Statement of Financial Accounting Standards No. 35

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Accounting and Reporting by Defined Benefit Pension Plans

March 1980

Financial Accounting Standards Board
of the Financial Accounting Foundation
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Paragraph Numbers

FAS 35: Accounting and Reporting by Defined Benefit Pension Plans

FAS 35 Summary

Standards

This Statement establishes standards of financial accounting and reporting for the annual financial statements of a defined benefit pension plan (*plan*). It applies both to plans in the private sector and to plans of state and local governmental units. It does not require the preparation, distribution, or attestation of financial statements for any plan.

The primary objective of a plan's financial statements is to provide financial information that is useful in assessing the plan's present and future ability to pay benefits when due. To accomplish that objective, the financial statements will include information regarding (a) the net assets available for benefits as of the end of the plan year, (b) the changes in net assets during the plan year, (c) the actuarial present value of accumulated plan benefits as of either the beginning or end of the plan year, and (d) the effects, if significant, of certain factors affecting the year-to-year change in the actuarial present value of accumulated plan benefits. If the date as of which the benefit information ((c) above) is presented (the *benefit information date*) is the beginning of the year, additional information is required regarding both the net assets available for benefits as of that date and the changes in net assets during the preceding year. Flexibility in the manner of presenting benefit information and changes therein (items (c) and (d) above) is permitted. Either or both of those categories of information may be presented on the face of one or more financial statements or in accompanying notes.

Information regarding net assets is to be prepared on the accrual basis of accounting. Plan investments (excluding contracts with insurance companies) are to be presented at fair value. Contracts with insurance companies are to be presented the same way as in the plan's annual report to certain governmental agencies pursuant to the Employee Retirement Income Security Act of 1974 (*ERISA*). Plans not subject to ERISA are to account for their contracts with insurance companies as though they also filed that annual report.

The primary information regarding participants' accumulated plan benefits reported in plan financial statements will be their actuarial present value. This Statement defines participants' accumulated plan benefits as those future benefit payments that are attributable under the plan's provisions to employees' service rendered to the benefit information date. Their

measurement is primarily based on employees' history of pay and service and other appropriate factors as of that date. Future salary changes are not considered. Future years of service are considered only in determining employees' expected eligibility for particular types of benefits, for example, early retirement, death, and disability benefits. To measure their actuarial present value, assumptions are used to adjust those accumulated plan benefits to reflect the time value of money (through discounts for interest) and the probability of payment (by means of decrements such as for death, disability, withdrawal, or retirement) between the benefit information date and the expected date of payment. An assumption of an ongoing plan underlies those assumptions.

The use of averages and other methods of approximation consistent with recommended actuarial practice is permitted, provided the results are substantially the same as those contemplated by this Statement. Such simplified techniques may be particularly useful for plans sponsored by small employers.

Plan financial statements are required to include certain information about (a) the plan, (b) the results of transactions and other events that affect the information presented regarding net assets and participants' benefits, and (c) other factors necessary for users to understand the information provided.

This Statement is effective for plan years beginning after December 15, 1980.

Basis for Conclusions

In developing the foregoing standards, the Board first identified both the users of plan financial statements and the objectives of those statements. The Board believes that the content of plan financial statements should focus on the needs of participants because pension plans exist primarily for their benefit. However, plan financial statements should also be useful to others who either advise or represent participants, are present or potential investors or creditors of the employer(s), are responsible for funding the plan, or for other reasons have a derived or indirect interest in the plan's financial status.

Because employees render service long before they receive the benefits to which they are entitled as a result of that service, they are concerned with whether the plan will be able to pay their future benefits. Therefore, the Board concluded that the primary objective of plan financial statements should be to provide financial information that is useful in assessing the plan's present and future ability to pay benefits when due. However, plan financial statements do not provide all the information necessary for that assessment. They should be used in combination with other pertinent information, including information about the financial condition of the employer(s) and, for plans subject to ERISA, the guaranty of the Pension Benefit Guaranty Corporation. Also, financial statements for several plan years can provide information more useful in assessing the plan's future ability to pay benefits than can the financial statements for a single plan year.

Because a plan's net assets are the existing means by which it may provide benefits, information about them (the *net asset information*) is considered essential in assessing a plan's ability to pay benefits when due. The Board believes that measuring a plan's investments (other than contracts with insurance companies) at fair value will provide the most relevant information about those assets consistent with the primary objective of plan financial statements.

Insurance companies offer plans a wide variety of contracts. Because of their complexity, several difficult issues arise in recognizing and measuring the elements of such contracts that constitute plan assets. The Board decided that sufficient information was not available at this time to enable it to reach definitive conclusions about certain conceptual and implementation issues. It therefore chose the practical solution of requiring contracts with insurance companies to be reported in plan financial statements in the same way they are reported (for ERISA plans) or would have been reported (for non-ERISA plans) in the annual report required by ERISA to be filed with certain governmental agencies. That approach may result in such contracts being presented at other than fair value.

To be useful in assessing a plan's present and future ability to pay benefits when due, plan financial statements must also present information about the benefits to be paid. The Board believes that information (the *benefit information*) should relate to the benefits reasonably expected to be paid in exchange for employees' service to the benefit information date. Because the Board did not deem it essential at this time to resolve the issue of the accounting nature of the benefit information, this Statement does not prescribe its location in the financial statements.

The initial Exposure Draft required that both the benefit and net asset information be determined as of the same date. Thus, if the plan's annual financial statements were as of the end of the plan year, end-of-year benefit information was required. A number of respondents expressed the view that determination of end-of-year benefit information on a timely basis was not practical and would cause increased actuarial fees. They indicated that most actuarial valuations are performed during the year using data as of the beginning of the year. Changing that practice at this time might create significant timing problems in terms of scheduling the actuaries' workload and, in some cases, obtaining necessary end-of-year data.

The Board concluded that the perceived costs of requiring end-of-year benefit information at this time may exceed the potential benefits of such information. Therefore, this Statement provides for the presentation of benefit information as of either the beginning or end of the year. However, the Board continues to believe that presenting both net asset and benefit information as of the same date is necessary to present the financial status of the plan. Therefore, if benefit information is presented as of the beginning of the year, this Statement requires that net asset information also be presented as of that date.

The information about a plan's ability to pay benefits when due that is provided by its financial statements is affected whenever transactions and other events affect the net asset or benefit information presented in those statements. Normally, a plan's ability to pay participants' benefits does not remain constant. Therefore, users of the financial statements are concerned with assessing the plan's ability to pay participants' benefits not only as of a point in time but also on a continuing basis. To facilitate that latter assessment, users need to know the reasons for changes in the net asset and benefit information reported in successive financial statements. Therefore, the Board concluded that plan financial statements should include (a) information regarding the year-to-year change in the net assets available for benefits and (b) disclosure of the effects, if significant, of certain factors affecting the year-to-year change in the benefit information.

If the benefit information date is the beginning of the year, the required disclosure regarding the year-to-year change in the benefit information will relate to the preceding year.

Presenting information regarding changes in both the net asset and benefit information for the same period is necessary to present the changes in the plan's financial status for that period. Therefore, if the benefit information date is the beginning of the year, information regarding the changes in net assets during the preceding year is also required.

Determination of the net asset and benefit information may be affected by estimates and judgment. The Board believes users can better evaluate that information if the underlying assumptions and methods are disclosed. In addition, certain explanations may be needed for users to understand the information provided by a plan's financial statements. Therefore, this Statement requires certain disclosures regarding the plan, the effects of certain transactions and events, and other factors necessary for users to understand the information provided.

INTRODUCTION

1. This Statement establishes standards of financial accounting and reporting for the annual financial statements of a **defined benefit pension plan** (**pension plan** or **plan**).[*] Plans covered are those that principally provide **pension benefits** but may also provide **benefits** on death, disability, or termination of employment.

2. This Statement applies to an ongoing plan that provides pension benefits for the **employees** of one or more employers, including state and local governments, or for the members of a trade or other employee association. Such a plan may have no intermediary **funding agency** or it may be financed through one or more trust funds, one or more contracts with insurance companies, or a combination thereof. This Statement applies to plans that are subject to the provisions of the Employee Retirement Income Security Act of 1974 (**ERISA** or the **Act**) as well as to those that are not. It is not intended to apply to a plan that is expected to be terminated, nor to a government-sponsored social security plan. This Statement does not require the preparation, distribution, or attestation of any plan's financial statements (paragraph 51).

3. Standards of financial accounting and reporting for defined benefit pension plans are presented in paragraphs 4-30. Background information for this Statement is presented in Appendix A. The basis for the Board's conclusions, as well as alternatives considered and reasons for their rejection, are discussed in Appendix B. Illustrations of certain applications of the requirements of this Statement appear in Appendixes D and E.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Existing Generally Accepted Accounting Principles

4. Existing generally accepted accounting principles other than those discussed in this Statement may apply to the financial statements of defined benefit pension plans. The financial accounting standards discussed in this Statement are those of particular importance to pension plans or that differ from existing generally accepted accounting principles for other types of entities.

Primary Objective of Plan Financial Statements

5. The primary objective of a pension plan's financial statements is to provide financial information that is useful in assessing the plan's present and future ability to pay benefits when due.[1] To accomplish that objective, a plan's financial statements should provide information

about (a) plan resources and how the stewardship responsibility for those resources has been discharged, (b) the **accumulated plan benefits** of **participants**, (c) the results of transactions and events that affect the information regarding those resources and benefits, and (d) other factors necessary for users to understand the information provided.

Financial Statements

6. The annual financial statements of a plan shall include:

a. A statement that includes information regarding the **net assets available for benefits** as of the end of the plan year
b. A statement that includes information regarding the changes during the year in the net assets available for benefits
c. Information regarding the **actuarial present value of accumulated plan benefits** as of either the beginning [2] or end of the plan year
d. Information regarding the effects, if significant, of certain factors affecting the year-to-year change in the actuarial present value of accumulated plan benefits.

7. The primary objective set forth in paragraph 5 is satisfied only if (a) information regarding both the net assets available for benefits and the actuarial present value of accumulated plan benefits is presented as of the same date and (b) information regarding both the changes in net assets available for benefits and the changes in the actuarial present value of accumulated plan benefits is presented for the same period. Therefore, if the **benefit information date** pursuant to paragraph 6(c) is the beginning of the year, a statement that includes information regarding the net assets available for benefits as of that date and a statement that includes information regarding the changes during the preceding year in the net assets available for benefits shall also be presented. Use of an end-of-year benefit information date is considered preferable. Plans are encouraged to develop procedures to enable them to use that date (paragraph 29).

8. The Board believes it is desirable to allow certain flexibility in presenting the information regarding the actuarial present value of accumulated plan benefits and the year-to-year changes therein. Therefore, either or both of those categories of information may be presented on the face of one or more financial statements or in notes thereto. Regardless of the format selected, each category of information shall be presented in its entirety in the same location. If a statement format is selected for either category, a separate statement may be used to present that information or, provided the information is as of the same date or for the same period, that information may be presented together with information regarding the net assets available for benefits and the year-to-year changes therein.

Net Assets Available for Benefits

9. The accrual basis of accounting [3] shall be used in preparing information regarding the net

assets available for benefits. The information shall be presented in such reasonable detail as is necessary to identify the plan's resources that are available for benefits.

Contributions Receivable

10. Contributions receivable are the amounts due as of the **reporting date** to the plan from the employer(s), participants, and other sources of funding (for example, state subsidies or federal grants—which shall be separately identified). Amounts due include those pursuant to formal commitments as well as legal or contractual requirements. With respect to an employer's contributions, evidence of a formal commitment may include (a) a resolution by the employer's governing body approving a specified contribution, (b) a consistent pattern of making payments after the plan's year-end pursuant to an established **funding policy** that attributes such subsequent payments to the preceding plan year, (c) a deduction of a contribution for federal tax purposes for periods ending on or before the reporting date, or (d) the employer's recognition as of the reporting date of a contribution payable to the plan.[4]

Investments

11. Plan investments, whether equity or debt securities, real estate, or other (excluding contracts with insurance companies) shall be presented at their fair value at the reporting date. The fair value of an investment is the amount that the plan could reasonably expect to receive for it in a current sale between a willing buyer and a willing seller, that is, other than in a forced or liquidation sale. Fair value shall be measured by the market price if there is an active market for the investment. If there is not an active market for an investment but there is such a market for similar investments, selling prices in that market may be helpful in estimating fair value. If a market price is not available, a forecast of expected cash flows may aid in estimating fair value, provided the expected cash flows are discounted at a rate commensurate with the risk involved.[5]

12. Contracts with insurance companies shall be presented in the same manner as that contained in the annual report filed by the plan with certain governmental agencies pursuant to ERISA.[6] A plan not subject to ERISA shall similarly present its contracts with insurance companies, that is, as if the plan were subject to the reporting requirements of ERISA.

13. Information regarding a plan's investments shall be presented in enough detail to identify the types of investments and shall indicate whether reported fair values have been measured by quoted prices in an active market or are fair values otherwise determined. (Paragraphs 28(g) and 28(h) require certain additional disclosures related to investments.)

Operating Assets

14. Plan assets used in plan operations (for example, buildings, equipment, furniture and fixtures, and leasehold improvements) shall be presented at cost less accumulated depreciation or amortization.

Changes in Net Assets Available for Benefits

15. Information regarding changes in net assets available for benefits shall be presented in enough detail to identify the significant changes during the year. Minimum disclosure shall include:

a. The net appreciation (depreciation) [7] in fair value for each significant class of investments, segregated between investments whose fair values have been measured by quoted prices in an active market and those whose fair values have been otherwise determined
b. Investment income (exclusive of (a) above)
c. Contributions from the employer(s), segregated between cash and noncash contributions [8]
d. Contributions from participants, including those transmitted by the **sponsor**
e. Contributions from other identified sources (for example, state subsidies or federal grants)
f. Benefits paid to participants
g. Payments to insurance companies to purchase contracts that are excluded from plan assets [9]
h. Administrative expenses.

Actuarial Present Value of Accumulated Plan Benefits

16. Accumulated plan benefits are those future benefit payments that are attributable under the plan's provisions to employees' **service** rendered to the benefit information date. Accumulated plan benefits comprise benefits expected to be paid to (a) retired or terminated employees or their beneficiaries, (b) beneficiaries of deceased employees, and (c) present employees or their beneficiaries.

17. To the extent possible, plan provisions shall apply in measuring accumulated plan benefits. In some plans, benefits are a specified amount for each year of service. Even if a plan does not specify a benefit for each year of service, another of its provisions (for example, a provision applicable to terminated employees or to termination of the plan—if independent of funding patterns) may indicate how to measure accumulated plan benefits. If the benefit for each year of service is not stated by or clearly determinable from the provisions of the plan, the benefit shall be considered to accumulate in proportion to (a) the ratio of the number of years of service completed to the benefit information date to the number that will have been completed when the benefit will first be fully vested, if the type of benefit is includable in **vested benefits** (for example, a supplemental early retirement benefit that is a vested benefit after a stated number of years of service), or (b) the ratio of completed years of service to projected years of service upon anticipated separation from covered employment, if the type of benefit is not includable in vested benefits (for example, a death or disability benefit that is payable only if death or disability occurs during active service).

18. In measuring accumulated plan benefits, the following shall apply:

a. Except as indicated in (b) and (c) below, accumulated plan benefits shall be based on employees' history of pay and service and other appropriate factors as of the benefit information date.[10]
b. Projected years of service shall be a factor only in determining employees' expected eligibility for particular benefits, such as:
   i. Increased benefits that are granted provided a specified number of years of service are rendered (for example, a pension benefit that is increased from $9 per month to $10 per month for each year of service if 20 or more years of service are rendered)
   ii. Early retirement benefits
   iii. Death benefits
   iv. Disability benefits.
c. Automatic benefit increases specified by the plan (for example, automatic cost-of-living increases) that are expected to occur after the benefit information date shall be recognized.
d. Benefits to be provided by means of contracts excluded from plan assets for which payments to the insurance company have been made shall be excluded.
e. Plan amendments adopted after the benefit information date shall not be recognized.
f. If it is necessary to take future compensation into account in the determination of Social Security benefits, employees' compensation as of the benefit information date shall be assumed to remain unchanged during their assumed future service. Increases in the wage base or benefit level pursuant to either the existing Social Security law or possible future amendments of the law shall not be recognized.

19. The actuarial present value of accumulated plan benefits is that amount as of the benefit information date that results from applying actuarial assumptions to the benefit amounts determined pursuant to paragraphs 16-18, with the actuarial assumptions being used to adjust those amounts to reflect the time value of money (through discounts for interest) and the probability of payment (by means of decrements such as for death, disability, withdrawal, or retirement) between the benefit information date and the expected date of payment.

20. An assumption of an ongoing plan shall underlie the other assumptions used in determining the actuarial present value of accumulated plan benefits. Every other significant assumption used in that determination and disclosed pursuant to paragraph 27(b) shall reflect the best estimate of the plan's future experience solely with respect to that individual assumption. As to certain assumptions, the following shall apply:

a. Assumed rates of return shall reflect the expected rates of return during the periods for which payment of benefits is deferred and shall be consistent with returns realistically achievable on the types of assets held by the plan and the plan's investment policy. To the extent that assumed rates of return are based on values of existing plan assets, the values used in determining assumed rates of return shall be the values presented in the plan's financial statements pursuant to the requirements of this Statement.
b. Expected rates of inflation assumed in estimating automatic cost-of-living adjustments shall

be consistent with the assumed rates of return.

c. Administrative expenses expected to be paid by the plan (not those paid by the sponsor) that are associated with providing accumulated plan benefits shall be reflected either by appropriately adjusting the assumed rates of return or by assigning those expenses to future periods and discounting them to the benefit information date. If the former method is used, the adjustment of the assumed rates of return shall be separately disclosed (paragraph 27(b)).

21. In selecting certain assumptions to be used in determining the actuarial present value of accumulated plan benefits, an acceptable alternative to that discussed in paragraph 20 is to use those assumptions that are inherent in the estimated cost at the benefit information date to obtain a contract with an insurance company to provide participants with their accumulated plan benefits. Those other assumptions that are necessary but are not inherent in that estimated cost shall be selected pursuant to the requirements in paragraph 20.

Presentation of the Actuarial Present Value of Accumulated Plan Benefits

22. The total actuarial present value of accumulated plan benefits as of the benefit information date shall be segmented into at least the following categories:

a. Vested benefits of participants currently receiving payments
b. Other vested benefits
c. Nonvested benefits.

Category (a) shall include those benefits due and payable as of the benefit information date. Present employees' accumulated contributions as of the benefit information date (including interest, if any) shall be disclosed. If interest has been credited on employees' contributions, the rate(s) shall be disclosed.

Changes in the Actuarial Present Value of Accumulated Plan Benefits

23. Changes in actuarial assumptions made to reflect changes in the plan's expected experience shall be viewed as changes in estimates. That is, the effects of those changes shall be accounted for in the year of change (or in the year of change and future years if the change affects both) and shall not be accounted for by restating amounts reported in financial statements for prior years or by reporting pro forma amounts for prior years.

24. Assumed rates of return used to determine the actuarial present value of accumulated plan benefits may change periodically due to changes in expected rates of return or as changes occur in the factors affecting estimates. A change in assumed rates of return need not necessarily result when a decision is made to replace fixed-income securities currently held with lower-rated fixed-income securities because the higher yield associated with the lower-rated securities reflects increased risk. Accordingly, a higher ultimate return on the aggregate investment

portfolio may not result.

Presentation of Changes in the Actuarial Present Value of Accumulated Plan Benefits

25. If significant, either individually or in the aggregate, the effects of certain factors affecting the change in the actuarial present value of accumulated plan benefits from the preceding to the current benefit information date shall be identified. Effects that are individually significant shall be separately identified. Minimum disclosure shall include the significant effects of factors such as the following:

a. Plan amendments
b. Changes in the nature of the plan (for example, a plan spin-off or a merger with another plan)
c. Changes in actuarial assumptions.[11]

The significant effects of other factors may also be identified, including, for example, benefits accumulated,[12] the increase (for interest) as a result of the decrease in the discount period, and benefits paid. If presented, *benefits paid* shall not include benefit payments made by an insurance company in accordance with a contract that is excluded from plan assets. However, amounts paid by the plan to an insurance company pursuant to such a contract (including purchasing annuities with amounts allocated from existing investments with the insurance company) shall be included in *benefits paid*.[13] If the minimum required disclosure is presented in other than a statement format, the actuarial present value of accumulated plan benefits as of the preceding benefit information date shall also be presented.

