy is driving the investment policy. I don't think most accountants would say this is desirable, and I don't think it's desirable.

ACCOUNTING STANDARDS AROUND THE WORLD

FAS 88, which has to do with accounting for settlements and mergers and acquisitions, has also had an effect on the investments of pension funds. In some cases, companies have found that if they settle a portion of their liabilities by purchasing annuities, that can sometimes have a huge, one-year effect on their bottom line. And, again, this is an example of pension funds being driven to an investment approach, which may not be the best long-term investment policy. But it makes things look better under the accounting standards, so we have accounting standards driving the investment approach.

Now are these general effects good or bad? I guess everybody has their own point of view. To the extent that it forces companies to face up to reality, which I guess many would say is the case with *FAS 106*, the effect may not be so bad. The long-term effects are probably good for the country, for the economy, and for the world. But there may be some bitter pills to swallow in the shorter term. To the extent that accounting standards force companies to pay more actuarial fees for additional contributions, I guess the short-term effects are good for us actuaries but are bad for everybody else. In the long term, I think these additional complications will hurt the actuarial profession, and it may be in our enlightened self-interest to work toward simplification of accounting standards. That's something that we really haven't been very good at in the past. Maybe we can change that.

MR. GARETH RICHARD WILLIAMS: My part of the presentation really is to run through the U.K. in detail, touch on Canada, and maybe mention a few other countries.

A typical pension plan in the U.K. will be something like a one-sixtieth accrual per year of service, based on final average pay; by *final average*, we probably now mean one or two years average, maybe three years, contracted out in the sense that the company can take over some of the state's responsibility for social security payments. There are usually spouses' pensions, both pre- and postretirement, in addition to the one-sixtieth and, interestingly, group life insurance is usually provided after the pension plan. That does cause some accounting issues. The U.K. companies index pensions and payments more than U.S. multinationals. There's legislation in that area, which will potentially move everybody to provide indexation up to at least 5% per year.

As in the U.S., there's an earnings cap, although it's not quite so restrictive. Up to only 75,000 pounds of earnings can be taken into account for new members of pension plans. Plans usually require employee contributions up to about 5% of pay. There's something of a shift toward defined contribution, mainly among small-company employees. Many big consulting firms based here in the U.S. will probably have you believe there's a major trend, but I think that's stronger among the U.S. multinationals than among the local companies. Statistics locally show there's not an enormous trend toward defined contribution, but there is some trend.

There is a move toward a hybrid plan, which may have a lower defined-benefit plus a defined-contribution topper, maybe on a voluntary basis. And, interestingly, there's a 5% limitation on surplus defined according to mandatory valuation methods and assumptions. And to the extent that you exceed that surplus, there's a requirement either to refund it to the company or to alternatively have the plan not be tax effective for that chunk of assets. That has implications not only for accounting but

also for tax, particularly in terms of the 404(a) draft regulations that have recently come out. So that's just a brief overview.

As Bob said, the U.K. accounting standard that deals with pension plans is SSAP 24. It applies to all listed U.K. and Ireland companies. All pension plans and all payments are treated very similarly to the application of *FAS 87*. There's no U.K. equivalent to *FAS 106*, but it's discretionary, and the level of postretirement benefits in the U.K. provided outside of a pension plan is generally low at the moment. So it's not seen as a big issue, but that could grow over time. And this standard was effective from July 1, 1988, although only from January 1, 1993 in Ireland.

What's the purpose of the standard? Again, it is similar to elsewhere in the world. The employer should recognize the expected cost to providing pensions on a systematic and rational basis during the period that it derives benefit from the employee's service. So, again, it is the same as *FAS 87*. Let's have the benefit accrued for by the time the employee leaves service.

The pension expense is comprised of basically two elements: what's referred to as regular cost and then variations from regular cost. Regular costs can be thought of in the same way as the service cost in the United States; the difference being that in the U.K., the regular cost should be the actuary's best estimate of what that regular cost is. This allows him or her to choose the assumptions rather than have them determined by the company or the auditor. It also allows the actuary to use more than one actuarial valuation method, although the projected unit credit has been the most common. Entry age normal also fits into the requirements. There's some talk about whether unit credit without the salary projection could also fit into those requirements. But there is some choice of valuation method. Generally, projected unit credit has been used.