26. Information regarding changes in the actuarial present value of accumulated plan benefits may be presented either (a) in a statement that accounts for the change between two benefit information dates or (b) elsewhere in the financial statements. If only the minimum required disclosure is presented, presentation in a statement format will necessitate an additional unidentified "other" category to reconcile the beginning and ending amounts.

Additional Financial Statement Disclosures

27. Disclosure of the plan's accounting policies [14] shall include the following:

a. A description of the method(s) and significant assumptions used to determine the fair value of investments and the reported value of contracts with insurance companies.
b. A description of the method and significant assumptions (for example, assumed rates of return, inflation rates, and retirement ages) used to determine the actuarial present value of accumulated plan benefits. Any significant changes of method or assumptions between benefit information dates shall be described.

28. The financial statements shall include the following additional disclosures, if applicable:

a. A brief, general description of the plan agreement, including—but not limited to—vesting and benefit provisions.[15]
b. A description of significant plan amendments adopted during the year ending on the latest benefit information date. If significant amendments were adopted between the latest benefit information date and the plan's year-end, it shall be indicated that the actuarial present value of accumulated plan benefits does not reflect those amendments.
c. A brief, general description of (i) the priority order of participants' claims to the assets of the plan upon plan termination and (ii) benefits guaranteed by the Pension Benefit Guaranty Corporation (**PBGC**), including a discussion of the application of the PBGC guaranty to any recent plan amendment.[16]
d. The funding policy and any changes in such policy during the plan year.[17] For a **contributory plan**, the disclosure shall state the method of determining participants' contributions. Plans subject to ERISA shall disclose whether the minimum funding requirements of ERISA have been met. If a minimum funding waiver has been granted by the Internal Revenue Service (*IRS*) or if a request for a waiver is pending before the IRS, that fact shall be disclosed.
e. The policy regarding the purchase of contracts with insurance companies that are excluded from plan assets. The plan's dividend income for the year that is related to excluded contracts shall be disclosed, and for purposes of paragraph 15 may be netted against item (g).
f. The federal income tax status of the plan, if a favorable letter of determination has not been obtained or maintained.
g. Identification of investments that represent five percent or more of the net assets available for benefits.
h. Significant real estate or other transactions in which the plan and any of the following parties are jointly involved: (i) the sponsor, (ii) the employer(s), or (iii) the employee organization(s).
i. Unusual or infrequent events or transactions occurring after the latest benefit information date but before issuance of the financial statements that might significantly affect the usefulness of the financial statements in an assessment of the plan's present and future ability to pay benefits. For example, a plan amendment adopted after the latest benefit information date that significantly increases future benefits that are attributable to employees' service rendered before that date shall be disclosed. If reasonably determinable, the effects of such events or transactions shall be disclosed. If such effects are not quantified, the reasons why they are not reasonably determinable shall be disclosed.

Use of Averages or Reasonable Approximations

29. The Board recognizes that literal application of certain of the requirements of this Statement could require a degree of detail in recordkeeping and computation that might be unduly burdensome. Accordingly, the use of averages or other methods of approximation is

appropriate, provided the results obtained are substantially the same as the results contemplated by this Statement. Thus, rolling back to the beginning of the year or projecting to the end of the year detailed employee service-related data as of a date within the year may be acceptable in approximating beginning- or end-of-year **benefit information**. The use of averages and other methods of approximation consistent with recommended actuarial practice may be useful in conjunction with other provisions of this Statement, particularly when applied to plans sponsored by small employers. If participants' individual historical salary data for plan years before the effective date of this Statement are not available, reasonable approximations thereof are acceptable.

Effective Date and Transition

30. This Statement shall be effective for plan years beginning after December 15, 1980. Earlier application is encouraged. Accounting changes adopted to conform to the provisions of this Statement shall be made retroactively. Financial statements of prior plan years are required to be restated to comply with the provisions of this Statement *only* if presented together with financial statements for plan years beginning after December 15, 1980. If accounting changes were necessary to conform to the provisions of this Statement, that fact shall be disclosed when financial statements for the year in which this Statement is first applied are presented either alone or only with financial statements of prior years.

The provisions of this Statement need not be applied to immaterial items.

This Statement was adopted by the affirmative votes of four members of the Financial Accounting Standards Board. Messrs. March, Morgan, and Walters dissented.

Messrs. March, Morgan, and Walters dissent to this Statement because, in their opinion, it establishes an unattainable objective for a plan's financial statements, it improperly includes what they consider to be actuarial statements within the financial statements rather than as supplementary information outside the financial statements, and it prescribes detailed reporting beyond reasonable usefulness to plan participants. They share an overriding concern that, taken as a whole, these provisions invite comparison of items that do not possess enough common properties to be directly comparable and lend an unjustified aura of reliability to estimates of the future.

They believe that the stated primary objective of a pension plan's financial statements, "... to provide financial information that is useful in assessing the plan's *present* and *future* ability to pay benefits when due," promises more than can be achieved and will foster unreasonable expectations. In most cases, the plan's ability to pay benefits will depend primarily on the continuing support and financial health of the plan sponsor far into the future. In their view, users are not well served by an objective and a presentation that suggest that a *spot comparison* of the estimated present value of benefits to the current market valuation of assets held is a relevant or reliable indicator of a plan's ability to pay benefits when due. The benefit information is a product of estimates of events and conditions and payments over decades; the asset information necessarily relates to specific assets existing and values prevailing at a specific moment, often emphasizing temporary or short-run conditions. The trend *over time* of accumulated assets and benefits payable may indicate funding progress and the historical record of the investment policy and actuarial assumptions, but even that has limited value in assessing ability to make remote benefit payments.

They believe the primary objective of a pension plan's financial reporting should be to provide financial information about resources and financial activities of the plan that is useful in assessing the stewardship of the plan's administrators; an appropriate supplemental objective is to provide information about plan benefits and the trends *over time* in the accumulation of resources and benefits.

They believe the total effect of the following factors creates a powerful presumption that the information regarding the actuarial present value of accumulated plan benefits, changes in such actuarial values, and related disclosures (paragraphs 6(c), 6(d), 7, 8, and 16-26) should not be designated as part of the financial statements of the plan:

1. The essence of the information presented is based on estimates of probabilities, conditions, and events that may happen far into the future, vulnerable to all kinds of uncertainties and less reliable than financial statement measurements in general. Although actuarial estimates and judgments are often used in accounting measurements, they are only a part of an accounting presentation and not, as here, the totality of the information content.
2. Accumulated benefits have not been identified as liabilities or other elements of financial statements of pension plans. Trustees and plan administrators are responsible for stewardship of the funds entrusted to them and payment of benefits in compliance with the plan, but only to the extent of those funds.
3. Independent auditors are not trained to perform a substantive audit (that is, make an expert challenge) of the actuarial findings.
4. Congress, in adopting ERISA, identified the financial statements of a plan (Statements of Assets and Liabilities and Changes in Net Assets Available for Plan Benefits) to be covered by the opinion of an independent accountant as separate and distinct from actuarial statements to be covered by the opinion of an enrolled actuary.

They conclude that this presumption has not been overcome and disagree with the Board's determination that what are effectively actuarial statements are to be included within the financial statements. This is not just a theoretical distinction. It has potentially significant cost/benefit implications if the financial statements are audited. If the actuarial data are considered to be within financial statements, there is a presumption that they will be covered by the report of the independent auditor. In their view, the benefits of an auditor's opinion on these actuarial statements are doubtful, but the costs of the audit are real. They believe that a plan's financial report should consist of financial statements accompanied by the report of the independent auditor and actuarial information accompanied by the report of the actuary, if expert opinions are desired.

Messrs. March, Morgan, and Walters believe that the active cooperation between the Board and the actuarial profession in this project is a significant milestone toward more consistent reporting of actuarial data. They believe, however, that the Board has dealt in this Statement with choices of details and refinements in actuarial determinations (paragraphs 17-21) that should be left to the actuarial profession as long as their guidelines produce information relevant to the objectives of financial reporting.

They also are not convinced that plan participants need the detailed disclosures prescribed by this Statement, particularly as to actuarial methods, changes, and assumptions (paragraph 27) and as to the matters in paragraph 28. Users wishing such details for large private plans can obtain them from the annual reports filed with the Department of Labor which are available to participants on request. It should be sufficient to provide summarized benefit information as of the most recent actuarial valuation for plans with fewer than 100 participants, rather than to require an update for each annual report. They understand that less statistical reliability can be expected from actuarial data for these small plans.

Members of the Financial Accounting Standards Board:

Donald J. Kirk, *Chairman*
Frank E. Block
John W. March
Robert A. Morgan
David Mosso
Robert T. Sprouse
Ralph E. Walters

Appendix A: BACKGROUND INFORMATION

31. Financial reporting by defined benefit pension plans in the private sector was generally quite limited before 1976. A few companies included a report of their pension plans in their annual reports to stockholders. Those financial statements that were distributed to participants were frequently limited to summary statements of assets and often did not purport to conform with generally accepted accounting principles.

32. The Employee Retirement Income Security Act of 1974 established minimum standards for participation, vesting, and funding for employee benefit plans of private enterprises. It also requires annual reporting of certain information to particular governmental agencies and summarized information to plan participants. For many plans, the reporting requirements include financial statements prepared in conformity with generally accepted accounting principles.

33. The House Pension Task Force Report indicates that many public employee retirement

systems do not report important financial and actuarial information to participants, public officials, and taxpayers.[18] Although ERISA does not apply to those plans, interest in financial information about them has increased since enactment of ERISA, and proposed legislation [19] to establish reporting requirements for them was introduced during the 1978 and 1980 congressional sessions.

34. Prior to this Statement, no authoritative accounting pronouncement issued by the FASB or its predecessor bodies addressed financial accounting and reporting standards specifically for defined benefit pension plans.

35. In recognition of the broadened financial reporting requirements for most employee benefit plans, the significance of both the assets held by pension plans and the benefits accumulated by participants in those plans, and the diversity of existing accounting and reporting practices of employee benefit plans, the FASB placed on its technical agenda in November 1974 a project on accounting and reporting for employee benefit plans.

36. A 10-member task force, composed of individuals from academe, the financial community, government, industry, organized labor, and the public accounting and actuarial professions, was appointed in February 1975 to counsel the Board in preparing a Discussion Memorandum analyzing issues related to the project.

37. In preparing the Discussion Memorandum, the FASB primarily relied on the published research studies and articles that are cited in that document. The additional research undertaken in connection with this project included (a) a review of relevant literature, (b) an examination of selected published annual reports of employee benefit plans and trust funds, and annual reports to stockholders of corporations that included information about pension plans, (c) interviews with actuaries and employee benefit consultants, and (d) analysis of the provisions of ERISA and its related regulations.

38. The Board issued the Discussion Memorandum on October 6, 1975 and held a public hearing on February 4 and 5, 1976. The Board received 104 position papers, letters of comment, and outlines of oral presentations in response to the Discussion Memorandum, and 23 presentations were made at the public hearing.

39. In its deliberations following the public hearing, the Board concluded for the reason expressed in paragraph 71 that the scope of the initial Statement of Financial Accounting Standards resulting from the project should be limited to financial accounting and reporting by defined benefit pension plans.

40. On April 14, 1977, an FASB Exposure Draft, *Accounting and Reporting by Defined Benefit Pension Plans*, was issued that, if adopted, would have been effective for plan years beginning on or after December 15, 1977. Approximately 700 letters of comment were received in response to that Exposure Draft. The Board announced on September 30, 1977 that because

of the need to analyze the large number of responses and the complexity of the issues involved it would be unable to issue a final Statement in 1977.

41. Throughout the project, the FASB worked with the United States Department of Labor, the actuarial profession, and others in an attempt to avoid conflicts, duplication, and confusion in providing meaningful financial reporting. In conjunction with that cooperative effort, the Board decided in the first quarter of 1979 to expose to task force members and certain other interested parties a staff draft of standards that incorporated previously announced tentative conclusions. The Board considered the comments received on that draft. It then concluded that a revised Exposure Draft should be issued for public comment because of the significant changes that had been made to the proposed standards in the April 14, 1977 Exposure Draft.

42. A revised Exposure Draft, *Accounting and Reporting by Defined Benefit Pension Plans*, was issued on July 9, 1979. The Board received approximately 300 letters of comment in response to that Exposure Draft.

Appendix B

BASIS FOR CONCLUSIONS

CONTENTS

Paragraph Numbers

Appendix B: BASIS FOR CONCLUSIONS

43. This appendix discusses factors deemed significant by members of the Board in reaching the conclusions in this Statement, including various alternatives considered and reasons for accepting some and rejecting others. Individual Board members gave greater weight to some factors than to others.

REPORTING ENTITY

44. Deciding whether the plan or **pension fund** is the reporting entity is related to the objectives of the financial statements, and many respondents [20] who addressed the issue of the reporting entity did so in that context. Thus, the views expressed in paragraphs 45-47 should be considered together with those expressed in paragraphs 48-69.

45. Arguments presented by proponents of the plan as the reporting entity include the view that a plan has many attributes of a legal entity. It gives rise to participants' rights, plan resources, and employer obligations. That view is reinforced for plans subject to ERISA (**ERISA plans**) by certain sections of the Act.[21] Further, and more importantly, to report only pension fund activities omits reporting the significant information about participants' benefits.

46. Supporting the pension fund as the reporting entity is the view that the pension plan consists only of a set of documents used by various entities, such as the sponsor, trust funds, and insurance companies, to assist in carrying out the terms of the agreement between the employer(s) and the employees. The fact that the plan may possess certain attributes of a legal entity is not viewed as sufficient reason for characterizing it as a reporting entity. Many respondents who supported the pension fund as the reporting entity linked that choice with the impropriety, in their view, of presenting quantitative information about plan benefits in the financial statements.

47. After considering the alternatives, the Board concluded that the needs of financial statement users and the related primary objective of the financial statements (as set forth in following paragraphs) necessitate establishing the plan, rather than the fund, as the reporting entity. The Board believes that financial information about both the promise to provide benefits and any assets committed to fulfill that promise are essential to present financial statements that are most meaningful to users (paragraphs 48-53).

PRIMARY OBJECTIVE OF PLAN FINANCIAL STATEMENTS

Users of Financial Statements

48. Potential users of plan financial statements include those who have an existing or potential relationship with either the plan or the employer(s). The initial Exposure Draft identified plan participants as the primary users of plan financial statements. Many respondents to that Exposure Draft expressed the view that the "typical" plan participant would be uninterested in or unable to properly assimilate the information presented in plan financial statements and thus would be confused and possibly misled.[22] Other respondents thought that Exposure Draft gave insufficient attention to the needs of other users, for example, employers, their investors and creditors, plan administrators, and governmental authorities responsible for regulating pension plans.

49. In response to such comments, the primary objective of plan financial statements as it appeared in that Exposure Draft was revised. Those revisions are intended only as clarifications and shifts in emphasis. For example, the phrase "useful in assessing the plan's present and future ability to pay benefits when due" now appears in place of "useful to plan participants in assessing the security with respect to receipt of their accumulated benefits." Although this Statement does not identify any one group as the primary users, the Board believes that the content of plan financial statements should focus on the needs of plan participants because pension plans exist primarily for their benefit. The Act provides additional support for that view. For example, Section 103(a)(3)(A), quoted in footnote 21, refers to an examination of plan financial statements by an independent accountant engaged on behalf of all plan participants. The Board recognizes, however, that plan financial statements should also be useful to others who either advise or represent participants, are present or potential investors or creditors of the employer(s), are responsible for funding the plan (for example, state legislators), or for other reasons have a derived or indirect interest in the financial status of the plan.

50. The Board recognizes that participants who have not had previous exposure to financial statements may need to be educated regarding the information presented in plan financial statements. However, the Board does not believe that a possible need to educate some users justifies disregarding the financial information needs of other users who have a reasonable understanding of financial reporting and economic activities and are willing to study the information with reasonable diligence. Financial statements should not exclude relevant information merely because it may be difficult for some to understand or because some members of the expected audience choose not to use it. To enhance their usefulness, **plan administrators** may wish to supplement the statements with a brief explanation that highlights those matters expected to be of most interest to participants. Including summary financial information for a period of years in such supplementary information, and thereby disclosing trends, may also be helpful.

51. Some respondents to the initial Exposure Draft who expressed concern regarding the usefulness of plan financial statements to participants presumed that it required that plan financial statements be distributed to all participants. Others interpreted that document as requiring plan financial statements to be audited. This Statement does not require the

preparation, distribution, or attestation of any financial statements, but only establishes standards of accounting and reporting to be followed in the preparation of plan financial statements that purport to be in accordance with generally accepted accounting principles.

52. The accounting and reporting standards established by this Statement are intended to result in general purpose external financial statements. To include in financial statements designed to serve many the specialized information needed by a few who can otherwise obtain that information may be uneconomical. For example, the plan administrator may need many kinds of specialized and detailed information to decide day-to-day matters and establish policies. But the plan administrator controls the plan's accounting system, and much of the accounting effort may be managerial accounting designed to help the plan administrator manage and control operations. Similarly, the information needed by the sponsor of a single-employer plan to evaluate potential plan amendments or to determine current minimum funding requirements under the Act is specialized information. But sponsors usually have the ability to acquire the specific information they need. To the extent that governmental authorities responsible for regulating plans wish to indicate their needs for financial information by requiring submitted financial statements to be prepared in accordance with generally accepted accounting principles, it seems appropriate to consider the needs of those authorities in establishing generally accepted accounting principles for plans (provided those needs do not conflict with the needs of participants and do not entail an adverse cost/benefit relationship). To the extent that governmental authorities need specialized information, they can probably obtain it.

53. Information consistent with the primary objective of plan financial statements (set forth in subsequent paragraphs) is likely to be useful to participants and others who are interested in essentially the same financial aspects of the plan, including those who have an existing or potential relationship with the employer(s). Although information presented in plan financial statements may fulfill certain needs of those who have a relationship with the employer(s), the Board believes that an in-depth consideration of their needs is more appropriately a part of another Board project.[23]

Objectives

54. The Board considered those user needs that could be reasonably satisfied within the constraints of the characteristics and limitations of financial accounting.

55. Because employees generally render service long before they receive the benefits to which they are entitled as a result of that service, they are concerned with the security [24] for their future benefits. Thus, the primary objective of plan financial statements stated in the initial Exposure Draft was to provide information that is useful to plan participants in assessing the security with respect to receipt of their accumulated benefits.

56. A number of respondents thought that primary objective was too narrow. Although the initial Exposure Draft was based on an assumption of an ongoing plan, certain aspects (primarily

those relating to measuring the actuarial present value of accumulated plan benefits) were seen as emphasizing the security of participants' benefits in the event of plan termination. Many respondents thought participants and other users should be interested not only in immediate security but in whether adequate progress is being made toward achieving security for the benefits participants expect to receive upon retirement or other termination of service. The Board agreed. Therefore, to emphasize the assumption of an ongoing plan, the phrase "plan's present and future ability to pay benefits when due" was substituted for "security with respect to receipt of [participants'] accumulated benefits."

57. Some respondents to the initial Exposure Draft also expressed the view that providing information useful in assessing the performance of pension plan administrators and other fiduciaries in managing the assets they control should be a part of the primary objective of plan financial statements. The Board believes that providing information useful in an assessment of stewardship is inherent in providing information useful in assessing **benefit security**. However, because of the importance of stewardship to a plan's ability to pay benefits, the Board concluded that that interrelationship should be explicitly indicated. (Paragraph 67 further discusses the use of financial statements in assessing stewardship.)

Other Information Needed in Assessing Benefit Security

58. Some respondents to the Exposure Drafts expressed the view that (a) the continued viability of the employer as an entity willing and able to meet the funding requirements of the plan and (b) (for ERISA plans) the guaranty of the PBGC were more important to long-range benefit security than the assets held by the plan at any given date. In their view, the Exposure Drafts either ignored or dealt inadequately with those factors, and thus the objective of providing information useful in assessing benefit security would not be achieved.

59. As indicated in the Exposure Drafts, the Board recognizes that information beyond that presented in plan financial statements is needed to assess benefit security. Whether participants receive their benefits when due depends not only on the existing relationship between plan resources and accumulated plan benefits but also on (a) the commitment and financial ability of the employer(s) to make future contributions to the plan and (b) (for an ERISA plan) the extent to which payment of benefits is insured by the PBGC. Although the commitment and financial ability of the employer(s) to make future contributions to the plan are primary factors in assessing benefit security, that kind of information is not within the limits of financial accounting for the plan itself.

60. However, a primary purpose of funding a pension plan is to enhance the plan's present and future ability to pay benefits when due. If a funding program is in effect, participants can look to funds that are irrevocably committed to the payment of benefits. Other factors being equal, the higher the ratio of those funds to the actuarial present value of accumulated plan benefits, the greater is the assurance that present accumulated plan benefits will be paid. With the information presented in plan financial statements, users can assess the extent to which the plan

itself is able to pay participants' benefits and the extent to which payment of benefits is dependent on other factors, namely, the commitment and financial ability of the employer(s), and, for ERISA plans, the security provided by the PBGC.

61. The existence of the PBGC guaranty as an element of benefit security was not, as some respondents contended, ignored in the Exposure Drafts. Both drafts required, as does this Statement, that financial statements of ERISA plans include a brief, general description of the PBGC guaranty. However, the initial Exposure Draft's requirement was expanded to require an explanation of the application of the PBGC guaranty to any recent plan amendments (paragraph 265).

62. There is also the view that the primary objective is unattainable because a comparison of the net asset and benefit information as presented in a plan's annual financial statements is not sufficient for an assessment of the plan's future ability to pay benefits when due. The Board recognizes that information regarding the trend of the relationship over time between plan resources and accumulated plan benefits, on both an absolute and a relative basis, can be more useful than information about that relationship at any given date. Information over time is, however, an aggregation of information as of a series of dates. Without annual information, trend information over a period of years cannot be ascertained. Therefore, the Board believes it is appropriate for the primary objective to indicate that the information provided by plan financial statements should be *useful in assessing* (as contrasted with *portraying*) the plan's future as well as present ability to pay benefits when due. Paragraph 50 acknowledges that the usefulness of annual financial statements may be enhanced by supplementing them with summary financial information for a period of years.

63. To summarize, the Board does not believe that the need for information beyond that provided by annual plan financial statements implies that the stated objective of providing information useful in assessing the plan's present and future ability to pay benefits when due is either unattainable or inappropriate. An analogous situation exists with regard to financial reporting by business enterprises. The objectives stated in FASB Concepts Statement No. 1, *Objectives of Financial Reporting by Business Enterprises*, focus on providing "information that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions." [25] That document recognizes, however, that financial reporting is but one source of economic information about business enterprises. The financial information provided by financial reporting for business enterprises should be used in combination with pertinent information from other sources, for example, information about general economic conditions or expectations, political events and political climate, or industry outlook.[26] Similarly, financial information presented in plan financial statements should be used in combination with other pertinent information, including information about the financial condition of the employer(s) and, for ERISA plans, the guaranty of the PBGC. Concepts Statement 1 also implicitly recognizes that financial reporting by a business enterprise for any one period may be insufficient to fulfill users' needs. For example, paragraph 48 indicates that "... procedures such as averaging or normalizing reported earnings for several periods... are

commonly used in estimating 'earning power'." Users of plan financial statements may likewise need financial information for several years in assessing benefit security.

Alternatives Considered

64. Alternatives suggested by respondents primarily focused on the objectives presented in the Discussion Memorandum, namely:

a. To provide information useful for assessing the aggregate future benefits payable to participants and the resources available to meet those payments
b. To provide information useful to individual pension plan participants for assessing the degree of risk that may be associated with the future receipt of their pension benefits
c. To provide information useful for assessing, in terms of amount, timing, and related uncertainty, the aggregate future benefits payable to participants should the pension plan be terminated
d. To provide information useful for assessing the performance of pension plan administrators and other fiduciaries in discharging their various responsibilities
e. To provide information useful for assessing the performance of pension plan administrators and other fiduciaries solely with regard to managing the assets that they control
f. To provide information useful for assessing the need for future contributions to the pension plan in terms of amount and timing
g. To provide information useful for assessing future earnings of the pension plan in terms of amount and timing.

65. As was indicated in the Discussion Memorandum and the Exposure Drafts, selection of a particular objective does not necessarily mean exclusion of an alternative; rather, selection of objectives determines the matters to be emphasized.

66. The Board views objectives (a)-(c) as falling within the broad objective of providing financial information that is useful in assessing the plan's present and future ability to pay benefits when due. However, each of those objectives and the views of respondents supporting them suggest an alternative manner of either measuring or displaying particular elements of the financial information. Accordingly, those alternatives are addressed in subsequent paragraphs that deal with the determination and presentation of benefit information.

67. Objectives (d) and (e) are concerned with whether the financial statements should be primarily oriented toward reporting what the plan administrator and other fiduciaries have done to carry out their duties. As indicated in paragraph 57, objective (e) is, to a significant degree, considered inherent in the broad objective adopted by the Board. In accomplishing that objective, plan financial statements will provide information regarding the management of plan assets together with information pertaining to participants' accumulated plan benefits as well as the results of transactions and events that affect those assets and benefits. Although that information should be useful in assessing performance, factors that are beyond the control of

plan management, such as the financial condition of the employer(s), participants' longevity, and general economic conditions, may contribute to plan performance. Plan financial statements provide information about a plan when it was under the direction of a particular management but cannot separate the effect of management performance from the effects of other factors. Users therefore need to form their own assessment of the effect of management performance on plan performance. Further, to focus solely on objectives relating to performance might, based on certain respondents' views, result in the exclusion of benefit information. The Board does not believe such exclusion would result in meaningful financial statements. Therefore, the Board does not believe that an objective relating to performance should, by itself, constitute the primary objective of plan financial statements.

68. Objectives (f) and (g) were rejected as primary objectives for reasons somewhat similar to those expressed in paragraph 67. To the extent that users' expectations about future plan performance are based on past plan performance, information about existing plan assets and the income from those assets together with information about present accumulated plan benefits may be useful in assessing the need for future contributions to the plan and future earnings of the plan. However, plan financial statements cannot provide information about assets or benefits that do not currently exist. Users need to assess the possible impact of factors that may cause change and form their own expectations about the future and its relation to the past.

69. Some respondents suggested another objective, namely that the financial statements for ERISA plans provide only the information required by ERISA and its related regulations. In their view, Congress established that pension plan financial statements serve plan participants and prescribed the information that it deemed appropriate for that purpose. The Board noted, however, that Section 103(a)(3)(A) (quoted in footnote 21) refers to financial statements "presented fairly in conformity with generally accepted accounting principles." The Board sees no indication in the Act that those principles of accounting are intended to be found in the Act's requirements or in regulations to be issued thereunder. It is the purpose of, and the Board believes Congress recognized the need for, financial accounting standards to determine the content of plan financial statements.

SCOPE OF THIS STATEMENT

70. This Statement establishes standards of financial accounting and reporting for defined benefit pension plans. In contrast, the Discussion Memorandum comprehended various types of employee benefit plans. However, most respondents to the Discussion Memorandum directed their attention to accounting and reporting for defined benefit pension plans—presumably the area of most concern to them. Some respondents to the Exposure Drafts suggested that the scope of this Statement should be expanded to include other types of employee benefit plans. Although requested to do so by paragraph 43 of the initial Exposure Draft, very few respondents to that document identified specific aspects of the accounting and reporting by other types of employee benefit plans that they believed the Board should focus on.

71. Because of respondents' overriding interest in reporting by defined benefit pension plans, the Board concluded that this Statement should focus on those plans. That focus is not intended to imply that the Board has concluded that the standards of financial accounting and reporting for other types of employee benefit plans should be the same as or different from those described in this Statement.

72. Some respondents to the initial Exposure Draft suggested that the scope of this Statement include interim as well as annual financial statements. Because few, if any, plans publish complete interim financial statements and because the consideration of related issues would delay issuance of this Statement, the Board did not consider interim financial statements.

73. Defined benefit pension plans of state and local governmental units are included in the scope of this Statement. Certain respondents suggested that because of the unique characteristics of governmental units, such as their taxing power and perpetual life, their plans are inherently different from private plans and therefore should be excluded. Others contended that governmental plans should be excluded because they may differ from private plans with respect to funding requirements, vesting and benefit provisions, or both.

74. Some respondents to the Exposure Drafts expressed the view that plans of state and local governmental units should be excluded because the stated primary objective of plan financial statements was not appropriate for such plans. In their view, because public plans are less likely to terminate than private plans, providing information useful in assessing benefit security is not relevant. The view was also expressed that the initial Exposure Draft's identification of participants as the primary users of plan financial statements was not appropriate for governmental plans. Those respondents thought the financial statements of such plans should be directed specifically to users other than plan participants (for example, public officials, state legislators, taxpayer groups, bond underwriters, potential investors, etc.) and that those users might have objectives other than assessing benefit security.

75. The Board recognizes that there are distinctions between business enterprises and governmental units. The Board also recognizes that the financial condition of the employer is of extreme importance for benefit security. However, the Board believes that only the characteristics of the plans themselves, not the characteristics of their sponsors, should affect the accounting and reporting by pension plans. The Board also did not find persuasive the argument that plans of state and local governmental units should be excluded because their vesting and benefit provisions may differ from those of private plans. The vesting and benefit provisions of private plans are not all the same. Such differences will be reflected in plan financial statements prepared in accordance with this Statement. (Paragraph 165 discusses how the basic method for determining the benefit information accommodates differences in such factors as plan provisions.)

76. The Board also believes that there is a need, as evidenced by the increasing interest [27] in financial information about public plans and by the House Pension Task Force Report on Public

Employee Retirement Systems,[28] to establish standards of financial accounting and reporting for plans of state and local governmental units. That report states: "Serious deficiencies exist among public employee retirement systems at all levels of government regarding the extent to which important information is reported and disclosed to plan participants, public officials, and taxpayers." [29] It also states that participants in such plans "do face the risk of pension benefit reductions or other benefit curtailments due to reasons other than plan termination," and that "the financing of many pension plans covering local government employees lacks stability and predictability due to state imposed taxing restrictions as well as to the indeterminate amount of funds available from federal revenue sharing, state insurance premium taxes, etc." [30] In view of the foregoing, the Board concluded that the primary objective of providing information useful in assessing the plan's ability to pay benefits when due is as appropriate for plans of state and local governmental units as it is for private plans.

77. Views regarding the needs of financial statement users other than participants were previously addressed (paragraph 49). Further, the primary objective adopted by the Board does not necessarily deny other objectives that are associated with those users. However, to the extent that certain users need specialized or detailed information and can otherwise obtain that information, the Board concluded (paragraph 52) that such information should not be required in general purpose external financial statements.

78. Government-sponsored social security plans (for example, the U.S. Social Security program and similar plans of foreign countries) are not included in the scope of this Statement. The scope of the Discussion Memorandum did not include those plans nor did the Board consider them in its deliberations.

79. This Statement does not differentiate among plans based on plan size. Some respondents to the initial Exposure Draft suggested that the cost of implementing that document would be excessive for small plans, and therefore such plans should be exempted. (Paragraphs 272-279 discuss certain changes made to that Exposure Draft's requirements to reduce the perceived implementation costs.) Other respondents objected because they interpreted the inclusion of small plans as requiring them to issue audited annual financial statements. As indicated in paragraph 2, this Statement does *not* require the preparation, distribution, or attestation of any plan's financial statements. The Board recognizes that ERISA plans with fewer than 100 participants are not required to have their annual financial statements audited and are subject to less detailed requirements regarding their annual reports to governmental agencies.

80. The Board believes that small plans should be included in the scope of this Statement. The financial information needed in assessing a plan's ability to pay benefits is not dependent on its size. Further, any size criterion selected for excluding plans would be arbitrary. To exclude small plans from the scope of this Statement would be justified only if the usefulness of the required information did not justify its cost. However, that cost/benefit relationship is difficult to determine. It is recognized that the incremental cost per participant to implement this Statement will be generally higher for smaller plans. Accordingly, the Board considered how the

provisions of the Statement, primarily those relating to benefit information, might be modified to apply to small plans. The Board noted that the American Academy of Actuaries in its Interpretation 2, *Interpretation of Recommendations Concerning the Calculation of the Actuarial Present Value of Accrued Benefits under an Active Plan*, does not differentiate among plans based on plan size. Although their basic method is the same for large and small plans, the Board is aware that certain actuaries use simplified techniques in applying that method to minimize the costs for small plans. As indicated in paragraph 29, this Statement permits the use of averages or other methods of approximation, including those consistent with recommended actuarial practice, provided the results obtained are substantially the same as the results contemplated by this Statement. That paragraph also notes that such approaches may be particularly useful for plans sponsored by small employers.

81. The revised Exposure Draft requested respondents, particularly those associated with small plans that intended to issue financial statements in accordance with generally accepted accounting principles, to express their views regarding whether the provisions of that document should be modified for small plans and, if so, to what extent. Of those relatively few respondents who thought modifications should be made, most suggested exempting small plans from the requirement to present benefit information. For such an exemption to be appropriate, it would be necessary to conclude that the primary objective of financial statements for a small plan is different from that for a large plan. The Board does not support that conclusion (paragraph 80).

82. The Board considered the American Society of Pension Actuaries' response to the revised Exposure Draft regarding specific simplified techniques that, in the Society's view, should be permitted in valuing small plans' ancillary benefits. Paragraph 29 of this Statement permits the use of such simplified techniques. Further, one reason for the delayed effective date of this Statement is so that small plans that intend to adopt this Statement will have additional time to develop the necessary procedures, which may include appropriate simplified techniques.

83. For plans maintained outside the United States that are similar to plans maintained in the United States, this Statement applies only when financial statements of such plans are intended to conform with U.S. generally accepted accounting principles.

84. The scope of this Statement excludes a plan that has been or is expected to be terminated. The event of termination, particularly for an ERISA plan, would make various requirements of this Statement inappropriate because they are based on the assumption of an ongoing plan.

85. This Statement applies to an unfunded plan. Although principally limited to the information required by paragraphs 6(c) and 6(d), the Board nevertheless considers that financial information useful in assessing such a plan's ability to pay benefits when due.

INFORMATION REGARDING NET ASSETS AVAILABLE FOR BENEFITS

86. Because a plan's net assets are the existing means by which it may provide benefits, **net asset information** is necessary in assessing a plan's ability to pay benefits when due. This Statement requires that information to be presented as of the end of the plan year. If the benefit information date is the beginning of the year, a statement that includes net asset information as of that date is also required. (Paragraphs 244-246 discuss the Board's conclusions regarding the format for presenting that information.)

Basis of Accounting

87. The Discussion Memorandum referred to the following bases of accounting for the net assets of a pension plan: cash basis, accrual basis, and a modified cash or modified accrual basis. Most respondents who addressed the issue indicated a preference for the accrual basis. Some who favored either the cash basis or a modified basis cited the administrative convenience of such an approach and noted that, in many instances, the difference from the accrual basis would not be material. Respondents favoring the accrual basis generally indicated that it is the only basis that provides complete financial information relating to transactions and events occurring during the period. The Board agreed with the latter argument and believes that basis is the only one that is consistent with the primary objective.

88. Some respondents to the Discussion Memorandum objected to the accrual basis because it would require that purchases and sales of securities be recorded on a trade-date basis. They contended that present recordkeeping is geared to a settlement-date basis, that a change in reporting would be an administrative burden, and that the information produced by the two methods would not be significantly different for most plans. The Board concluded that, subject to materiality considerations, the accrual basis should be used. Therefore, if the results are not significantly different from the results on a trade-date basis, accounting for sales and purchases of securities on a settlement-date basis is acceptable (footnote 3).

Receivables from Employer(s) and Others

89. This Statement requires reporting as contributions receivable those amounts that, as of the reporting date, are due the plan from the employer(s), participants, and other sources of funding. Amounts due include those pursuant to formal commitments as well as legal or contractual requirements.

90. The initial Exposure Draft did not address receivables from sources other than the employer(s) and participants. However, certain other sources (for example, state subsidies and federal grants) constitute a significant source of financing for many plans of state and local governmental units.[31] Accordingly, receivables from such sources should be included and separately identified. However, funds from sources such as federal revenue-sharing programs that are used for plan funding purposes at the employer's discretion are, in effect, employer contributions and should be reported as such.

91. The initial Exposure Draft limited employer contributions receivable to amounts legally or

contractually due the plan. A number of respondents indicated that some employers (but not employers participating in collectively bargained multiemployer plans) contribute amounts in excess of legal or contractual minimums and, in some cases, those contributions are made after the plan's year-end. Respondents questioned the appropriateness of excluding those "excess" amounts from plan receivables. Some indicated that determining the amounts that are "legally or contractually" due could be burdensome if such amounts are less than actual contributions. The Board agreed and concluded that contributions receivable should include amounts evidenced by a formal commitment. Paragraph 10 indicates certain factors that may provide evidence of a formal commitment. The revised Exposure Draft did not include the employer's recognition as of the reporting date of a contribution payable to the plan as possible evidence of a formal commitment. Certain respondent suggested that that factor be added. The Board agreed that such a factor could provide *additional* support for the existence of a formal commitment. (Paragraph 92 indicates that the existence of accrued pension costs does not, by itself, provide sufficient support.) Receipt of formally committed amounts soon after the plan's year-end provides additional evidence of the existence of a receivable at year-end. In accordance with existing generally accepted accounting principles applicable to receivables, an adequate allowance should be provided for estimated uncollectible amounts.

92. Certain respondents favored treating as receivables all amounts reported as accrued pension costs by the employer(s). That position was generally founded on the belief that there should be symmetry in the financial reporting of the employer(s) and the plan. The Board has on its technical agenda a project on accounting by employers for pensions. The Board intends to consider further the issue of symmetry in that project. While neither accepting nor rejecting the concept of symmetry at this time (paragraph 163), the Board concluded that present practices of employers in accounting for pension costs are not a sufficient basis on which to account for employer contributions receivable. For various reasons, amounts recorded as accrued pension costs by an employer may differ from amounts formally committed to the plan. For example, the method used for measurement of periodic pension costs for the employer's financial statements may differ from the method used for determining the amount and incidence of employer contributions.

93. A few respondents to the initial Exposure Draft questioned whether the entire amount of "unfunded **prior service costs**" is a receivable of the plan. Because at the reporting date that amount is not due from the employer(s), it is not a receivable of the plan. The employer(s) may or may not intend to eventually contribute amounts sufficient to eliminate the "unfunded prior service costs." Until such payments are formally committed to the plan, "unfunded prior service costs" do not constitute a recordable resource of the plan. For similar reasons, any existing excess of the actuarial present value of accumulated plan benefits over the net assets available for benefits (excluding contributions receivable) is not a plan receivable unless at the reporting date that amount is legally, contractually, or pursuant to a formal commitment due the plan.

Alternatives Considered for Measuring Investments (Other Than Contracts with Insurance Companies)

94. Alternatives presented in the Discussion Memorandum encompassed the following approaches to measuring plan investments: fair value, historical cost, and certain hybrid methods. Opinion was divided among respondents as to whether a single method should be used for all investments.

Single Method

95. Most respondents to the Discussion Memorandum who favored a single method advocated fair value. In their view, the fair value of plan investments is the most relevant information that can be provided for assessing (a) the security within the plan for participants' benefits and (b) the plan's investment performance. Further, for ERISA plans, a number of respondents noted that there would be no additional administrative burden caused by requiring its use because fair value is presently required in financial data filed with certain governmental agencies.

96. Some respondents favoring use of only one method advocated historical cost. Generally, they emphasized the high degree of objectivity associated with that method and that its use does not result in the recognition of unrealized gains or losses as do other methods. Certain respondents who advocated that the primary objective of plan financial statements be limited to portraying stewardship responsibility considered historical cost to be the most useful measure for achieving that objective. Many who supported historical cost nevertheless advocated supplemental disclosure of fair value.