The expense needs to be presented as a percentage of payroll and insured benefits, such as the group life benefits. Maybe the spouse's in-service pension that is insured can be accounted for as the insurance cost. *FAS 87* will require you to accrue that benefit in a different way and just treats the insurance premium as being an investment decision.

On valuation frequency there is no need to do annual valuations under SSAP 24. Basically, to cut down the expense of complying, you only need to do a SSAP 24 valuation when you do a funding valuation, which in the U.K. is every three years. Three years is the maximum period, although some companies do them more regularly.

FROM THE FLOOR: In the intervening two years, are roll-forward techniques used, or are they basically the same number?

MR. WILLIAMS: Usually you'll calculate the pension expense as a percentage of payroll, and as a result, you just roll forward that percentage of payroll. Obviously, if something happens in the meantime that requires you to change that estimate, then you will need to do that. Any substantial change would probably result in redoing the actuarial calculations anyway, so you can build the SSAP 24 calculations on that.

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You come across variations between *FAS 87* and *SSAP 24* with respect to transition asset and liability, gains and losses, changes in methods and assumptions, benefit changes, and increases in pensions. Those are dealt with in different ways in the *SSAP 24*, and I'll come to that.

Bob talked about the valuation of assets. Again, that's actuarial discretion. You don't have to use market value or smooth that value. You can use discounted cash flow, which is a common method in the U.K., and many actuaries do that.

In terms of the variations, how are they accounted for? Gains and losses, changes in assumptions, benefit improvements, as in the U.S., are accounted for over the expected average remaining service life. Immediate recognition of the pension increases to the extent that those pension increases are not covered by surplus under the fund assets. So if there is a surplus, you don't have to recognize the cost of pension increases immediately. If there is not a surplus, and you've got pension increases, you have to recognize them at the capital cost at the point that they're granted.

The closure of a business segment would be similar to a *FAS 88* event. That would be recognized immediately. A refund of surplus, interestingly, although that's a cash transaction (that is, a cash flow back from the fund to the company), would be recognized as income when it occurs, which is sort of inconsistent with the idea behind accounting, which tends to ignore actual cash flows.

Any switch to defined contribution will be treated like a closure and, hence, would get immediate recognition. There's also some discretion on recognition. Regarding the transition assets or liability, there are three ways in which that can be, or could have been, (because most companies have gone through this process already) accounted for. One is to recognize it immediately. One is to go back and restate your accounts, assuming that *SSAP 24* had been in place previously. And one is to amortize it under a *FAS-87*-type method. A reduction in work force, as opposed to a closure of business, allows you discretion as to how you account for it.

Also, there's discretion on how you calculate the amortization. You can calculate the amortization as a percentage of payroll. You can calculate it on what would be the straight-line method, which would be, if you like, a reducing balance plus interest. Or you can do it on a mortgage method, which would be a fixed annual pound or dollar amount each year. Not specifically addressed within *SSAP 24*, but generally, we found it acceptable over there is to use the *FAS 87*-style amortization. That allows you to, at least in the initial years, perhaps keep your *FAS 87* and *SSAP 24* expenses equal. One of the interesting aspects is that the first three of those methods don't allow for any interest on any prepayment or accrual that you may have on your accounts. The *FAS 87* one does automatically. So it actually means that you could move to a situation whereby your assets in your plan exactly meet your liabilities in your plan, but you still have a pension accrual on your balance sheet. This sort of doesn't make sense, but it's a quirk of the U.K. accounting system. It does not require you to add interest to anything that you have on your books. The first three of those methods don't automatically adjust for that.

There's also been discussion over pension income, if you like negative pension expense. It's allowable in the U.K. not to recognize that, and some firms have decided that they don't want to recognize pension income as such. That will tend to lead to some more volatility in pension expense.

The disclosure is very detailed, and yet is not the same information as you get in the United States. I'm not going to run through all that point by point. But you don't have to disclose the accumulated benefit obligation (ABO), projected benefit obligation (PBO), and market value of assets, and all that sort of information, but you do have to disclose when the last actuarial valuation was done, what assumptions were used, and generally what the results were.