97. A number of respondents preferred a method other than fair value or historical cost. Two such methods were the moving-average-market-value method and the long-range-appreciation method. Support for those methods generally was based on the view that the effects of short-term market fluctuations on financial position and investment performance should be avoided. In addition, because investments are normally held for a long time, the current fair value of those investments is not necessarily indicative of the amount to be ultimately realized.

98. Some respondents to the Exposure Drafts favored a method other than fair value based on their perceptions of the possible effects that disclosing fluctuations in fair values might have on a plan's investment policy. In their view, measurement of investments at fair value is undesirable because plan sponsors or administrators might attempt to avoid the financial statement effects of fluctuating fair values by adopting a more conservative investment policy or by avoiding certain types of investments whose fair values may be subject to wide fluctuations. Some who expressed that view favored historical cost for either all or certain types of investments; others favored some type of averaging method.

99. To avoid additional administrative costs and possible confusion of users of plan financial statements, some respondents argued in favor of using whatever method was used in determining the **actuarial asset value**.

Different Methods

100. Some respondents favored use of different methods for different types of investments. The principal investment categories addressed were fixed-income securities, not-readily-marketable investments, and contracts with insurance companies. (Paragraphs 112-126 discuss the last category.) The views supporting particular methods for marketable equity securities were basically the same as those indicated in paragraphs 95-99.

101. Regardless of the method(s) used to measure other types of investments, certain respondents advocated use of (amortized) historical cost for long-term, fixed-income investments that the plan had both the intent and ability to hold to maturity. They argued that measuring those investments at fair value does not reflect the amounts ultimately expected to be received. Further, any appreciation or depreciation that is recognized using fair value will ultimately be reversed in subsequent periods.

102. Certain respondents focused on investments that are not readily marketable. They advocated use of historical cost for those investments. In their view, if market quotations are not available, determining fair value is highly subjective. Because users of plan financial statements might be misled by subjective measurements, historical cost should be used.

Conclusions on Measuring Investments (Other Than Contracts with Insurance Companies)

103. The Board concluded that plan investments (excluding contracts with insurance companies) should be measured at fair value. The Board believes that basis provides the most relevant information about the resources of a plan consistent with the primary objective of the financial statements. The Board recognizes that there may be practical problems in determining the fair value of certain types of investments. Notwithstanding those difficulties, the Board believes that the relevance of fair value is so great as to override any objections to its use.

104. If available, the Board considers quoted market prices to be the most objective and relevant measure of fair value. Paragraph 11 provides certain guidelines for determining fair value if no active market exists. The use of independent experts who are qualified to estimate fair value may be necessary for certain investments.

105. The Board rejected using historical cost because prices in past exchanges do not provide the most relevant information about the present ability of the plan's assets to provide participants' benefits. Further, the Board does not believe that historical cost is the most appropriate measure for use in assessing how the stewardship responsibility for plan assets has been discharged. Plan administrators or other fiduciaries who manage plan assets are accountable not only for the custody and safekeeping of those assets but also for their efficient and profitable use in producing additional assets for use in paying benefits. Investment performance is an essential element of stewardship responsibility. Measuring changes in fair value provides information necessary for assessing annual investment performance and stewardship responsibility. Historical cost provides that information only when investments are sold.

106. The Board does not consider perceived effects on investment policies to be an appropriate factor on which to base conclusions concerning measurement of investments. The Board has considered and rejected similar arguments regarding perceived effects of accounting standards on management decisions in conjunction with other projects on its agenda. Even if accounting results were to influence some managers' decisions, it does not follow that accounting standards should be designed to encourage or discourage an action by management. Developing accounting standards on that basis would require a judgment by the Board as to which actions are desirable and which are undesirable. The role of financial reporting is to provide neutral, evenhanded, or unbiased information that is useful to those (including management) who make economic decisions. It is not a function of financial reporting to try to influence those decisions. Even if an approach based on an attempt to avoid possible effects on investment decisions were deemed appropriate, an equally valid argument might be made against the use of historical cost. That is, if investments were presented at historical cost, decisions regarding timing of disposition of investments might be influenced by the effect on reported gains or losses.

107. For fixed-income investments held to maturity, the Board recognizes that market fluctuations will reverse before maturity (assuming no defaults). However, at the reporting date, it is the fair value, not the historical cost or the expected value at maturity, that is relevant to an assessment of the plan's ability to pay benefits. Changes in value from period to period are relevant to an assessment of investment performance and discharge of stewardship responsibility. Presenting fixed-income investments at historical cost (whether or not the intent is to hold them to maturity) does not provide essential information about the effect on investment performance of the decision to hold. Further, it may be difficult to determine whether the plan has both the intent and ability to hold a particular fixed-income investment to maturity.

108. At least two additional issues would need to be considered if fixed-income investments were to be presented at historical cost. First, some respondents contended that recognizing a gain or loss (based on historical cost) is inappropriate for a bond swap, that is, when one bond is sold and replaced by a similar investment-grade bond. Those respondents consider such gains and losses to be, in effect, modifications of future interest income. Therefore, to accomplish the desired results, gain/loss deferral and amortization approaches have been used. Those approaches, however, result in a measure of historical cost of fixed-income investments that other respondents believe is inconsistent with the generally accepted notion that historical cost represents exchange price at date of acquisition. The second issue is that the historical cost of a fixed-income investment reflects the effective interest rate at the date the plan acquired the investment rather than current and prospective interest rates which are considered more relevant for purposes of measuring the actuarial present value of accumulated plan benefits. The use of historical cost would necessitate resolving that inconsistency in order for the net asset and benefit information to be comparably measured. Presenting fixed-income investments at fair value eliminates any need to address those issues.

109. To address the concerns expressed about the subjectivity of fair value determinations for certain investments, this Statement requires that information regarding a plan's investments

indicate whether their fair values have been measured by quoted prices in an active market or are fair values otherwise determined. That requirement replaces the initial Exposure Draft's requirement to segment investments into those that are readily marketable and those that are not. Some respondents expressed the view that a criterion of "readily marketable" would be difficult to apply and would not necessarily be interpreted on a consistent basis among plans. The Board agreed and concluded that the intent of that requirement, namely to provide an indication of (a) the relative degree of subjectivity in the valuation of plan investments and (b) the relative liquidity of the investments, could be achieved by substituting the revised requirement.

110. Because the Board believes that quoted market prices, or in their absence other methods (for example, discounted cash flows or appraisals), are more relevant indicators of fair value than are any of the measures produced by hybrid methods, it rejected those methods for measuring investments.

111. For reasons similar to those expressed in paragraphs 165 and 166, the Board concluded that the measure of investments reported in financial statements should not be dependent on actuarial asset valuations. The Board believes that actuarial asset valuation methods are used in conjunction with objectives, principally determining measures of pension costs for purposes of financial reporting by the employer(s) and for determining periodic funding requirements, that differ from the primary objective of plan financial statements.

Alternatives Considered for Measuring Contracts with Insurance Companies

112. A plan may enter into various contractual agreements with an insurance company. Such agreements may be distinguished based on whether related payments to the insurance company are currently used to purchase immediate or deferred annuities for participants (**allocated contracts**) or are accumulated in an unallocated fund (**unallocated contracts**) to be used to meet benefit payments when employees retire, either directly or through the purchase of annuities. Funds in an unallocated contract may also be withdrawn and otherwise invested.

113. Under an allocated contract (for example, a group deferred annuity contract), the insurance company has a legal obligation to make all benefit payments for which it has received the premiums or consideration requested.

114. An example of an unallocated contract is a group deposit administration (*DA*) contract. Under a DA contract, payments to the insurance company that are intended to provide future benefits to present employees are credited to an account. For investment purposes, the monies in the account are commingled with other assets of the insurance company. The account is credited with interest at the rate specified in the contract; it is charged with the purchase price of annuities when employees retire and with any incidental benefits (death, disability, and withdrawal) disbursed directly from the account.

115. The immediate participation guarantee (*IPG*) contract is a variation of the DA contract. In an IPG contract, the account is credited with the contributions received during the contract

period plus its share of the insurance company's actual investment income. The IPG contract is written in two forms. Under either form the insurance company is obligated to make lifetime benefit payments to retired employees. One form provides for the actual purchase of annuities as employees retire. There is an annual adjustment to the account to reflect the insurance company's experience under the annuities. In the other form, the IPG contract may accomplish the same objective through a different technique. When an employee retires, pension payments are made directly from the account without the purchase of an annuity. However, the balance of the account must be maintained at the amount required, according to a premium schedule in the contract, to provide for the remaining pension benefits for all current retirees. That portion of the account is referred to as the **retired life fund**. Thus, if necessary, the account could always be used to buy all annuities in force.

116. Allocated contracts may or may not provide for plan participation in the investment performance and experience (for example, mortality experience) of the insurance company. Under those that do (**participating contracts**), the right to receive future dividends is referred to as a **participation right**.

117. The initial Exposure Draft prescribed that contracts whereby an insurance company was required to pay certain specified benefits were to be excluded from plan assets. If no such obligation existed, the contracts were to be included in plan assets.

118. Certain respondents to that Exposure Draft favored excluding allocated contracts from plan assets and including unallocated contracts. Others favored excluding contracts under which funds were *assigned* to provide benefits that the insurance company is obligated to pay. Presumably, both proposals are based on the view that when an insurance company agrees to provide certain benefits, it incurs (and removes from the plan) the obligation to pay those benefits. To assess the security for those benefits, one should look to the financial statements of the insurance company rather than those of the plan. By paying premiums for the purchase of annuities, the plan has fulfilled its obligation to provide those benefits and ceases to be the focal point for financial information about those particular benefits and the assets that will be used to pay them.

119. Although the preceding proposals are similar, there may be a significant distinction between them regarding the retired life fund of an IPG contract. Although an IPG contract is an unallocated contract, the retired life fund could be viewed as having been effectively and permanently transferred to the insurance company (that is, the funds have been assigned) in return for the insurance company's agreement to provide certain benefits. Because no annuities are purchased while the contract is active, the funds are not physically transferred. However, because the plan is required to maintain the retired life fund at a level sufficient to purchase annuity contracts to provide the retired participants' remaining benefits, it could be argued that the insurance company has control of that fund.

120. Certain respondents favored including in plan assets all contracts with insurance

companies. Some expressed the view that all contracts represent plan assets and to exclude certain contracts would be inconsistent with the reporting of assets and liabilities by other types of entities. Others favor such an approach because they believe the value of participation rights under allocated contracts should be included in plan assets. Presumably, those respondents believe that when a plan purchases a participating contract at a cost that is higher than that for a nonparticipating contract, it purchases an asset (the participation right) in exchange for the incremental cost because under either contract the insurance company is obligated to provide the same benefits. Presumably, subsequent values for the participation right can be determined, for example, upon cancellation of the contract. Thus, an asset with a determinable value (the participation right) seems to be created when the contract is purchased. A subsequent valuation of the participation right may be more or less objective depending on when it is made.

121. The initial Exposure Draft required that contracts included in plan assets be measured at fair value. Certain respondents preferred to measure those contracts at amounts determined by the insurance company in accordance with the terms of the contract. For purposes of this Statement, those values are referred to as **contract values**. Those respondents argued that, except for investments held in an insurance company's **separate account**, it is impossible for anyone other than the insurance company to determine a value for those contracts. They also argued that requiring a fair value approach for contracts under which the plan's investment is maintained in an insurance company's **general account** would necessitate extra calculations, whereas the information for determining contract values is readily available. Some respondents requested guidance as to how fair value should be determined for specific types of contracts, for example, IPG contracts and deposit administration contracts.

122. In view of certain respondents' comments, the Board solicited additional information from certain persons, including members of the project's task force and members of the insurance industry, before issuing the revised Exposure Draft. The issues raised were (a) what criteria should be used to determine the elements of contracts with insurance companies that constitute assets to be recognized in plan financial statements and (b) how to measure those elements that do constitute assets. Views regarding whether it was feasible to determine the value of participation rights were specifically requested. Some respondents indicated such valuation could be very difficult. Others indicated that it could be done.

Conclusions on Measuring Contracts with Insurance Companies

123. The initial Exposure Draft's requirements regarding contracts with insurance companies were changed to require that those contracts be presented in the same manner as that contained in the annual report filed by the plan with certain governmental agencies pursuant to ERISA. A plan not subject to ERISA is required to similarly present its contracts, that is, as if it were subject to the reporting requirements of ERISA. For 1979 plan years, the pertinent governmental reporting requirements relate to item 13 of either Form 5500 or Form 5500-C. Essentially, allocated contracts are excluded from, and unallocated contracts are included in, plan assets.

124. The Board believes that certain aspects of contracts with insurance companies might be appropriately accounted for in a manner different from the regulatory reporting requirements. For example, the applicable instructions for the 1979 Form 5500 and Form 5500-C appear to result in the inclusion of retired life funds under IPG contracts as plan assets and the exclusion of participation rights from plan assets. As discussed in paragraphs 119 and 120, it *may* be conceptually more appropriate to exclude retired life funds and include participation rights. Further, Form 5500 and Form 5500-C permit unallocated contracts recognized as plan assets to be measured at either fair value or at amounts determined by the insurance company (that is, contract value). The Board recognizes that presenting contracts with insurance companies at contract value is inconsistent with requiring all other plan investments to be presented at fair value. However, as previously discussed, the information required for determining contract value is readily available, whereas a fair value approach would necessitate extra calculations that, according to information the Board received (paragraph 122), might be extremely complex. The Board concluded that it did not have sufficient information at this time to enable it to reach definitive conclusions concerning matters such as the recognition of retired life funds and participation rights as plan assets and the feasibility of determining a contract's fair value. Moreover, obtaining the information considered necessary to properly assess both the conceptual and the cost/benefit considerations involved would unduly delay the issuance of this Statement. During the Board's deliberations, it was noted that the PBGC and the IRS had proposed certain regulations.[32] Before reaching definitive conclusions, it was thought advisable to consider any final regulations relating to contracts with insurance companies. For the present, the Board concluded that it should adopt the practical solution stated in paragraph 123.

125. Certain respondents to the revised Exposure Draft objected to inclusion of a reference to governmental reporting requirements in a Statement of Financial Accounting Standards and suggested that the pertinent instructions to Form 5500 be incorporated into this Statement. Because the Board has not concluded that those instructions contain the conceptually appropriate treatment of contracts with insurance companies, it rejected that suggestion.

126. Some respondents asked whether benefits to be provided by contracts excluded from plan assets should be excluded from the benefit information. Paragraph 18(d) provides an affirmative response to that query. As discussed in paragraph 118, the insurance company rather than the plan may be viewed as the principal obligor of such benefits. Nevertheless, the fact that contracts excluded from plan assets exist is considered useful information. Accordingly, the Board concluded that the plan's policy with regard to the purchase of excluded contracts should be disclosed. The Board believes that information together with the required disclosure of payments to insurance companies to purchase contracts that are excluded from plan assets (paragraph 15(g)) will adequately inform users that certain benefits will be provided by means of excluded contracts. To inform users that a plan has participation rights and that plan assets reflect dividend income but not the source of that income, the Board concluded that disclosure of the year's income that is related to excluded contracts should be required.

Assets Employed in Operations

127. Certain respondents who advocated use of fair value to measure investments also advocated measuring assets employed in operations at fair value. In their view, a consistent measurement basis should be used for all plan assets. They also noted that fair value is presently required in the financial data filed with governmental agencies pursuant to ERISA.

128. Other respondents favored using historical cost (adjusted for any depreciation or amortization). Some argued that measuring operating assets at historical cost and appropriately allocating that cost to each plan year is the appropriate manner for recognizing that portion of the administrative expenses incurred to provide benefits. Expenditures for operating assets are in the nature of advance payments for future administrative services; in that respect they differ from investments which are expected to generate future cash flows that will be used to provide benefits. Others noted that ERISA reporting requirements are not applicable to plans of state and local governmental units and that requiring fair value could increase their administrative costs.

129. The Board considered the foregoing views together with the objective of the financial statements and concluded that operating assets should be measured at historical cost less accumulated depreciation or amortization.

INFORMATION REGARDING ACTUARIAL PRESENT VALUE OF ACCUMULATED PLAN BENEFITS

The Need to Present Benefit Information

130. To be useful in assessing a plan's present and future ability to pay benefits when due, it is essential that the financial statements present information about both the net assets available for benefits and the benefits to be paid.

131. Some respondents opposed disclosure of any benefit information on the basis that it was outside the scope of financial statements. They asserted that the information is appropriately the province of the actuarial report. In their view, to include such information would at least duplicate information available elsewhere (the actuary's report) and might be confusing and misleading if it differed from amounts reported by the actuary.

132. Similarly, some respondents interpreted certain provisions of the Act to mean that any disclosure of benefits for an ERISA plan is an issue that should be resolved independently of the plan's financial statements. Some who expressed that view thought that excluding benefit information from the financial statements is preferable because it alleviates the possibility of conflicts between the responsibilities of auditors and those of actuaries in the certifications required by the Act.

133. The Board considered whether the need to involve members of the actuarial profession in the development of financial information should be a factor that constrains the content of

financial statements. From the project's inception, the Board has recognized the essential role of actuaries in developing any required benefit information. It undertook an extensive cooperative effort with the American Academy of Actuaries (*Academy*) to develop a basic method of determining benefit information that would be both meaningful and implementable. The Board appreciates the Academy's willingness to undertake that effort. The substantial agreement reached (discussed further in subsequent paragraphs of this appendix) should enhance the necessary ongoing cooperative effort among those who have a responsibility regarding the development or dissemination of plan financial information.

134. The Board believes that actuaries are best qualified to develop the benefit information required by this Statement because of their unique professional qualifications and their existing relationship with plans on other matters (for example, funding policy and measurement of pension costs). Although it acknowledges the role of the actuarial profession in developing certain financial information, the Board does not accept the notion that if the preparation of information does not fall within the professional qualifications of accountants, it is outside the scope of financial accounting. Certain financial information presently disclosed in financial statements of business enterprises is prepared exclusively by or with the assistance of professionals other than accountants. For example, the aggregate reserves for life, accident, and health policies of stock life insurance companies that appear in those entities' financial statements and measurements of pension costs in employers' financial statements are prepared by actuaries. The use of appraisers is common in establishing the value of nonmonetary assets acquired in a business combination accounted for as a purchase and may be necessary in conjunction with accounting for certain troubled debt restructurings. (With respect to plan reporting, paragraph 104 of this Statement recognizes that appraisers may be needed to determine the fair value of certain plan investments.) Information oriented to engineering and law may also enter into the preparation of financial accounting information. Thus, the Board rejected the view that the need, by itself, to involve actuaries should be a constraint on the content of financial statements.

135. The Board believes that unnecessary differences between the benefit information presented in plan financial statements and related information presented in schedules filed by ERISA plans pursuant to the Act could result in additional costs being incurred by preparers of the information and might also cause some confusion to those who use the information. Therefore, the Board worked closely with the Department of Labor (*Department*) in an attempt to avoid such unnecessary differences. As discussed further in subsequent paragraphs, that cooperative effort was successful in developing a basic method of determining benefit information that will satisfy both financial reporting requirements and Form 5500 reporting requirements.

136. The Board recognizes that there will be available other actuarial information concerning a plan that may differ from the benefit information in plan financial statements. The Board recognizes (and believes that both the Academy and the Department also recognize) that such differences are unavoidable when the information is intended to serve different purposes. For

example, information that is useful in assessing the plan's ability to pay benefits may not be the most useful for determining periodic cost measurements or establishing minimum funding requirements pursuant to ERISA. The Board acknowledges that care needs to be exercised in the presentation of financial accounting information to mitigate any confusion that might result from the presence of other information about the plan. If other information that is made available to users of plan financial statements is accompanied by appropriate disclosure of its nature and purpose, possible confusion on the part of certain users may be avoided.

137. The view expressed in paragraph 132 apparently reflects a concern that inclusion of benefit information will involve auditors in actuarial matters because of their examination of the plan's financial statements in accordance with generally accepted auditing standards. This Statement does not mandate auditor involvement in financial statements; matters relating to the attest function are not within the scope of the Board's authority. The Board recognizes, however, that both the auditing and actuarial professions have responsibilities under the Act and that their respective professional bodies have promulgated standards or recommendations regarding the conduct of their members. It is not within the Board's authority to attempt to resolve any issues relating to the relationship between those professions. The Board is aware of ongoing efforts by the interested parties to resolve certain such issues and is hopeful that those efforts will result in prompt solutions that are acceptable to all involved. The Board does not agree, however, that the proper manner of resolution is to omit from the financial statements information that is essential to users of those statements. Further, the Board does not believe that considerations relating to whether or by whom certain information should be audited are, of themselves, relevant to a determination of whether the information should be presented in financial statements. For example, Section 2520.103-8 of Department of Labor regulations provides that the auditor's examination need not include any statement or information regarding plan assets held by a bank or insurance carrier if the bank or insurance company is regulated, supervised, and subject to periodic examination by a state or federal agency and the bank or insurance company certifies to the correctness of the statement or information. In the absence of such regulations, it would be equally inappropriate to exclude information regarding those assets from plan financial statements to avoid attestation by an auditor.

Alternatives Considered for Determining Benefit Information

138. Having concluded that benefit information should be in the financial statements, the Board considered how that information should be determined. Respondents' recommendations can be broadly categorized as follows:

a. Some focused on benefit information that would represent those benefits to which employees would be entitled if they terminated their employment at the benefit information date. For present employees, the benefit information would include only that portion of the benefits accumulated under the plan's benefit accrual provision that is vested at that date.
b. Some focused on benefit information that would represent those benefits that are at risk at the benefit information date. The benefit information would include the benefits

accumulated by present employees under the plan's benefit accrual provision, without adjustment for future withdrawal. This method is independent of the plan's vesting provision.

c. Some focused on benefit information that would represent the benefits attributable to employees' service to the benefit information date. Respondents' recommendations for determining those benefits can be broadly categorized as follows:
   i. Some would include the benefits of present employees determined as in (a) above (vested benefits) plus that portion of present employees' accumulated plan benefits, determined in accordance with the benefit accrual provision, that is expected to become vested. Some proponents of this approach believe that the benefit information should differ from that determined in (b) above only in that future withdrawal should be recognized. Others would include some portion of certain types of benefits (for example, death and disability benefits) for which the plan does not clearly specify the amount attributable to each year of service.
   ii. Others would measure the benefits as some pro rata portion of the expected benefits to be received by present employees who retire or terminate in a vested status after the benefit information date. That pro rata portion would relate in some manner the service rendered to date with total service expected to be rendered.

d. Some focused on the amount that is assigned by the **actuarial cost method** to periods before the benefit information date.

139. Categories (a)-(c) above refer to present employees; there is little, if any, difference of opinion about how to determine the accumulated plan benefits of employees who have retired or terminated before reaching retirement age. Accordingly, paragraphs 140-168 primarily focus on determining the accumulated plan benefits of present employees. Those paragraphs elaborate on the preceding alternatives. They do not focus on other measurement factors, such as various assumptions (other than withdrawal) [33] used in determining the benefit information. Paragraphs 169-204 address that aspect of the measurement process.

Vested Benefits

140. Some respondents emphasized that only **vested benefit information** should be presented. Nonvested benefits are forfeitable if certain conditions (primarily age and length of service) are not met, whereas vested benefits are not. Thus, some believe that only vested benefit information could be properly presented as a plan liability. Some respondents to the initial Exposure Draft (which required presentation of information about both vested and nonvested benefits) believe that ERISA supports their view. Under ERISA the legal obligation of the plan upon plan termination cannot exceed vested benefits except to the extent that plan assets are available to provide benefits in excess of vested benefits.

141. Certain respondents to the Exposure Drafts expressed the view that participants would be confused and unduly alarmed by the fluctuations in the security for nonvested benefits that, in their view, are a likely result of the combination of the subordinate status of nonvested benefits

and the presentation of plan investments at fair value. However, others argued that employees do not expect any security until they have met the plan's vesting requirements. It was also suggested that presenting **nonvested benefit information** might affect management decisions about plan funding. Respondents who expressed the foregoing views believed that presenting only vested benefit information would avoid such perceived effects and is therefore preferable.

Benefits at Risk

142. Some respondents recommended that the benefit information represent potential claims of employees in the event of plan termination. A defined benefit pension plan normally contains a formula or schedule that specifies the rate at which employees accumulate their benefits. That benefit accrual provision is necessary primarily to determine the benefits attributable to service rendered by an employee who separates from service before retirement. In the view of some, that provision best defines the benefits that are at risk at any time. Because nonvested benefits become vested to the extent of available assets upon plan termination, they are considered equally at risk as vested benefits and therefore could be included in the benefit information under this approach. Because future service is not a factor in measuring benefits at risk, those who support this approach would not adjust the benefit information for future withdrawal. Some view this approach as providing benefit information that is most useful to participants because of its comparability with the computational basis used to prepare the individual statements of accrued benefits that participants in an ERISA plan are entitled to receive. In their view, reflecting future withdrawal would decrease the usefulness of the resulting benefit information. Supporters of this approach do not consider it inconsistent with the concept of an ongoing plan. Providing the specified benefit information is not the same as providing a measure of the benefits that would be paid assuming plan termination. Providing the latter measure would be consistent with the assumption that the plan had, in fact, terminated.

Benefits Attributable to Service Already Rendered

143. Some respondents recommended that the benefit information represent the benefits to which employees are entitled as a result of their service to the benefit information date. For purposes of this Statement, the two basic approaches to determining those benefits are referred to as (a) vested benefits and those accumulated plan benefits expected to become vested and (b) pro rata allocation of projected benefits.

Vested Benefits and Those Expected to Become Vested

144. Some respondents recommended that the benefit information include benefits presently vested plus that portion of employees' accumulated plan benefits at the benefit information date that is expected to become vested. Those holding this view object to presenting only vested benefit information because that information fails to recognize the benefits that may be reasonably expected to be paid for services already rendered. Adjusting the benefit information for future withdrawal is inherent in the notion of benefits expected to become vested. Thus, this approach differs in that respect from a benefits-at-risk approach. Some holding this view would

include in the benefit information a portion of certain nonvested benefits for which the plan does not clearly specify the amount attributable to each year of service, for example, death and disability benefits. The benefits-at-risk approach, on the other hand, would include such benefits only to the extent that employees presently have vested rights to them.

Pro Rata Allocation of Projected Benefits

145. Some respondents recommended that the benefit information be determined on the basis of the relationship between the total benefits expected to be ultimately paid to present employees and the service rendered in exchange for those benefits. Inherent in this view is the projection of future benefits determined in accordance with employees' projected future pay, service, or both. The relationship between projected benefits and service rendered can be determined by various methods. For purposes of this Statement, those methods are referred to as:

a. The benefit-compensation-correlation method
b. The cost-compensation-correlation method
c. The benefit-years of service-correlation method
d. The cost-years of service-correlation method.

Benefit-compensation-correlation method

146. One method of relating benefits to service is to relate the *benefits* (rather than the cost of such benefits) to compensation. Under that method, the percentage of (a) the actuarial present value at retirement date (or date of termination, if earlier) of the total estimated benefits to (b) the total estimated compensation to retirement (or termination, if earlier) is first determined for each employee.[34] That percentage is then applied to the employee's compensation each year to determine the *benefits* attributable to that year's service. The benefits so determined are then discounted to reflect the time value of money. The benefit information would be the aggregate of those discounted benefits attributable to all present employees' years of service to the benefit information date, increased for interest for the period from the year of service to the benefit information date.

Cost-compensation-correlation method

147. Under the method in which the cost of providing benefits (rather than the benefits) is correlated with compensation, a determination is made for each employee [35] of the percentage relationship of (a) the actuarial present value at retirement date (or date of termination, if earlier) of the total estimated benefits to (b) the total estimated compensation to retirement (or termination, if earlier) adjusted to reflect an interest factor from the period that service is rendered to that date. The resulting percentage is then applied to each year's compensation to allocate the employer's cost of providing benefits attributable, on the basis of compensation, to that year's service. This method results in each year's cost allocation remaining a constant percentage of each year's compensation. (That is not the case under the

benefit-compensation-correlation method.) The benefit information would be the aggregate cost of benefits attributable to all present employees' years of service to the benefit information date, increased for interest for the period from the year of service to the benefit information date.

Years of service-correlation methods

148. The years of service-correlation methods are basically the same as the compensation-correlation methods described in paragraphs 146 and 147 except for the basis of allocation. Similar to the benefit-compensation-correlation method, the benefit-years of service-correlation method allocates a constant percentage of total estimated benefits to each year of service and discounts that amount to reflect the time value of money. Likewise, the cost-years of service-correlation method allocates to each year of service a constant dollar cost for providing the estimated total benefits.

Actuarial Cost Methods

149. Actuarial cost methods are primarily used to determine annual pension cost estimates; those cost estimates may be used for determining the amount and incidence of employer contributions, establishing tax deductibility of the amounts funded, determining pension expense for recognition in the employer's financial statements, determining the minimum funding required by the Act, and possibly other purposes. The view discussed here is not whether the use of actuarial cost methods is appropriate for financial reporting by the employer but whether actuarial cost methods, in general, produce measures that are acceptable for determining the benefit information to be presented in plan financial statements.

150. Certain respondents recommended that determination of any benefit information be left to the discretion of the actuary and that all actuarial cost methods acceptable under the Act be acceptable for plan financial statement purposes. In their view, the actuary is best qualified by training to select the appropriate measure. Certain respondents to the Exposure Drafts (which rejected actuarial cost methods for determining the benefit information) objected to the cost of requiring a method for determining benefit information that might differ from the actuarial cost method. In their view, requiring plans to incur such costs for financial reporting purposes alone would be inappropriate. It was also suggested that the apparent comparability among plans achieved by the initial Exposure Draft's requirement for use of both a uniform basic method and uniform assumptions would be illusory because differences in plan provisions, characteristics of participants, and investment strategies would not be reflected. Other respondents thought use of the actuarial cost method used for funding purposes was appropriate because the resulting benefit information would be determined in the same way as employer contributions.

Conclusions on Determining Benefit Information

151. The Board concluded that the benefit information should include vested benefits plus employees' nonvested benefits expected to become vested as determined by the plan's benefit accrual provision using primarily employees' history of pay and service to the benefit

information date. Projected service should be a factor only in determining employees' expected eligibility for particular benefits such as those listed in paragraph 18(b). The actuarial present value of those benefits should then be determined using appropriate actuarial assumptions to reflect the time value of money (through discounts for interest) and the probability of payment (by means of decrements such as for death, disability, withdrawal, or retirement) between the benefit information date and the expected date of payment.

152. The benefit information required by the initial Exposure Draft was based entirely on employees' history of pay and service and other appropriate factors at the benefit information date. Therefore, benefits such as those listed in paragraph 18(b) were not included, except to the extent that employees' eligibility for them at the benefit information date was not dependent on future service. That method of determining benefit information was primarily based on the benefits-at-risk approach. A number of respondents expressed the view that that approach was not as useful in an assessment of benefit security on an ongoing plan basis as would be an approach that included estimated amounts for benefits such as those listed in paragraph 18(b) for all employees expected to receive such benefits, to the extent those benefits related to service already rendered. For reasons discussed in the following paragraphs, the Board agreed.

153. The Board believes that the benefit information should relate to the benefits reasonably expected to be paid in exchange for employees' service to the benefit information date. In the Board's view, vested benefits and nonvested benefits expected to become vested, determined primarily in accordance with the benefit accrual provision and employees' history of pay and service to the benefit information date, best represent the benefits attributable to service already rendered. For example, if a plan provides a benefit of 2 percent of final 5-year average salary per year of service, the accumulated pension benefit for an employee with 10 years of service would be 10 times 2 percent of the employee's average salary for the 5 years immediately preceding the benefit information date.

154. In the Board's view, future service should be considered only in determining employees' expected eligibility for certain benefits. The need to consider projected service for that purpose can be illustrated by assuming an employee [36] becomes eligible for a disability benefit in the 15th year of service pursuant to a plan that provides disability benefits when an active employee with 10 or more years of service becomes totally and permanently disabled. If projected disability in a future year of service is not considered during the first 14 years of service in determining that employee's expected eligibility for the disability benefit, the entire incremental actuarial present value of that benefit (that is, the excess, if any, over the actuarial present value of the normal retirement benefit previously recognized) is recognized in the 15th year of service, as if it were all attributable to that year of service. In the Board's view, the disability benefit should be related to the service rendered during the employee's entire career. A portion of the disability benefit should thus be attributed to each of the employee's 15 years of service. Similar illustrations could be developed for other types of benefits. For example, future service should be considered for determining an employee's expected eligibility for an early retirement benefit in order to appropriately relate that benefit to each year of service rendered; not doing so would

result in attributing the entire incremental actuarial present value of the early retirement benefit to years after the employee initially becomes eligible for an early retirement benefit.

155. In the Board's view, the approach discussed in paragraphs 153 and 154 results in a measure of accumulated plan benefits that is most useful in assessing the plan's present and future ability to pay, when due, the benefits to which employees will ultimately be entitled as a result of their service to the benefit information date. Therefore, the approach is consistent with the primary objective of plan financial statements.

156. For certain types of benefits, the amount attributable to each year of service cannot be directly determined from the plan's provisions. The manner in which such benefits should be considered to accumulate depends on whether the benefit is includable in vested benefits. To illustrate, assume a plan provides a supplemental early retirement benefit of $200 per month upon early retirement at age 55 with at least 25 years of service, payable from the date of early retirement until age 62 (the eligibility age for collecting Social Security benefits). If that benefit becomes a vested benefit after 25 years of service, it should be considered to accumulate in proportion to the ratio of the number of years of service completed to the benefit information date to the projected number of years of service that will have been completed when the benefit first becomes fully vested. Therefore, 1/25 of the $200 benefit (that is, $8) is attributed to each year of service (assuming the employee is expected to render at least 25 years of service).[37] In the case of a benefit that does not become a vested benefit (for example, a $5,000 death benefit that is payable only if death occurs during active service), the benefit should be considered to accumulate in proportion to the ratio of the number of years of service completed at the benefit information date to the number of years of service completed at the estimated time of separation from covered employment. For example, if the foregoing $5,000 death benefit is expected to be paid after the 20th year of service (that is, the employee is expected to die at the end of the 20th year of service), 1/20 of the benefit should be attributed to each year of service. Thus, after 5 years of service, the employee's accumulated death benefit is $1,250.[38]

157. Because the Board considered vested benefit information to be too restrictive of the benefits reasonably expected to be paid as a result of service rendered to the benefit information date, it rejected the views expressed in paragraphs 140 and 141. As further discussed in subsequent paragraphs regarding the location of benefit information, the Board concluded that it need not decide whether any part or all of the benefit information is a plan liability. Therefore, views regarding the liability nature of vested benefit information were not considered relevant.

158. The Board also did not find persuasive the views regarding perceived effects of presenting nonvested benefit information. If participants are properly educated in the use of financial statements (paragraph 50), the Board believes that they should not be confused or unduly alarmed if the portion of nonvested benefits that is covered by plan assets changes between periods. Further, information about such fluctuations, if they occur, is pertinent to an assessment of the plan's ability to pay benefits. (The Board also notes that the view that participants will be alarmed by information about such fluctuations in security for nonvested benefits and the view

that participants do not expect security for nonvested benefits appear somewhat contradictory.) Arguments similar to the views regarding perceived effects on funding decisions were discussed in paragraph 106. As stated in that paragraph, the Board does not believe that accounting standards should be designed to encourage or discourage an action by management.

159. The initial Exposure Draft's approach to determining benefit information was primarily a benefits-at-risk approach. For reasons discussed in preceding paragraphs, the Board concluded that the method required by this Statement would result in more useful benefit information for assessing benefit security on an ongoing plan basis. Further, the revised approach is believed to be consistent both with the views of the Department of Labor as reflected in the revised Schedule B, "Actuarial Information," of Form 5500 (footnote 41) and with the views of the American Academy of Actuaries as reflected in its Interpretation 2 (paragraph 80). That Interpretation was developed during the previously mentioned cooperative effort between the Board and the Academy. Paragraphs 17-20 essentially reiterate the recommendations contained in Interpretation 2 and also provide certain additional guidance to ensure that the resulting benefit information is relevant for financial reporting purposes.

160. The Board also rejected the pro rata allocation methods discussed in paragraphs 145-148. In the Board's view, benefit information intended to be useful in assessing the plan's ability to pay benefits attributable to service already rendered should be based primarily on pay already earned and service already rendered. One significant difference between the method adopted by the Board and the pro rata allocation methods relates to whether future salary increases are considered in measuring benefits attributable to service already rendered. Because that difference relates to the assumptions to be considered in determining the benefit information, it is addressed in subsequent paragraphs that focus on that aspect of the measurement process.

161. The Board recognizes that financial accounting measures are rarely exact and that the uncertainty that surrounds economic activities often requires use of approximations or predictions of various amounts and judgment about their inclusion and disclosure in financial statements. The foregoing is particularly true in determining benefit information. However, because the method it adopted does not necessitate subjective assumptions about future salary increases, the Board believes that method results in benefit information that is more objective and verifiable than the benefit information that results from the pro rata allocation methods.

162. It was also apparent from the responses of certain supporters of the pro rata allocation methods that their views were significantly affected by the view that there should be symmetry in the accounting by the employer(s) and the plan regarding the measure of *earned* benefits.

163. The Board considered and rejected the view that symmetrical reporting should be a necessary factor in selecting the method for determining benefit information for purposes of plan reporting. The information that is useful in assessing the plan's ability to pay benefits may differ from the information that would best serve the objectives of accounting by employers for pensions. The Board will consider those objectives in another project.[39] Further, those who

support symmetrical reporting are presumably influenced by the view that if benefit information is presented as a liability in the financial statements of both the employer(s) and the plan, the liability should be determined in the same manner by both parties. Because the Board concluded that the benefit information need not be presented as a plan liability (paragraph 231), the issue of symmetry may not be pertinent even though some amount may appear as a liability in financial statements of the employer(s).

164. The Board rejected the two cost-correlation methods for an additional reason. Those methods focus solely on the principle of income statement cost-allocation rather than on attributing *benefits* to service rendered. Therefore, the Board does not believe that the measures that are by-products of those methods provide information useful in achieving the primary objective of plan financial statements.

165. For similar reasons, the Board rejected use of actuarial cost methods. APB Opinion No. 8, *Accounting for the Cost of Pension Plans*, recognizes several actuarial cost methods as acceptable for determining employers' costs. Likewise, a number of actuarial cost methods are recognized by ERISA as acceptable for funding purposes. Each of those methods is designed to allocate the expected ultimate cost of the plan to particular time periods. (The pro rata allocation methods discussed in preceding paragraphs are, in effect, applications of allocation approaches employed under certain actuarial cost methods.) The portion allocated to periods before a valuation date, formerly identified as *prior service costs*, the *accrued liability*, or *prior service liability*, but now described as the **supplemental actuarial value**,[40] will vary widely from method to method. Although that variation may be appropriate for funding purposes, the Board considers it inappropriate for plan financial reporting. The Board has previously considered the question of accounting alternatives and has concluded that using different accounting methods for the same types of facts and circumstances impairs the comparability of financial statements and thus significantly detracts from their usefulness. Use of actuarial cost methods for determining the benefit information could result in two plans with essentially the same benefit provisions, participant populations, etc., reporting widely differing benefit information because different actuarial cost methods were used. Further, the Board does not believe that differences in factors such as benefit provisions, participant populations, and investment policies constitute different facts and circumstances that justify use of a different basic method for determining the benefit information. Differences in such factors are appropriately accommodated by the method adopted by the Board. For example, that method requires that employees' accumulated plan benefits be determined in accordance with the individual plan's benefit provisions. Differences in factors such as rates of disability, withdrawal, or mortality and differences in investment policies are reflected in the selection of assumptions that reflect the best estimate of the plan's expected experience with respect to those factors.

166. The Board also rejected the view that using the actuarial cost method used for determining employer contributions would result in an appropriate comparison of net asset and benefit information. Determination of benefit information in accordance with the actuarial cost method used for funding purposes might produce a measure that would be useful in assessing the

progress of the funding program relative to the actuarial cost method. However, because most actuarial cost methods are not designed to attribute benefits to service rendered, such an approach would not, in most cases, produce benefit information that would be useful in achieving the primary objective of plan financial statements. Further, that view taken to its logical conclusion would mean that no benefit information would be presented by an unfunded plan.