So how does it compare with *FAS 87*? First, it's more flexible. You have more choice over the methods, so you perhaps have more control over your pension expense. There's certainly more power for the actuary in determining the approach to be taken. It can be consistent, but you do have issues with amortization. You have issues when *FAS 88*-type events start occurring. I think we're going to see over the next year or so that falling interest rates in the U.K. are going to bring the discount rates into *FAS 87* down quite significantly. That's going to cause problems when comparing with SSAP 24. And it's going to be interesting to see how the auditors react to the different sets of assumptions that may be used. Up until now it's been possible to keep reasonably consistent assumptions in terms of salary increases and so on. What I foresee happening is that actually for SSAP 24 purposes, the U.K. won't want to change its assumptions, but there will be pressure from the U.S., if discount rates are coming down, to reduce salary increase assumptions, so you might get some inconsistency. I don't know how auditors are going to react to that.

If SSAP 24 gives the British actuaries the best pension expense, then what does *FAS 87* give U.S. actuaries? Well, it gives you the accountants' best expense, the best estimate.

The U.K. Pensions Research Accounting Group (PRAG) is a group of accountants and actuaries who have gotten together to look at SSAP 24 and make recommendations for future changes. They are suggesting that everybody, except in exceptional circumstances, should move to a projected unit-credit method. It should not be just the actuary's best estimate of expense, but individual assumptions should be the best estimate. And that really might bring us into conflict somewhere with *FAS 87* assumptions. They suggest retaining choice on amortization. They suggested there should be interest added to the prepayment or accrual on the books, which makes sense. They suggest no immediate recognition of refunds of surplus, because that's a cash item and not an expense item. They suggest more detailed but simplified disclosure.

FROM THE FLOOR: I have a question on the asset valuation method. Do you see large differences between the discounted cash from market value on the investments?

MR. WILLIAMS: There can be, but I haven't seen enormous differences. You may be within 90-110% most of the time. David, have you seen it?

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MR. DAVID H. HEALY: I think the wide ranges are more theoretical than actual. Anytime it really deviates significantly outside that sort of range, or clearly outside of the 20% range, the U.K. actuary typically finds another way to account for that or resolve the difference.

MR. WILLIAMS: The actuary suddenly loses confidence in the discounted cash-flow method and moves back to a close-to-market-value method.

Canada's defined-benefit plans allow movement away from that maximum benefit from the plan in terms of tax law. Various provinces have either completed or are on their way toward mandatory indexation of benefits. They move to defined contribution, generally.

The accounting standard in the Canadian Institute of Chartered Accountants Handbook, Section 3460 was effective in 1987. It is similar to *FAS 87*, but isn't equivalent to *FAS 88* and *FAS 106*. Lately there has been some discussion on *FAS 106* type of accounting.

Compared with *FAS 87*, how does it differ? Well, first is the best-estimate assumption. There's no requirement to use market-related assumptions for the discount rate. It's the actuary's best estimate of the various assumptions. In terms of amortization, there's no requirement or opportunity to allow a 10% corridor on gains and losses. The amortization schedules tend to vary slightly in that they tend to be year by year rather than grouped. There's some flexibility when dealing with settlements and curtailments, because there's no equivalent of *FAS 88* and some flexibility on materiality. The disclosure is limited. It's just necessary to show assets and projected liabilities, but there is the opportunity for optional, additional disclosure. So they're similar but not quite the same. Our experience has been that over time it's a little tough to keep them exactly the same. And, with falling interest rates, we might see that problem magnified.

A particular issue that's come up is the recognition of surplus. How much prepayment can you have on your books? The Emerging Issues Committee there has basically agreed that you should not be able to show more surplus on your books than you can recoup either through a surplus refund or through a contribution holiday. So you have to calculate the normal cost of the plan and value that going forward into the future, adding to that any surplus that could be refunded. If your actual surplus exceeds the sum of those two amounts, you can only recognize the sum of those two amounts and not the excess. The impact of that is if you reach that stage, the level of expense could be reasonably volatile.

I just summarized a few countries. Australia came up with a crazy accounting standard whereby the value of any surplus or deficit would be immediately recognized on the books, so pension expense could jump all over the place, depending on investment performance. It has gone back to the drafting stage on that one.