167. The Board's conclusions with respect to the appropriate method of determining the benefit information are based solely on plan accounting considerations. It recognizes that other methods, including actuarial cost methods and specifically the cost-correlation methods discussed above, are widely used by actuaries in establishing pension funding programs; the Board is not concerned with, nor does it question, their appropriateness for that purpose.

168. In rejecting the use of actuarial cost methods, the Board is not rejecting the use of actuarial expertise in determining the benefit information. On the contrary, the Board recognizes that it is critical to the measurement process.

Assumptions Used in Determining Benefit Information

169. The following paragraphs discuss the Board's conclusions regarding the more significant assumptions that may be used in determining the actuarial present value of accumulated plan benefits.

Future Salary Increases

170. As previously indicated, some believe that an assumption regarding present employees' future salary increases should be considered in measuring benefits attributable to service already rendered (at least when benefits are stated in terms of future salary as, for example, in a final-pay plan).[41] In rejecting that view, some Board members gave greater weight to some factors than to others.

171. Certain Board members believe that benefits attributable to future salary increases should not be considered "earned" until the related compensation is earned. That view holds that the total increase in an employee's accumulated plan benefit attributable to compensation earned in a given year of service is properly considered to have been earned in that year, not in an earlier year.

172. Certain Board members also believe that future salary increases are not unlike certain other future price changes, the accounting effects of which are recognized in the periods in which the price changes occur. Future salary increases may be related to employees' future productivity levels, as well as to changes in wage levels (either as a result of general price changes or changes in the factors of supply and demand). This view considers it inappropriate to reflect salary increases due to either changing levels of productivity or changes in the exchange prices for constant levels of productivity until the economic conditions giving rise to those

changes are also present. However, this view distinguishes those prices to be paid in exchange for future service and future price increases that will affect the exchange prices for past service. Thus, this view does not consider it inconsistent to reflect automatic cost-of-living adjustments (which affect the price paid for past service) and not reflect future salary increases (which are prices paid for future service). (The Board's conclusions regarding automatic cost-of-living adjustments are discussed in paragraphs 176-178.)

173. The American Academy of Actuaries' position in its Interpretation 2 was an additional factor that influenced certain Board members' conclusions. For both conceptual and practical reasons, the Academy opposes considering future salary increases. Because of the actuary's important role in developing the benefit information, those Board members gave particular weight to the Academy's views. As a result of not considering future salary increases, the Board's and the Academy's views on the basic method for determining employees' accumulated plan benefits appear to be substantially the same. Therefore, those Board members believe that not considering future salary increases will not only result in benefit information that is meaningful for an assessment of benefit security but will also enhance the necessary ongoing cooperative relationship among those who have a responsibility regarding the development or dissemination of plan financial information.

174. To a lesser degree, some Board members are concerned about certain implementation problems that might arise were it necessary to consider both past and future salary in determining the benefits attributable to service already rendered. Such potential problems include the availability of historical salary information needed to apply to a compensation-allocation basis and the possible need to develop detailed guidelines for applying that allocation basis for various types of benefit formulas and fact situations.

175. Certain respondents to the Exposure Drafts linked the propriety of considering future salary increases with funding considerations. For example, the view was expressed that not considering future salary increases for a public plan would be inconsistent with assumptions used for funding purposes and might therefore influence the decisions of those responsible for allocating public funds to the plan. As previously stated, the Board's conclusions are based solely on plan accounting considerations. The benefit information presented in plan financial statements is intended to be useful in assessing benefit security. Other measurement methods may be more useful for determining periodic funding requirements. Further, as previously discussed, the Board does not consider it appropriate to establish accounting and reporting standards based on the perceived effects on management decisions. Regarding future salary increases, certain Board members consider it appropriate to note that the concept of long-term funding requirements should not be confused with the concept of benefits accumulated by employees. The former may require projections based on all relevant future factors, including future salary increases. The latter, however, carries with it a notion of "what has occurred to date" to determine the benefits attributable to service rendered to date.

Automatic Cost-of-Living Adjustments

176. Unlike future salary increases, automatic benefit increases specified by the plan, such as automatic cost-of-living adjustments, may be appropriately considered a part of the benefits exchanged for employee service already rendered. The propriety of that view can be illustrated with an example of a plan that provides that a retiree's monthly benefit will be increased on each January 1 by the percentage increase reflected in the change in the Consumer Price Index from the preceding January 1, up to a maximum increase of three percent in a single year. Recognizing amounts payable to a retiree pursuant to that plan provision only as benefits are increased would result in attributing the effect of the cost-of-living adjustment to periods after the employee's retirement, that is, *after* all service had been rendered. The Board considers that result inappropriate. The effects of automatic cost-of-living adjustments should be attributed in an appropriate manner to each year during which an employee renders service.

177. The initial Exposure Draft proscribed recognizing automatic cost-of-living adjustments in determining the benefit information. Some respondents expressed the view that exclusion of such amounts was inappropriate for purposes of providing information useful in assessing benefit security on an ongoing plan basis. As indicated in the preceding paragraph, the Board agreed.

178. This Statement requires that assumed rates of inflation used in measuring benefits attributable to automatic cost-of-living adjustments be consistent with those inherent in assumed rates of return (that is, interest rates). (Paragraphs 187-197 address the Board's conclusion regarding assumed rates of return.) Interest rates are generally perceived as comprising several factors, including a factor to compensate the lender for expected inflation during the life of the loan. The assumed rates of return required by this Statement relate to the periods for which payment of benefits is deferred and therefore encompass the periods on which automatic cost-of-living adjustments are based. Thus, the inflation assumptions for such periods used to reflect automatic cost-of-living adjustments should be consistent with the inflation assumptions inherent in the assumed rates of return for those periods. If an automatic cost-of-living adjustment is subject to a maximum annual percentage increase (sometimes referred to as a "cap"), the assumed rate of benefit increase may differ from the assumed rate of inflation. For example, in the illustration discussed in paragraph 176, which has a three percent "cap," the assumed annual rate of benefit increase would not exceed three percent regardless of the assumed rate of inflation.

Social Security Payments

179. Certain plans integrate pension benefits with payments provided under the federal Social Security program. That integration may take a variety of forms. Whatever the form, certain provisions of the Social Security law are used in determining the benefit information. Therefore, an issue arises regarding whether the benefit information should reflect (a) the Social Security provisions in effect at the benefit information date, (b) the provisions of the present Social Security law scheduled to be in effect at employees' assumed dates of retirement or other

termination, or (c) the provisions of possible amendments to the Social Security law in effect at employees' assumed dates of retirement or other termination. This Statement requires that Social Security provisions in effect at the benefit information date be used ((a) above). Because both levels of Social Security payments and taxable wage bases are related to employees' salary, the Board concluded that use of presently effective provisions of the Social Security law is consistent with use of historical salary information.

Certain Assumptions Relating to the Probability and Timing of Benefit Payments

180. Among the more significant assumptions relating to whether and when benefits will initially become payable and for how long they will be paid are (a) pre- and post-retirement mortality, (b) withdrawal, (c) disability, and (d) ages at which employees will retire.

Mortality

181. Pension benefits are not paid unless employees live to retirement, and they cease upon death unless there is a co-annuitant, as in the case of a joint and survivor option. Therefore, accumulated plan benefits should be adjusted to reflect participants' longevity. If a plan provides death benefits, those benefits should also be reflected in the benefit information.

182. The initial Exposure Draft required that certain plans use the mortality and interest rates prescribed by the PBGC to value benefits upon plan termination. Because most respondents' comments focused on PBGC interest rates rather than mortality rates, their use is discussed in that context (paragraphs 188 and 189).

Withdrawal

183. For reasons other than death or disability (which are addressed in paragraphs 181 and 185, respectively), employees may cease rendering service. If they do so before their pension benefits become fully vested, some or all of those benefits (depending on the plan's vesting provision) are forfeited. For multiemployer plans, withdrawal includes termination of service resulting from withdrawal of a participating employer from the plan. For reasons discussed in paragraph 142, the initial Exposure Draft proscribed adjusting the benefit information for those benefits that may be so forfeited in the future.

184. Although not necessarily disagreeing on a conceptual basis with the views stated in that Exposure Draft about the relationship between future withdrawal and benefits at risk, certain respondents nevertheless felt that nonrecognition of future withdrawal overstated the benefits reasonably expected to become payable. The Board agreed. It also believes that consideration of future withdrawal is consistent with consideration of future service in determining employees' expected eligibility for increased benefits (paragraph 154).

Disability

185. Certain plans provide disability benefits. Because it primarily focused on a benefits-at-risk approach, the initial Exposure Draft required that the benefit information exclude those benefits expected to become payable if an employee became disabled while in service. Some respondents thought excluding such benefits understated the benefits reasonably expected to become payable as a result of service already rendered. As previously indicated, the Board agreed.

Early Retirement

186. Certain plans provide that an employee may retire early, subject to the attainment of a specified age, typically 55. Additional conditions may also be imposed. As previously discussed, the Board concluded that the benefit information should reflect the estimated early retirement benefits to be paid to those employees expected to become eligible for and to elect early retirement. The initial Exposure Draft's requirements and respondents' comments regarding early retirement benefits were similar to those regarding disability benefits. In addition, a few respondents asked whether rates of early retirement should be assumed based on an ongoing or a terminating plan. This Statement requires that all assumptions be consistent with an ongoing plan.

Rates of Return

187. To be of use in assessing benefit security, the net asset and benefit information must be determined on a comparable basis. Therefore, accumulated plan benefits must be discounted to reflect the time value of money in order for the benefit information to be on a basis comparable to the net asset information, which is stated in terms of present dollars. Few, if any, respondents who advocated presenting benefit information in the financial statements disagreed. To increase the comparability of the net asset and benefit information, this Statement requires that assumed rates of return used to discount the accumulated plan benefits reflect the expected rates of return on plan investments applicable to the periods for which payment of benefits is deferred.

188. A principal factor behind the initial Exposure Draft's requirement that certain plans use PBGC interest (and mortality) rates to determine the benefit information was that the initial interest rates used by the PBGC were derived from annuity price data obtained from the private insurance industry. PBGC rates therefore represented currently available interest rates, and their use resulted in benefit information that was comparable with the net asset information. Certain respondents objected to the use of PBGC rates. They viewed those rates as relating to a "guaranty" basis rather than a "best estimate" basis and thus unduly conservative for an ongoing plan. The view was also expressed that requiring the use of the same interest and mortality rates by a wide divergency of plans was inappropriate. Questions also were raised about the feasibility of mandatory use of PBGC rates; those questions primarily related to the timeliness of their availability.

189. Because of (a) inherent differences among plans as to investment policies and participants'

longevity and (b) questions about the appropriateness of using PBGC rates (that is, the view that their use implies plan termination), the Board concluded that requiring use of assumptions that reflect the plan's expected experience would result in more appropriate benefit information than would requiring the use of PBGC interest and mortality rates.

190. The determination of assumed rates of return for most plans is, to a significant degree, a matter of judgment. Thus, various factors should be considered in estimating rates of return to be used in determining the actuarial present value of accumulated plan benefits. Among them are (a) rates of return expected from investments currently held or available in the marketplace, (b) rates of return expected from the reinvestment of actual returns from those investments, and (c) the investment policy of the plan, including the diversity of investments currently held and expected to be held in the future.

191. Accordingly, accumulated plan benefits will generally not be discounted solely at rates of return expected on existing investments, and changes in assumed rates of return will probably not equal the change during the reporting period in either short-term or long-term interest rates.[42] However, to the extent that assumed rates of return are affected by the rates of return expected from existing investments, this Statement requires that those expected rates be based on the values presented for those investments in the plan's financial statements. Further, the assumed rates of return at which accumulated plan benefits are discounted should be reconsidered in light of changes in the fair values of investments between one period and another.

192. Some believe that year-to-year changes in reported benefit information as a result of changes in assumed rates of return should be avoided to the maximum extent possible. In their view, some averaging technique should be used to smooth out potential year-to-year changes so that assumed rates of return are changed only when it is apparent that the long-term trend has changed. The Board recognizes that long-term rates of return must be considered in determining appropriate assumed rates of return. However, it rejects the view that apparent material changes in long-term rates should be ignored on an annual basis solely to avoid annually adjusting assumed rates of return. Over a period of years, plan financial statements may display a trend of assumed rates of return. However, the Board believes that an assessment of that trend should be based on information determined in a neutral manner rather than on information that is biased so as to produce a presumed trend.

193. Some who object to potential year-to-year changes in assumed rates of return are apparently influenced by funding considerations. An approach to selecting assumed rates of return designed to avoid changing the size of annual contributions may be appropriate for funding purposes. However, the Board does not believe that such a smoothing approach is appropriate for purposes of determining the benefit information to be presented in plan financial statements. As discussed in paragraph 187, determining the benefit and net asset information on a consistent basis is necessary for an appropriate assessment of benefit security. Therefore, to employ a smoothing approach to determining assumed rates of return would require employing a

similar approach (for example, certain actuarial asset valuation methods) to determining the values at which investments are presented in plan financial statements. As discussed in paragraph 111, the Board rejected such asset valuation methods for purposes of plan financial statements.

194. Certain respondents to the revised Exposure Draft expressed the view that if it was inappropriate to recognize future salary increases in determining the accumulated plan benefits under plans whose benefit formulas include employees' compensation (for example, final-pay plans), it was equally inappropriate to discount those benefits at rates of return that inherently reflect anticipated future inflation. Those respondents would prefer to recognize future salary increases (at least the inflation component thereof) in determining employees' accumulated plan benefits. However, as a less preferable alternative, they suggested excluding any inflation component from the rates of return used to discount benefits.

195. As acknowledged by its supporters, excluding the inflation component from the assumed rates of return is essentially an attempt to compensate for the exclusion of future salary increases in determining accumulated plan benefits. For the reasons discussed in paragraphs 170-175, the Board rejected considering future salary increases in determining accumulated plan benefits. The Board rejected the suggested approach because it attempts to nullify that decision.

196. In the Board's view, the appropriate method of determining accumulated plan benefits and the selection of assumed rates of return at which to discount those benefits are separate issues. The purpose of the former is to determine the benefits attributable under a plan's benefit formula to the service employees have rendered. The latter, however, is designed to present the net asset and benefit information on comparable bases and is independent of the plan's benefit formula. That is, the purpose of the discounting process is the same regardless of a plan's benefit formula, for example, whether it is a final-pay or flat-benefit plan. Given the purpose of the discounting process, the Board believes the appropriate relationship is between the measurement bases for plan investments and assumed rates of return, not between the method of determining accumulated plan benefits and assumed rates of return. Rates of return on plan investments are economic factors related to the plan's existing investments and investment policy, not to its benefit formula. Further, to be consistent, the suggested approach might make it necessary to attempt to exclude the effects of future inflation from all factors [43] used in determining the actuarial present value of accumulated plan benefits, and perhaps also from the values of plan investments. The Board believes that such potential modifications, if adopted, would result in financial information that is less useful in achieving the primary objective of plan financial statements.

197. The suggested approach of discounting benefits at assumed rates of return that exclude future inflation seems inappropriate for additional reasons. For example, future salary increases are a factor only in determining nonvested benefits. Therefore, to achieve the result desired by its supporters (that is, to compensate for the nonrecognition of future salary increases), it would seem necessary to modify the approach so that it would affect only the determination of the

actuarial present value of nonvested benefits. Also, the period for which salary increases due to inflation might be a factor (that is, an employee's service period) is less than the period for which payment of benefits is deferred. Therefore, without certain modifications, the suggested approach would not result in the same total actuarial present value of accumulated plan benefits as that which would result from incorporating future salary increases into the measurement process. Modifications of the suggested approach that might be necessary for it to accomplish its intended purpose could be impractical to implement as well as difficult for users of plan financial statements to understand.

Administrative Expenses

198. Because administrative expenses are incurred when making benefit payments, those expenses should be considered in determining the benefit information. That is commonly done by reducing assumed rates of return by an appropriate factor. The initial Exposure Draft required use of that method. Certain respondents expressed the view that assigning anticipated administrative expenses to future periods and discounting them to the benefit information date should also be acceptable. Because the Board is not aware of any conceptual arguments supporting the preferability of either method and because the resulting benefit information should be the same, the Board concluded that both methods are acceptable. However, in similar circumstances, their use results in the disclosure (pursuant to paragraph 27(b)) of different rates of return. The Board therefore concluded that the adjustment of assumed rates of return should be disclosed if that method is used.

Explicit Approach

199. This Statement requires that each significant assumption used in determining the benefit information reflect the best estimate of the plan's future experience solely with respect to that assumption. That method of selecting assumptions is referred to as an *explicit approach*. An *implicit approach*, on the other hand, means that two or more assumptions do not individually represent the best estimate of the plan's future experience with respect to those assumptions. Rather, the aggregate effect of their combined use is presumed to be approximately the same as that of an explicit approach. The Board believes that an explicit approach results in more useful information regarding (a) components of the benefit information, (b) changes in the benefit information, and (c) the choice of significant assumptions used to determine the benefit information.

200. The following illustrates the preferability of an explicit approach as it relates to measuring components of the benefit information (that is, vested benefits of participants currently receiving payments, other vested benefits, and nonvested benefits). Under an implicit approach, it might be assumed that the net result of assuming no withdrawal before vesting and increasing assumed rates of return by a specified amount would approximate the same actuarial present value of total accumulated plan benefits as that which would result from using assumed rates of return and withdrawal rates determined by an explicit approach. Even if that were true, increasing assumed rates of return to compensate for withdrawal before vesting might significantly misstate

components of the benefit information. Withdrawal before vesting relates only to nonvested benefits. Therefore, discounting vested benefits at rates of return that have been adjusted to implicitly reflect that withdrawal understates that component of the benefit information and correspondingly overstates the nonvested benefit information.

201. The disadvantage of an implicit approach with respect to information regarding changes in the benefit information can be similarly illustrated. Assume that under an implicit approach, assumed rates of return are decreased to implicitly reflect the effects of a plan's provision for an automatic cost-of-living adjustment (*COLA*). In that situation, the effect of a plan amendment relating to the automatic COLA, for example, an amendment to increase the "cap" on the COLA from three percent to four percent, might be obscured. If significant, the effect of such an amendment should, pursuant to the requirements of this Statement, be disclosed as the effect of a plan amendment. If an implicit approach is used, however, assumed rates of return would be adjusted to reflect the effect of that amendment and accordingly, some part or all of the effect might be presented as the effect of a change in an actuarial assumption rather than as the effect of a plan amendment (particularly if assumed rates of return are also changed for other reasons).

202. In addition to the foregoing possible disadvantages, an implicit approach might result in less meaningful disclosure of the significant assumptions used to determine the benefit information. For example, disclosure of the assumed rates of return resulting from the implicit approaches described in paragraphs 200 and 201 could mislead users of the financial statements regarding the plan's investment return expectations and could result in noncomparable reporting for two plans with the same investment return expectations. Users might also draw erroneous conclusions about the relationship between the plan's actual and assumed rates of return.

Insurance Company Premium Rates

203. Paragraph 21 provides that in selecting certain assumptions, an acceptable alternative to the requirements in paragraph 20 is to use those assumptions that are inherent in the estimated cost at the benefit information date to obtain a contract with an insurance company to provide participants with their accumulated plan benefits. Those other assumptions that are necessary but are not inherent in that estimated cost should be selected pursuant to the requirements in paragraph 20. For plans below a certain size, that alternative may be preferable to selection of certain assumptions (for example, mortality rates) appropriate for the participant group because the validity of actuarial assumptions is dependent on the law of large numbers. It has also been suggested that use of insurance company premium rates might reduce for some plans the cost of implementing this Statement. Because the alternative approach results in benefit information that is useful in assessing benefit security and because it also appears desirable on a practical basis, the Board concluded that it should be allowed.

204. The revised Exposure Draft requested those plans that used or intended to use the alternative approach to comment about the difficulty of obtaining information about the significant assumptions inherent in premium rates. The few respondents who commented

expressed differing views regarding the difficulty of obtaining that information. It should be noted that paragraph 21 merely establishes an alternative; it does not require any plan to use that alternative. Because some plans apparently wish to use the alternative and expect to be able to obtain the necessary information, the insurance company premium rate approach has been retained.

Date of Required Benefit Information

205. The initial Exposure Draft required that the benefit information and net asset information be determined as of the same date. Thus, if the plan's annual financial statements were as of the end of the plan year, end-of-year benefit information was required. A number of respondents expressed the view that determination of end-of-year benefit information on a timely basis was not practical and would cause increased actuarial fees. They indicated that most actuarial valuations are performed during the year using data as of the beginning of the year. Changing that practice at this time might create significant timing problems in terms of scheduling the actuaries' workload and, in some cases, obtaining necessary end-of-year data.

206. Schedule B of Form 5500, as revised, requires that both net asset and benefit information be presented as of the beginning of the plan year. As originally proposed, the revised Schedule B would have required end-of-year benefit information. In response to that proposal, the Department received comments similar to those received by the Board in response to the initial Exposure Draft.

207. After considering the letters of comment on the initial Exposure Draft and certain of those received by the Department on the Schedule B proposal, the Board concluded that, at present, the perceived costs of requiring end-of-year benefit information may exceed the potential benefits of such information. Among the costs considered was the cost to ERISA plans of financial reporting requirements that would differ from Schedule B requirements. Therefore, this Statement provides for the presentation of benefit information as of either the beginning or end of the year. However, the Board continues to believe that presenting both net asset and benefit information as of the same date is necessary for a presentation of the financial status of the plan. Therefore, if the benefit information date is the beginning of the year, only the net asset and benefit information presented as of that date may be considered to present the financial status of the plan. In that situation, the year-end net asset information required by paragraph 6(a) is an incomplete presentation of the plan's financial status.

208. The Board considered allowing the benefit information date to be any date within the year. However, presentation of benefit information as of an interim date would necessitate presentation of net asset information, at least the aggregate amount thereof, as of that interim date if the financial statements were to be useful in assessing the plan's ability to pay benefits. The Board believes that (a) requiring net asset information as of an interim date might cause certain difficulties (for example, determining contributions receivable at that date) and could cause plans to incur additional expense (for example, determining fair values of investments

more often than annually) and (b) use of benefit information dates other than the beginning or end of the year is not a common practice. Accordingly, the Board decided not to permit interim benefit information dates.

209. The revised Exposure Draft encouraged respondents that used a benefit information date other than the beginning or end of the year to comment on whether disallowing interim benefit information dates would cause substantial problems. Follow-up discussions with most of those respondents who indicated that such action would cause them substantial problems revealed that the majority had interpreted the revised Exposure Draft as disallowing the roll-back to the beginning of the year of detailed employee data as of a date within the year. Paragraph 29 indicates that that method of approximating beginning-of-year benefit information is acceptable, provided the results obtained are substantially the same as those that would be determined using employee data as of the beginning of the year.

210. Although the Board decided not to require end-of-year benefit information, it considers presentation of such information to be a desirable goal. Plans are encouraged to develop procedures to enable them to use an end-of-year benefit information date. In that regard, paragraph 29 of this Statement provides, as did the Exposure Drafts, that detailed service-related data for individual employees as of a date preceding the end of the year may be projected to that latter date, provided the results obtained are substantially the same as those that would be determined using data as of the end of the year.

211. Because ERISA permits benefit valuations for funding purposes to be performed on a triennial rather than annual basis, certain respondents opposed requiring annual benefit valuations for financial reporting purposes. This Statement permits detailed service-related data for individual employees collected at an earlier date to be projected to the benefit information date. However, based on testimony by certain actuaries at hearings held by the Department of Labor regarding the proposed revision of Schedule B of Form 5500 (footnote 41), projecting beginning-of-year employee data to year-end would be difficult. Therefore, it is expected that only in unusual circumstances will projecting the data collected during a triennial valuation to a benefit information date in a subsequent year satisfy the criterion of providing results that are substantially the same as those that would be obtained using data as of that latter date. An example of such unusual circumstances might be a small plan with a stable participant population.

Minimum Required Display of Benefit Information

212. Unless all participants' benefits represent claims against plan assets of equal status and timing, any assessment of benefit security for an individual participant or group of similarly situated participants would be impaired to the extent it was based solely on the relationship between total net assets available for benefits and the actuarial present value of all accumulated plan benefits. (Paragraph 219 discusses required disclosure regarding the priority order of participants' claims to plan assets.) It seems reasonable to assume, however, that the benefits of

participants who are already receiving payments (*benefits in pay status*) will generally be paid sooner than will the benefits of present or terminated employees. In determining their respective actuarial present values, fewer subjective assumptions are required for benefits in pay status than are required for benefits not in pay status. For example, assumptions regarding when benefit payments will begin are required for the latter but not for the former. Thus, the actuarial present value of benefits in pay status is a more objective measurement. Similar relationships exist between other vested benefits and nonvested benefits.

213. Some respondents view vested and nonvested benefits differently. As previously indicated, some believe that only vested benefits are a plan liability. For an ERISA plan, nonvested benefits do not enter into the determination of an employer's contingent liability to the PBGC upon plan termination. That contingent liability relates to the value of PBGC-guaranteed benefits, and that value will probably differ from the vested benefit information presented in plan financial statements. Nevertheless, in the absence of more accurate information, some consider vested benefit information useful in assessing an employer's potential liability in the event of plan termination.

214. This Statement requires that the benefit information be segmented into at least the following categories:

a. Vested benefits of participants currently receiving payments
b. Other vested benefits
c. Nonvested benefits.

The Board concluded that such minimum segmentation would be useful in assessing a plan's near-term vs. long-range liquidity requirements. It might also provide some indication of the relative degree of objectivity or subjectivity inherent in determining the benefit information and would provide information needed by those who wish to make certain judgments or wish to compute certain financial ratios, for example, net asset information to vested benefit information. (Paragraph 221 discusses another ratio sometimes used.) Certain actuaries with whom the Board consulted indicated that the required segmentation could be provided at minimal cost.

215. The initial Exposure Draft required similar benefit segmentation. However, it also required further segmentation if that would provide information particularly useful in assessing the security for the benefits of a significant number of participants. That additional requirement was consistent with that Exposure Draft's focus on a benefits-at-risk approach and its requirement that certain plans use PBGC rates to determine the benefit information.

216. Only in the event of plan termination is the security for each participant's benefits actually determined. Should that event occur, the degree of risk that particular participants bear depends on their benefits' priority position in the allocation of plan assets. For most **noncontributory plans**, benefits in pay status generally have the highest priority, followed by other vested benefits and then nonvested benefits. (In contributory plans, benefits derived from participants'

contributions normally have the highest priority.) Additional priority positions may be specified within those broad classifications. In an ERISA plan, for example, vested benefits that are insured by the PBGC generally have a higher priority than do vested benefits that are not so insured.

217. The initial Exposure Draft recognized that, particularly for ERISA plans, segmenting the benefit information by plan termination priority class could be a complex procedure, and its intent was to require that procedure only in certain limited circumstances. Because termination priorities govern the allocation of plan assets upon plan termination, those priorities are an essential element in assessing benefit security. Further, when an ERISA plan terminates, PBGC rates are used to value participants' benefits for purposes of determining plan sufficiency and allocating the assets of an insufficient plan. Thus, for ERISA plans, that Exposure Draft's requirement for the use of PBGC rates would (when the further segmentation provisions applied) generally have allocated to each applicable termination priority category the same actuarial present value that would have been allocated to it if the plan had been terminated at the benefit information date.

218. Many respondents objected to the benefit segmentation requirements of the initial Exposure Draft. Some objected to the basic segmentation. However, most objections focused on the possible additional segmentation requirement. Reasons for those objections included (a) the complexity and expense of making the termination priority allocations pursuant to Section 4044 of ERISA, (b) the view that termination priorities are irrelevant for an ongoing plan, and (c) concern that employers might become reluctant to improve benefits because of the resulting disclosure of the effect that plan amendments have in reallocating available assets among various categories of benefits in the event of plan termination.

219. Because (a) this Statement places more emphasis than did the initial Exposure Draft on providing information useful in assessing future rather than immediate security and (b) the requirement for use of PBGC rates was deleted, the Board concluded that the further segmentation requirement should not be retained. If the benefit information for an ERISA plan is determined using other than PBGC rates, the amount allocated to a given termination priority category may differ significantly from the amount that would be allocated to that category in the event of plan termination. However, because the primary objective adopted by the Board encompasses both the present and future ability of the plan to pay benefits (that is, both immediate and future security) the Board does not agree that disclosure of termination priorities is irrelevant for an ongoing plan. Therefore, this Statement requires that plan financial statements include a brief, general description of the priority order of participants' claims to the assets of the plan upon plan termination. The Board concluded that such a description will serve to alert participants that a comparison of total net assets with the total actuarial present value of accumulated plan benefits (or with the three minimum required categories of benefit information) does not necessarily indicate which benefits would be covered by plan assets in the event of plan termination. However, the Board believes that unnecessary duplication of disclosures should be avoided. Therefore, if a description of termination priorities is otherwise

published and made available to participants, the required description may be omitted if both a reference to such other source and a statement such as that illustrated in footnote 16 are made.

220. For reasons similar to those in paragraph 106, respondents' views regarding perceived effects on employers' decisions were rejected. Even if they had been accepted, the Board believes that at least as strong a case might be made that disclosure of termination priorities is appropriate because both employers and participants should understand the effect of plan amendments on benefit security.

221. Certain respondents to the initial Exposure Draft indicated that disclosure of present employees' accumulated contributions (including interest, if any) would provide useful information. Terminating employees are generally entitled to return of their accumulated contributions (sometimes with interest). Therefore, regardless of their overall view on the accounting nature of the benefit information, some view present employees' accumulated contributions as a plan liability. Others consider present employees' accumulated contributions to be a contingent liability that should be disclosed. It has been suggested that the relationship between net assets and the sum of accumulated employee contributions (including interest, if any) and the actuarial present value of benefits in pay status provides a useful measure for assessing minimum funding adequacy. That is, some believe that net assets available for benefits should, at a minimum, be adequate to provide all benefits in pay status and to refund present employees' accumulated contributions. The recommended disclosure would also provide some indication of relative amounts of plan assets that originated from employee contributions. Based on the foregoing, the Board concluded that disclosure of present employees' accumulated contributions (including interest, if any) should be required. Because the rate of interest credited on employees' contributions may vary among plans, disclosure of that interest rate is also required. Because plans generally maintain records of employee contributions, the Board believes that the benefits of the required disclosure can be obtained at minimal incremental cost.

222. If some or all employee contributions have been used to purchase contracts with insurance companies that are excluded from plan assets, comparison of the total amount of present employees' accumulated contributions with plan assets might be misleading as an indication of relative amounts of plan assets that originated from employee contributions. Therefore, employee contributions that have been so used should be excluded when making the required disclosure. The revised Exposure Draft asked respondents that have used employee contributions in the manner described to comment on the feasibility of determining the amount to be excluded. Responses generally indicated that that determination would be feasible.

Alternatives Considered for Location of Benefit Information

223. Respondents suggested the following alternative locations for presenting benefit information: as a liability, as an equity interest, as supplemental disclosure, or as a combination of the foregoing.

224. Certain respondents contended that a liability should be recognized to the extent that

participants have legally enforceable rights to their benefits. They argued that generally accepted accounting principles require other accounting entities to recognize as liabilities those claims that are legally enforceable against them and that there is no reason to apply a different standard to pension plans. Other respondents advocated a liability presentation because they believed that, regardless of the legal relationship, benefits are an equitable obligation of the plan. In their view, participants earn their benefits as they perform services. Therefore, the financial statements should present as a liability those benefits considered earned by participants.

225. Certain respondents advocated presentation of benefit information as participants' equity in the net assets of the plan. Some did not believe that the benefit information satisfied present criteria for recognizing an accounting liability. Because they considered it necessary to display the measure in a prominent manner so users could focus on the relationship between the plan's resources and the benefits accumulated under the plan, they favored presentation of benefit information as an equity interest. Others considered that presentation appropriate because they view the relationship between the plan and its participants primarily as a fiduciary one. In their view, the plan's resources are held in trust for participants who have a beneficial interest in those resources.

226. Some respondents favored presenting benefit information in the notes to the financial statements. Others preferred a separate financial statement. For some, presenting the benefit information as either a liability or an equity interest limited the information to less than that considered necessary in assessing the plan's ability to pay benefits. Others did not view benefit information as satisfying the criteria for either a liability or an equity interest. Certain respondents who expressed that view nevertheless felt that the benefit and net asset information should be combined and presented in a single financial statement. Those respondents believed that the relationship between the net assets available for benefits and the actuarial present value of accumulated plan benefits should be made explicit.

227. Certain respondents advocated some combination of the foregoing. Generally, those recommendations were based on what was perceived to be (a) an appropriate measure of a liability for an ongoing plan and (b) information necessary in assessing benefit security. Thus, certain respondents advocated presenting vested benefit information as a liability in the basic financial statements and nonvested benefit information in the accompanying notes.

228. For reasons similar to those discussed in paragraphs 131 and 132, other respondents favored presenting the benefit information as supplemental information, that is, in a financial report but outside of the financial statements.

Conclusions on Location of Benefit Information

229. Certain Board members are not convinced that the benefit information required by this Statement satisfies the criteria for presentation as a liability *of the plan*. Employees render services *to the employer* in exchange for their benefits. Therefore, if any liability exists, it is

more likely that of the employer(s) rather than that of the plan.[44] Other Board members believe that the benefit information does represent a liability of the plan. Certain Board members believe that provided the benefit information is located in the financial statements, the primary objective is satisfied; that is, it is not necessary to resolve whether the benefit information constitutes a liability of the plan or the employer(s).

230. Although there is a fiduciary relationship between a plan and its participants, an equity presentation would have the disadvantage of limiting the net equity of participants to the plan's net assets available for benefits.

231. Notwithstanding the divergence of individual Board members' views regarding the accounting nature of the benefit information, the Board concluded that that issue need not be resolved at this time. As part of its ongoing effort to develop a conceptual framework for financial accounting and reporting, another project on the Board's agenda addresses the definitions of elements of financial statements.[45] If in the future it becomes necessary to readdress the accounting nature of the benefit information, that effort should be facilitated by the existence of a Statement of Financial Accounting Concepts that contains definitions of assets, liabilities, and equity interests. Because of its decision not to resolve the issue at this time, the Board concluded that this Statement should not restrict the location of the benefit information within the financial statements. However, because the primary objective of plan financial statements focuses on providing information useful in assessing the plan's ability to pay, when due, the aggregate benefits attributable to service already rendered, the Board concluded that the benefit information (that is, categories (a), (b), and (c) identified in paragraph 22) should be presented together. The Board believes that the usefulness of the financial statements in assessing benefit security might be impaired if the user had to extract portions of the benefit information from various locations. Further, those who favored a combination approach (paragraph 227) generally did so because of their views about the liability nature of certain components of the benefit information. Although it decided not to resolve the issue of whether some part or all of the benefit information is a plan liability, the Board considered it inappropriate to have differing views on that issue serve as a basis for allowing portions of the benefit information to be presented in different locations.

232. The Board decided not to restrict the location of the benefit information within the financial statements, but it did conclude that the benefit information should not be presented as supplemental information outside of the financial statements. To require presentation outside of the financial statements, the Board believes it would be necessary to conclude that no part of the benefit information is an essential element of plan financial statements, that is, that the benefit information, either in part or in total, is neither a liability of nor an equity interest in the plan. The Board did not reach that conclusion; rather, it decided that it was not necessary at this time to resolve the nature of the benefit information.

233. The Board has on its agenda a project to develop guidelines for determining where information that meets the objectives of financial reporting should be disclosed—either within or

outside of financial statements. In the absence of such guidelines, the Board compared the benefit information with the types of information that it has previously decided should be presented outside of financial statements (for example, the current cost and historical cost/constant dollar information required by FASB Statement No. 33, *Financial Reporting and Changing Prices*). It noted that other information permitted to be reported outside of financial statements was supplemental to the primary information about elements presented in an enterprise's financial statements (that is, the enterprise's assets, liabilities, owners' equity, revenues, expenses, etc.). Such supplemental information is not the only information about those elements that appears in the financial report of the enterprise. In the absence of that supplemental information, the information contained in the financial statements would still present the enterprise's financial condition and results of operations. An analogous situation does not exist with regard to the benefit information. The benefit information does not supplement other information about an element in a plan's financial statements. It is the only information required to be presented about the benefits attributable to the service rendered by employees—which information is necessary to present the plan's financial status and to achieve the primary objective of plan financial statements. The Board believes that distinction supports requiring the benefit information to be presented within the financial statements.

234. Some who favored reporting the benefit information outside of the financial statements expressed views similar to those discussed in paragraphs 131 and 132. That is, they thought the benefit information was appropriately the province of actuaries rather than accountants. Some also wished to exclude the benefit information from the scope of an independent accountant's audit. As discussed in paragraph 134, the Board does not accept the notion that if the preparation of financial information is not within the professional qualifications of accountants, it is outside the scope of financial statements. Further, inclusion of the benefit information within plan financial statements does not necessarily require it to be audited by an independent accountant. A plan administrator's assessment of various factors, including the needs of particular users of the plan's financial statements, may determine the extent of auditor involvement. For example, as allowed by ERISA regulations, some plan administrators are presently choosing to exclude certain plan investments from the scope of an audit (paragraph 137). The Board does not believe it is appropriate or necessary to exclude the benefit information from plan financial statements solely for the purpose of avoiding auditor involvement.

CHANGES IN NET ASSET AND BENEFIT INFORMATION

235. The information about a plan's ability to pay benefits when due that is provided by the plan's financial statements is affected whenever transactions and other events affect the net asset or benefit information presented in those statements. Normally, a plan's ability to pay participants' benefits does not remain constant. Therefore, users of the financial statements are concerned with assessing the plan's ability to pay participants' benefits not only as of a point in time but also on a continuing basis. To facilitate that latter assessment, users need to know whether perceived changes in the plan's ability to pay benefits result from changes in investment

performance, levels of contributions, improvements of benefits, changes in assumptions, or other factors. Further, as previously indicated, information regarding changes in the value of plan assets is essential in assessing stewardship responsibility. Accordingly, this Statement requires that plan financial statements include (a) a statement that contains information regarding changes during the year in the plan's net assets and (b) disclosure of the effects, if significant, of certain factors affecting the year-to-year change in the benefit information. Presenting information regarding both the changes in the net assets available for benefits and the changes in the actuarial present value of accumulated plan benefits for the same period is necessary to present the changes in the plan's financial status for that period. Therefore, if the benefit information date is the beginning of the year, this Statement requires that information regarding changes in the net asset information for the preceding year also be presented. In that situation, information regarding changes in the net asset information during the current year is an incomplete presentation of the changes in the plan's financial status during that year.

Changes in Net Asset Information

236. Information regarding changes in net assets available for benefits is to be presented in enough detail to identify the significant changes during the year. Paragraph 15 indicates particular items to be separately identified. The Board considered those items to be of such significance that they are required, to the extent applicable, for all plans. Paragraph 15 is not intended to limit the amount of detail or manner of presenting information regarding changes in the net asset information. Subclassifications and additional classifications may be useful. For example, separately reporting refunds of terminated employees' contributions may be useful. Alternatively, such refunds may be netted against contributions received from participants or included in benefits paid. The Board has not considered issues relating to detailed application of the general guidance provided in paragraph 15. Accordingly, plan administrators should use their best judgment in light of the relevant circumstances.

237. The initial Exposure Draft required separate disclosure of (a) the net change in the fair value of investments sold during the year and (b) the net change in the fair value of investments held at year-end. Some respondents suggested that combining those two amounts would provide a sufficiently informative measure of the change in the fair value of the plan's investments during the year and would avoid substantial detailed calculations. The Board agreed.