In Japan, if you fund the plan, you expense your contributions. If you book reserve it, you expense your allocations to book reserve.

In France, contributions demand the three plans. It's common in France to provide relatively small retirement indemnities. Companies historically may have tended to ignore that, but in terms of expensing prior to payment, there is a move toward advance expensing for those benefits.

In Germany, the accounting standard basically requires a reasonable cost allocation, and most companies expense what they're allowed to under the book-reserve system or, alternatively, if they have insured plans, their insurance costs.

In the Netherlands, there's a prescribed standard. It's basically a unit-credit standard with a 4% interest rate that coincides closely with the tariff rates on the insurance contracts. Many plans in the Netherlands are insured. It basically gives you an expense that is close, if not equal, to your insurance premium.

MR. HEALY: There isn't a lot to say on the area of local accounting standards in Latin America. To my knowledge, the only country that has put forward a formal local accounting standard for retirement plans and other employee benefits is Mexico. Mexico last year came out with the accounting standard under the acronym of D3. The Mexican actuarial community was actively involved in putting forward ideas and meeting with the accountants. Interestingly enough though, the actual standard that came out is really for all intents and purposes a carbon copy of *FAS 87*. At this point, there are few clear differences with *FAS 87*. It sets out the projected unit credit as the method, similar but much more briefly stated requirements on amortization, etcetera. I think the test will be as it is being used and, particularly, if NAFTA goes forward and more attention is paid to consistency of accounting between Canada, the U.S., and Mexico. We will see if D3 really works out to be exactly the same as *FAS 87*. Using Bob's description of *FAS 87* being more prescriptive, even though D3 is similar to *FAS 87*, it has very broad statements as opposed to some of the specificity of *FAS 87*. The reliance on it being similar or identical to *FAS 87* really comes from the interpretation currently being given by Mexican actuaries. So it is a standard, but it is a very broad standard and currently is being interpreted to be similar to *FAS 87*.

Elsewhere in Latin America, there are really no accounting standards that I'm aware of, either in existence or formally proposed. A number of issues on accounting for employee benefits in Latin America caused difficulties, particularly with multinationals consolidating their results. Two of the areas that seem to be problematic for many multinationals of termination indemnities, which are widely spread throughout Latin America, and accounting for inflation.

Most of the countries in South America have some sort of termination indemnity plan (Mexico has two). As you know, *FAS 87* says if it acts like and walks like a retirement plan, it should be accounted for like a retirement plan. There are some great differences in the accounting of local operations when termination indemnities are put into the *FAS 87* hopper. A very different number from what is accrued locally on the books results. The typical practice in most countries is either the company gets a tax deduction for a termination indemnity when paid, or it accrues some sort of windup liability, an arithmetic calculation of what would be paid if everybody left today. Both are different numbers and fluctuate in a very different pattern from the *FAS 87* accrual.

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Another area in Latin America with distinct differences is inflation accounting. For example, Brazil has a growing private retirement practice and has had steady, double-digit monthly inflation for the last few years and will have for the foreseeable future. To cope, the Brazilians extend inflation accounting to pension plans and just update things regularly, be it on a monthly, semi-annual or yearly basis, to adjust for inflation. This is in direct contradiction with the U.S. accounting principles, which specifically do not permit automatic roll-ups, per se, for inflation. Under GAAP, you have to account by setting actuarial assumptions for the longer term and not just automatically roll up for inflation. When the Brazilian pension plans meet *FAS 87*, there are several different ways they are tackled, and each can produce startlingly different results as to incidence of expense and liabilities. It's a complex area. Of course, *FAS 87*, having been written for U.S. plans and the U.S. environment, did not foresee any of these issues. And to a lesser degree, in other countries in Latin America where the inflation is high, there are similar problems.

I have two last comments on Latin America. As Bob mentioned, our presentation is focusing on retirement plans, but in Latin America, with the proliferation of termination indemnities, many also pay other postemployment benefits, and hence, the new *FAS 112* standard becomes an issue in Latin America. Also in Latin America, in countries such as Brazil, there is a surprising number of medical plans extend at least some significant benefits into the retirement zone. This has been a direct result of many of the problems with the local Medicare coverage. Even though it's widespread, it's been very deficient in many areas in countries like Brazil. So private employers with very young populations have fallen into the trap of providing very generous medical benefits extended into retirement, because they currently have no retirees so they see no cost to this benefit! Now it's becoming an issue, as companies look closer at what the promises are to an increasing retirement population. Of course, if they apply *FAS 106* to it, it doesn't matter how many retirees they currently have. It's the function of what the benefit promise is and what they are going to have in the future. So that's creating some problems in Latin America.

Unless there are specific questions on Latin America, I will touch on the international accounting standard. It was originally formulated under IAS 19. The IASC was formed in 1973 by the somewhat different accounting bodies in ten countries. The countries were Australia, Canada, France, Germany, Japan, Mexico, the Netherlands, the U.K., and Ireland, and the U.S. Those are countries with fundamentally different approaches to accounting, not just for pensions but overall principles.

Part of the impetus for the formation was the fact that U.S. GAAP accounting was getting a higher profile worldwide, so the other countries got together and said maybe they should come up with some other standard to counter the lack of any international standard and the influence of U.S. GAAP. The objective as stated was to formulate and promote accounting standards that would be accepted and observed on a worldwide basis. It's much broader than pensions, but we're going to focus specifically on the pension area. Well, the original pronouncement, the IAS 19, was very general and very permissive. After years of review, the IASC then came out with Exposure Draft (ED) 47. It is actually dated December 1992, but to my knowledge it did not really surface until well into the first quarter of 1993. It has a couple of interesting comments in the preamble. Comments were due by March 15, 1993. I have not seen any of the comments, and I don't know for a fact that there

are none, but we've not been able to find any written comments that have been submitted to the body. And then in almost the next sentence the IASC goes on to state it is putting forward a new exposure draft based on comments on the prior IAS 19. "The board has recognized that it may have to carry out a more comprehensive review of IAS 19 in the foreseeable future." So before it gets started, it is saying that maybe this isn't the end-all.

In spite of its apparent lack of publicity at the moment, it will become an issue. It has broad statements on what constitutes a pension/retirement plan to be accounted for. In the area of termination indemnities, it has a weaker statement than *FAS 87*. *FAS 87* says very specifically that termination indemnities *are* to be treated and accounted for. This says they *may* be accounted for like a retirement plan. As *FAS* did, it puts some teeth into insured plans and says that you do not end your liability just because part of the fund is with an insurance company. It has what I would call wishy-washy statements on assumptions, and the only semiconcrete statement is that it allows implicit assumptions. In this regard it is similar to *SSAP 24*, saying you can use implicit assumptions even if none of the individual ones really are appropriate today, if together they form a good package. This is contrary to *FAS 87* and *CICA*.

On methods, *ED 47* is like some of the actuarial material in the U.S. and Canada from 10 or 15 years ago. It breaks them down into accrued-benefit methods and projected-benefit methods and has descriptions of why one method has increasing costs and another doesn't. It then says any of the methods are acceptable. So by using Bob's terminology, it's totally nonprescriptive when it comes to the actuarial method.

Let me read you some of the disclosure items that are required under it. It is required "To disclose the actuarial method, the pension expense, but no components thereof," and something referred to as the "actuarial present value of promised retirement benefits at the date of the most recent actuarial evaluation." This is sort of an ABO. You have to show the fair-plan assets. You don't have to show any prepaid or accrued liability. You have to show the vested benefit liability. It doesn't really say how that compares with the accrued liability. You have to show the assumptions, frequency of valuations, and any other significant changes. So, in general, it is a fair list of disclosure, but it doesn't get into the components of the pension expense, so you don't really see some of the interaction and what's happening. There is no requirement as under *FAS 87* for something similar to the PBO. Where it goes from here is an open question. Evidenced by this audience it hasn't received high publicity, but international accounting standards are, I think, going to come under more scrutiny in the near future. That wraps up Latin America and the international accounting standard.

One of the areas, in my experience, in which a great deal of interest in accounting for retirement plans exists, is in mergers and acquisitions. With recent activity, disparate accounting standards, and different treatments, pensions have come to the forefront frequently in these transactions. Companies of several different nationalities may be involved in a split of a given company or a complicated acquisition. To the extent that each is looking at its own accounting treatment for the pension or retirement plan, it produces a confusing set of numbers to be dealt with to finalize a transaction.

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It is an area in which U.S. multinationals have pushed to try to use *FAS 87* accounting. Even when they're acquiring a European company, they will try to write *FAS 87* into their transaction up front. This provides a basis they understand that can quantify any promises as opposed to being subject to the German company saying, "We've accounted for the German plan on the German book-reserve basis, and that's what you get." A U.S. company will typically try to impose its own standards.

My own personal opinion, nothing I can document concretely, is that unless the international accounting standard moves very quickly and becomes much more specific, there may be a movement (seconding what Bob said) toward adopting *FAS 87* as the more universal standard. Bob mentioned a couple of reasons why he sees it growing and expanding in popularity and use, because the U.S. economy is fairly dominant and *FAS 87* is very prescriptive. I think those are very valid reasons. I think there are even more reasons why it would become more widespread. As I mentioned, in many ways it has become a "de facto" standard on mergers and acquisitions. We've seen transactions between a European and a Japanese company in which they've written PBO, ABO, *FAS 87* terms into their buy-sell agreement, and they have no reason to account under U.S. GAAP. So mergers and acquisition is one reason. The other is what I call "confusing proliferation." A number of countries are adopting new accounting standards in the area of pensions and seem to be doing their version or a carbon copy of *FAS 87*. I mentioned Mexico. Another one in Europe is Norway, with a proposal that is similar to *FAS 87*. So in the resulting confusion, *FAS 87* may become the dominant force.

Another reason is coupled with the fact that many foreign companies are borrowing from U.S. banks and are trying to get American Depository Receipts (ADRs) listed on the U.S. stock exchange. U.S. banks and the SEC essentially want anybody that does business with them to account for everything worldwide on a U.S. GAAP basis. That brings in *FAS 87*. So this is a very broad net that brings in U.S. accounting and, hence, *FAS 87*.

There is another example. A non-U.S. company made headlines when it just announced unilaterally that it is adopting U.S. accounting standards on a worldwide basis to keep its books and evaluate its operations; this would extend to the pension accounting. This was a unilateral statement not directly related to it wanting to be listed on the New York Stock Exchange or any other. It was a decision that it could run its business better by having a more prescriptive set of accounting standards, such as the U.S. GAAP, as opposed to rather flexible German accounting standards. In some ways this is reminiscent of the old days in life insurance companies when you could hide a lot of surplus under other names in the statements.

One area that I think will be quite interesting in the next year will be the precipitous drop in interest rates. Of course, I'm sure all of you are aware of how it's affecting what's happening in the U.S. The drop has been even more dramatic internationally. In France, in one recent 12-month period, the actual benchmark interest rate that we look at for *FAS 87* – government bonds or high-grade corporate bonds – dropped very close to 3%. That's a rather significant effect and there was a similar drop in many of the European countries in the last 12 months.

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MR. HEITZMAN: Okay, what David said about mergers and acquisitions has been my experience as well. Typically what happens is the buyer wants the PBO and the seller wants the ABO written into the contract for the sale. And what that means is they would like assets equal to the PBO to be transferred from the seller's pension plan. If that's not possible under local statutory requirements for divvying up pension assets, then there may be some adjustment made in the purchase price. We represent some buyers and some sellers, as I'm sure David and Gareth do. But personally my opinion is that the PBO is the appropriate measure to measure the pension expense that has truly accrued during the period in which the plan was maintained by the seller. Of course, depending on which side of the transaction your client's on, you advocate his or her position. But in theory, I think the PBO is the right number.

FROM THE FLOOR: Bob, this is a general question although my exposure's been to U.S. accounting. I've heard generalizations about accounting in German-speaking countries, and I'm told that the accounting practices are designed to conceal value in the company. And then in south European countries, the accounting practices are designed to conceal information from taxing authorities. Now these may be unfair generalizations, but is it possible that U.S. accounting rules are becoming more dominant because until recently we were the only ones who really cared about theoretical accuracy?

MR. HEITZMAN: It's sounds pretty plausible to me. I don't know much about it. I think David mentioned some things about German accounting that certainly ring true.

FROM THE FLOOR: Was I overgeneralizing?

MR. HEALY: No. I think that's true. It is comparable to the parallel with life insurance companies in the old days, when they could mask surplus under another name. I think the German and Swiss companies have used their local accounting standards to hide the true worth of their companies by overstating liabilities. Their rationale is "we want to be very conservative and make sure the company is very stable, so the fact that our accounting standards permit this is not a problem." The problems that such companies now realize is that it was okay in a small community, but now with the worldwide scope of these large companies, it's very hard to ensure any consistency from year to year because they've exported the local "flexibility" on their books worldwide. And so it was very easy to mask problems for many years. Companies are now fearful that some of their operations around the world would do that independently, and with all the flexibility, management would have difficulty knowing soon enough when things were starting to go bad.

I have not seen any great push from the accounting authorities in Germany or Switzerland to do anything to their local accounting standards to make them more specific like the U.S. But if companies start using FAS 87, there will be competitive pressure for the other companies to be comparable.

FROM THE FLOOR: Is the company in question going to actually report its numbers to the public on the U.S. GAAP basis, or are they just distributed for internal purposes?

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MR. HEALY: No, it stated it would publish its annual reports on that basis. Yes, it was more than internal.

FROM THE FLOOR: Does that mean it's going to fall under German accounting rules, or are German accounting rules flexible enough?

MR. HEALY: Under German accounting rules, they have to footnote a few things, but in general they're flexible enough that they could do something like that. In the European community, some of the Europe 1992 initiatives have temporarily been delayed, and accounting was never a high priority. There has been discussions such as the ones Gareth alluded to. Also, on the employee benefits side, the actuaries are trying to come to some common understanding in the U.K. and the European continent. They've touched on accounting but really haven't gotten into it, because they have some more basic issues to deal with before they get to accounting.

MR. WILLIAMS: I don't really have anything tied to that, but I'll add something to what Bob and David said about whether *FAS 87* becomes a worldwide standard. I can see it moving in that direction as well, but I would just have one hope and plea that they don't involve this ridiculous discount rate in the methodology, because I don't think anyone's been too excited up until now. But I think we're seeing that it doesn't make much sense to have pension expense jumping around like it is.

FROM THE FLOOR: I am a practicing U.S. actuary. I agree with you 100%. It's outrageous.

MR. HEITZMAN: With *FAS 87* I don't think the projected unit-credit method is the best method to use there either, because it tends to be very sensitive to the average age of the covered group. And you might have an industry or a company in which the work force is maturing and the average age of the group is rising because people who retire are not being fully replaced by new people. It has a tendency to climb as a percentage of pay, and I see that as being contrary to the goals of the FASB when it developed this statement. And I think we would have been better off with some sort of an entry-age normal or a level-premium approach. But I remember when that whole discussion was going on. Actuaries didn't really address that issue. They didn't really talk about which funding method to prescribe if you were going to prescribe one. Actuaries spent all their energy saying don't tell us what to do. Now what is it they're going to tell us to do never happened. And I don't think there was ever really much actuarial input into that decision. And it was sad to see. I thought it was kind of a futile episode in the history of our profession, because we never really gave up on the idea that we were going to convince the FASB not to do this. As a result, we never got really involved in the discussion of what the statement would say.

MR. WILLIAMS: There's supposed to be a review of SSAP 24 in the works, but I'm not sure of the status of that. I think they're not being overprescriptive. When they say projected-unit credit, they're saying projected-unit credit, unless the circumstances of the plan mean that another method makes more sense. For example, in Bob's situation in which there is a closed fund and no new entrants, then it won't require projected-unit credit, so it's a little gentler than the U.S.

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MR. HEALY: One footnote. I didn't mean to paint a picture of *FAS 87* being a panacea. The facts indicate that it is becoming generalized. However, in addition to the interest rate problems, one problem that surfaces dramatically internationally is the specificity of the projected unit-credit attribution. It has to follow the pattern of the benefits. With some of the designs and the ancillaries under many foreign pension plans, if you follow the letter of *FAS 87*, it will produce some strange, incomprehensive, and illogical results. So if it were to become more widespread, it would require at least some supplementary guidance on how those standards could be reasonably applied to plans that were never envisioned by the drafters of *FAS 87*.