238. That Exposure Draft also required disclosure of the net gain or loss realized during the year on sales of investments. Some respondents expressed the view that disclosure of realized gains and losses is not relevant in a fair value reporting environment. The Board is not convinced that disclosing the net gain or loss realized on investments sold during the year would enhance an assessment of the plan's ability to pay benefits when due. The Board believes that the basic rationale for requiring a fair value reporting basis for plan investments (excluding contracts with insurance companies) does not support *requiring* disclosure of realized gains and losses. Such disclosure, however, is not proscribed.

239. To further assist users in understanding the changes in net assets during the year, this Statement requires disclosure of the net change in fair value for each significant class of investment, segregated between investments whose fair values have been measured by quoted prices in an active market and those whose fair values have been otherwise determined. The Board believes that information may be useful in assessing the relative degree of objectivity or subjectivity in measuring the plan's investments and the relationship thereof to investment performance during the year. Disclosure of the change in fair value for each significant class of investments provides useful information because different types of investments may perform differently and those differences may be assessed differently. For example, a decrease in the fair value of bonds during a period of rising interest rates may be assessed differently than a decrease or an increase in the fair value of equity securities during the same period.

Changes in Benefit Information

240. The initial Exposure Draft required that the effects of all significant factors affecting the year-to-year change in the benefit information be presented in a statement format. Although such presentation remains acceptable, that requirement has been modified to permit disclosure of only the significant effects of certain factors such as plan amendments and changes in actuarial assumptions. A number of respondents expressed concern about the perceived complexity and expense of developing the information required by the initial Exposure Draft. However, certain respondents and certain actuaries with whom the Board consulted, including representatives of the American Academy of Actuaries and the American Society of Pension Actuaries, agreed that disclosure of at least certain factors having significant effects is important in understanding the year-to-year change in the benefit information. The Board concluded that the minimum required disclosure specified in paragraph 25 would provide that information. The Board believes that each of those factors is distinct in nature. Therefore, their effects should be separately disclosed. The minimum required disclosure may be presented either in a statement format (with the addition of an unidentified "other" category to reconcile beginning and ending balances) or elsewhere in the financial statements.

241. The Board believes that identification of the significant effects of all factors affecting the year-to-year change in the benefit information provides additional information useful in understanding that change. Therefore, disclosure of the effects of the additional factors identified in paragraph 25 is encouraged. The items specified in paragraph 25 are not intended to be an exhaustive list of all factors that may affect the change in the benefit information during the year. If additional information regarding that change is presented, it need not be limited to nor include all other factors identified in paragraph 25.

242. Certain respondents expressed concern that disclosing the effects of plan amendments might affect union negotiations or result in pitting one group of participants against another, as in the case of a benefit increase for retirees that present employees believe decreases the security for their benefits. Similar arguments regarding perceived effects of accounting and reporting standards on the decisions of those responsible for managing plan assets, plan funding, or

deciding whether to amend the plan were addressed in preceding paragraphs (paragraphs 106, 158, and 220). The Board considers the reasons stated in those paragraphs for rejecting such arguments to be equally applicable to this concern.

243. Certain respondents to the Exposure Drafts suggested that the Board prescribe a uniform order for calculating the effects of individual factors on the change in the benefit information. They indicated that the effects of factors such as those enumerated in paragraph 25 are not all independent and that the order in which they are calculated will vary among plans. The Board recognizes that the determined effects of factors comprising the net change in the benefit information will vary depending on the order in which the effects are calculated. The Board solicited additional information from certain sources for use in considering the order in which the effects of individual factors should be determined; such information, however, was not forthcoming. Because the Board is not aware of any conceptual basis supporting a particular approach to determining the effects of individual factors, any prescribed order would be somewhat arbitrary. Thus, the Board concluded that at this time it would not prescribe an order.

FORMAT FOR PRESENTING FINANCIAL INFORMATION

244. The Board recognizes that divergent views exist about the appropriate format for presenting the net asset and benefit information (and changes therein) required by this Statement. Certain of those views have been previously discussed. In addition, many respondents to the Discussion Memorandum favored presenting net asset information in the format of a statement of net assets available for benefits because that is the statement that ERISA plans presently file with governmental agencies.

245. In view of the Board's conclusion not to restrict the location of benefit information in the financial statements, this Statement permits certain flexibility in presenting the benefit information and changes therein required by paragraphs 6(c) and 6(d). Net asset and benefit information may be presented with equal prominence but in separate financial statements, or benefit information may be presented in notes to a statement of net assets available for benefits. A statement that combines net asset and benefit information is also acceptable. Similar alternative methods of presenting information regarding changes in benefit information are permitted.

246. All financial information presented in a single financial statement is generally understood to be determined as of the same date or for the same period. For a comparison of two amounts or a deduction of one amount from the other to be valid, both amounts must be determined on a comparable basis. Therefore, this Statement permits a single statement that combines benefit and net asset information only if the benefit information is determined as of the same date as the net asset information. Likewise, a single statement that combines information regarding changes in the benefit and net asset information is permitted only if the respective change information is for the same period.

DISCLOSURES

247. The Board concluded that the financial statements should provide (a) information about the results of transactions and events that affect the net asset and benefit information and (b) other factors necessary for users to understand the information provided. Disclosure of underlying methods, assumptions, and estimates, including an indication of their objective/subjective nature, aids users in evaluating the information provided.

248. The Discussion Memorandum considered 4 broad areas of disclosure and within those areas 23 possible disclosures. A number were of the type required for business enterprises; others were specifically enumerated by ERISA as worthy of consideration for disclosure in financial statements filed pursuant to the Act. Opinion was divided among respondents who addressed the issue as to which specific disclosures should be required. The basis for the Board's conclusions regarding certain disclosures required by paragraphs 28(c) and 28(e) were previously discussed (paragraphs 219 and 126, respectively). The following paragraphs discuss the Board's conclusions with respect to other disclosure requirements. As indicated in paragraph 4, the financial accounting standards dealt with in this Statement are those of particular importance to pension plans or that differ from existing generally accepted accounting principles. Accordingly, this Statement does not address all disclosures required by generally accepted accounting principles for other types of entities that are also applicable to pension plans.

Plan Description

249. The Board concluded that a brief plan description could assist users, particularly nonparticipants, in understanding the financial statements. Of those who addressed the issue, many respondents favored that disclosure. Others were opposed because, for many plans, that information is available from other sources. The view was also expressed that it would be difficult to describe briefly but adequately the possibly numerous and complex provisions of a plan. The Board did not find those arguments persuasive. The Board believes that the usefulness of plan financial statements will be increased with a brief description of the plan and that, although there may be some difficulty in initially preparing that information, there should be little, if any, difficulty in presenting it in subsequent plan financial statements. Additionally, for plans not covered by ERISA, a summary plan description may not be readily available. However, the Board also believes that unnecessary duplication of disclosures should be avoided. Accordingly, the Board concluded that if a plan agreement or a description thereof providing the required information is otherwise published and made available, the plan description required by this Statement may be omitted provided reference to such other source is made.

Methods and Assumptions Used to Determine Fair Value of Investments and Reported Value of Contracts with Insurance Companies

250. This Statement requires that the plan's accounting policy disclosure include a description

of the methods and assumptions used to determine the fair value of investments and the reported value of contracts with insurance companies. Investments are normally the principal resource of a plan. Therefore, their measurement can significantly affect an assessment of the plan's ability to pay benefits when due. Most respondents who addressed the issue urged disclosure of the methods and assumptions used for measuring investments. The Board agreed.

Significant Investments

251. Some respondents to the initial Exposure Draft favored disclosure of significant investments. Presumably, they believe that such information is useful in assessing stewardship and investment performance and the degree of risk related to future changes in the fair value of a plan's investments. Because (a) certain securities' market prices may fluctuate more than others and (b) determination of the fair value of investments by means other than quoted prices in an active market may be subjective, the degree of risk related to changes in the fair value of a plan's investments may depend, to some extent, on the degree of diversification and the nature of a plan's investment portfolio.

252. Presumably, the more information that is disclosed about plan investments, the more useful are the financial statements in assessing the plan's ability to pay benefits when due. However, there is a cost associated with detailed disclosure. Therefore, this Statement requires only identification of significant investments, that is, those that represent five percent or more of the net assets available for benefits. Identification of other investments, however, is not proscribed. Because no more than 20 investments need be identified, the Board believes the incremental cost to provide the information will not be significant.

Cost Basis of Investments Presented at Fair Value

253. The initial Exposure Draft required that the historical cost of investments, at least for each significant category, be disclosed. A number of respondents urged deleting that requirement because, in their view, historical cost information is not relevant in a fair value reporting environment and does not provide information useful in assessing benefit security. Questions were raised regarding how to determine historical cost, including its application to bond swaps (paragraph 108). The Board is not convinced that knowledge of the historical cost of significant classes of plan investments would necessarily enhance a user's assessment of the plan's ability to pay benefits when due. Thus, it concluded that such disclosure should not be required. However, it is not proscribed. Given the Board's conclusion, it was not deemed necessary to resolve issues relating to determination of historical cost.

Transactions with Certain Related Parties

254. A number of respondents advocated disclosure of investments in, or transactions with, related parties—primarily the plan sponsor, the employer(s), and the employee organization(s). An investment in an employer is viewed as increasing the degree to which a plan's ability to pay participants' benefits depends on the financial condition of the employer. Accordingly, disclosure is considered necessary to allow financial statement users to evaluate the relative

significance of such investments. Because the sponsor, employer(s), and employee organization(s) may have close relationships with the plan, disclosure of transactions with those parties may provide information useful in assessing stewardship responsibility.

255. Because this Statement requires identification of investments that represent five percent or more of the net assets available for benefits, the Board concluded that it need not specifically require disclosure of investments in the employer(s). However, disclosure of other significant transactions with the employer(s), the sponsor (if not the employer), or the employee organization(s) is required.

Method and Assumptions Used to Determine the Benefit Information

256. The actuarial present value of accumulated plan benefits is an essential factor for assessing a plan's ability to pay benefits when due. Many users will be unaware of this Statement's requirements regarding how that amount is calculated. Therefore, the Board concluded that the usefulness of the financial statements would be enhanced by requiring disclosure of the method and significant assumptions used to determine the benefit information.

257. Numerous assumptions are used in determining the benefit information. A given percentage variation in certain of those assumptions may be expected to result in a greater percentage variation in the actuarial present value of accumulated plan benefits than would the same variation in other assumptions (that is, the benefit information is more sensitive with respect to certain assumptions than to others). The Board believes that users of financial statements should be aware of the degree to which financial information is affected by estimates and judgment. Accordingly, the Board believes that the usefulness of plan financial statements would be enhanced by disclosure of the estimated effect on the benefit information, or on the difference between the net asset information and the benefit information, of a given variation in the assumptions to which that information is most sensitive. Examples of such assumptions are assumed rates of return and, for plans that provide automatic cost-of-living adjustments, assumed inflation rates. However, the Board does not have sufficient information to assess the cost/benefit implications of *requiring* that disclosure. Therefore, at this time it is only encouraging plans to experiment with such disclosure.

Changes in the Plan, Methods of Measurement, or Assumptions

258. The requirement that plan financial statements include (a) a description of significant plan amendments made during the year ending on the latest benefit information date and (b) a description of significant changes in assumptions stems from the conclusion that the financial statements should include information about other factors necessary for users to understand the information provided. The Board believes that users' understanding of the significant effects of plan amendments and changes in actuarial assumptions will be enhanced if descriptions of those events are provided. In addition, users need to know what plan provisions serve as a basis for the benefit information. Accordingly, the Board concluded that if any significant amendments are adopted between the latest benefit information date and year-end, the financial statements

should indicate that the benefit information does not reflect those amendments.

259. Some respondents to the initial Exposure Draft opposed requiring a description of significant plan amendments because such information is included in the ERISA-required summary plan description. The Board recognizes that a supplement to the summary plan description concerning any "material modifications" to the plan must be provided to participants by 210 days after the end of the plan year during which the modification became effective. However, because of the potential significance of plan amendments to the year-to-year change in the actuarial present value of accumulated plan benefits and thus to an assessment of the plan's ability to pay benefits, the Board concluded that providing a brief description of the plan amendment in the notes is preferable to incorporating by reference that supplement to the summary plan description in the financial statements. Further, for plans not subject to ERISA, a description of the plan amendment may not be readily available elsewhere.

260. The Board concluded that disclosure of changes in methods or assumptions used to determine the net asset information should be in accordance with existing generally accepted accounting principles. For example, a change from contract value to fair value for measuring contracts with insurance companies should be viewed as a change in accounting principles pursuant to APB Opinion No. 20, *Accounting Changes*.

Funding Policy

261. Many respondents advocated disclosure of the funding policy. A primary purpose of funding is to enable a plan to pay benefits when due. Assessment of the plan's ability to pay benefits is therefore enhanced if information about the pattern of funding adopted by the employer(s) and, if applicable, participants and other sources is also disclosed. Accordingly, this Statement requires disclosure of the funding policy and any changes therein. Some respondents to the initial Exposure Draft suggested that the disclosure for ERISA plans indicate whether the minimum funding requirements of the Act have been met. The Board agreed that such information could be useful in assessing benefit security. Thus, that disclosure is required.

262. Certain respondents to that Exposure Draft suggested that the requirement for disclosure of the funding policy be more specific about the nature of the required information. For example, it was suggested that the actuarial cost method and the amortization period for the unfunded supplemental actuarial value be disclosed. Other respondents suggested that the funding policy be specifically related to the benefit information, to any existing difference between the net asset and benefit information, or to both. Although the Board believes it unlikely that a funding policy disclosure incorporating the technical name of the actuarial cost method and the amortization period for the unfunded supplemental actuarial value would be meaningful to most users, such disclosure is not proscribed. The Board believes that a brief description, in general terms and in layman's language, of how contributions are determined pursuant to the actuarial cost method would be more understandable and therefore more useful. Thus, the latter disclosure is considered preferable.

263. The Board agreed that information regarding the estimated future impact of the funding policy on an existing difference between the net asset and benefit information would be useful in assessing the plan's future ability to pay benefits. However, at this time, sufficient information to develop and evaluate specific requirements regarding that type of disclosure has not been received. Therefore, it is not required. However, the Board encourages plans to experiment with such disclosures.

Tax Status of the Plan

264. A principal reason for funding a pension plan through a qualified trust or contract with an insurance company is to avoid having participants or the plan pay current federal income taxes on employer contributions and the plan's investment earnings. Virtually all defined benefit pension plans are designed to qualify for exemption from income taxes. Failure to obtain, or to maintain, an exempt status could have a significant effect on a plan. Because of its significance, some respondents recommended that the tax status of the plan be disclosed in all cases. However, because (a) the vast majority of private defined benefit pension plans receive favorable letters of determination from the IRS as to their tax-exempt status, (b) it is the *lack* or *loss* of an exempt status that could have a significant effect on a plan's ability to pay benefits, and (c) the Board believes that disclosures required annually for all plans should be kept to a minimum, the Board concluded that disclosure of a plan's tax status should be required only if the plan has not received a favorable letter of determination, or if that letter has not been maintained. However, disclosure of the plan's tax status is not proscribed in other circumstances.

Description of Benefits Guaranteed by the PBGC

265. For plans that are subject to Title IV of ERISA, the guaranty of the PBGC provides an additional source of security for certain participants' benefits. Providing information about that guaranty enhances the usefulness of the financial statements in assessing benefit security. Accordingly, the Board concluded that ERISA plans should provide a brief description of the benefits guaranteed by the PBGC. Because coverage by the PBGC of increased benefits resulting from plan amendments is phased-in over a period of years, the Board also concluded that the description should include an indication of the application of the PBGC guaranty to any recent plan amendments. For the same reason as that stated in paragraph 219, if the required disclosure is otherwise published and made available, it may be omitted from the financial statements provided the statements make reference to such other source.

266. Some respondents favored placing more emphasis on the PBGC guaranty, and a few favored disclosure of quantified amounts of PBGC-guaranteed benefits. Others, however, contended that calculation of the benefits guaranteed by the PBGC would be administratively burdensome for an ongoing plan. The Board has not assessed the additional cost of measuring the benefits guaranteed by the PBGC, but has concluded that requiring that disclosure is not necessary to achieve the primary objective of plan financial statements.

Unusual or Infrequent Events

267. The benefit information presented in plan financial statements is intended to provide information as of a specific date, that is, the benefit information date. Measures of that information at subsequent dates will necessarily change as events (for example, service rendered) affect the measurement basis. This Statement does not contemplate disclosure of normal changes after the benefit information date, such as benefits attributable to service rendered after that date. However, the Board recognizes that an unusual or infrequent event or transaction that might significantly affect an assessment of the plan's ability to pay participants' benefits may occur after the latest benefit information date and therefore should be disclosed. For example, a plan amendment that significantly increases benefits for service rendered before the latest benefit information date should be disclosed. If reasonably determinable, the effects of such an event or transaction should be disclosed.

EFFECTIVE DATE AND TRANSITION

268. The effective date in paragraph 30 is one year later than that proposed in the revised Exposure Draft. ERISA plans with at least 100 participants are presently required to prepare benefit information for Form 5500 reporting purposes that is similar to that required by this Statement. The Board believes that many of those plans should be able to comply with this Statement in financial statements prepared for the 1980 plan year, and they are encouraged to do so. However, the Board recognizes that small plans and plans of state and local governmental units are not presently required to prepare the benefit information. Those that choose to issue financial statements in accordance with this Statement may need additional time to develop the necessary procedures. Accordingly, the Board concluded that the effective date specified in paragraph 30 is appropriate.

269. In the Board's view, the usefulness of the financial statements in assessing benefit security and changes therein over time will be enhanced by restating the financial statements of prior years if those prior years' statements are presented together with financial statements for plan years that are subject to this Statement. Accordingly, the Board concluded that retroactive application of this Statement is appropriate.

270. Certain respondents to the initial Exposure Draft expressed the view that restating the financial statements of prior years could be difficult and expensive and suggested that the requirement be eliminated. The Board believes that some respondents misinterpreted that Exposure Draft as *requiring presentation* of restated prior years' statements, rather than as requiring only that such statements be restated *if they are presented*. This Statement does *not* require presentation of the financial statements of prior years.

271. A few respondents to the Exposure Drafts suggested that information regarding changes in the net asset and benefit information not be required for the initial year of compliance with this Statement. Regarding changes in net asset information, the Board notes that ERISA plans presently file similar information with governmental agencies. For plans not subject to ERISA, it does not appear that initially providing that information should be that difficult. Because of

the Board's conclusions that (a) beginning-of-year benefit information is acceptable, (b) a statement of changes in benefit information that identifies the effects of all significant factors is not required, and (c) the Statement is not effective until the 1981 plan year, the Board concluded that there should be sufficient time to develop the required information regarding changes in the benefit information. Accordingly, the Board concluded that an exemption for the initial year of compliance should not be provided.

REDUCTIONS IN PERCEIVED COST OF IMPLEMENTING INITIAL EXPOSURE DRAFT

272. Many respondents to the initial Exposure Draft were concerned that compliance with its requirements would impose a substantial and inappropriate cost burden on plans. Those concerns primarily related to the required benefit information and the changes therein, although some concerns addressed other requirements, including the required net asset information and the changes therein. Certain of those concerns were apparently based at least partially on misinterpretations of the requirements. For example, some respondents apparently interpreted that Exposure Draft as requiring that annual financial statements for a plan, regardless of its size, be prepared, audited, and distributed to all participants. Others thought that restated financial statements for one or more prior years were required. This Statement does not require the preparation, attestation, or distribution of any financial statements. It is applicable only to financial information that purports to be in accordance with generally accepted accounting principles. Whether a plan prepares such information; who, if anyone, attests to that information, either in part or in total; and who receives that information are issues that are not within the scope of this Statement.

273. The Board recognizes that certain other concerns were not based on misinterpretations. The Board agrees that the benefits of providing financial information should be expected to exceed (or at least equal) the cost involved. A number of changes made to the initial Exposure Draft's requirements were directly related to the Board's desire to reduce the perceived implementation costs.

274. Most concerns about implementing the requirements regarding the net asset information and the changes therein related to (a) determination of the fair value of contracts with insurance companies and (b) segregating the net change in fair value of investments during the year into the net change in fair value of investments held at year-end and the net change in fair value of investments sold during the year. Those requirements have been deleted. This Statement permits contracts with an insurance company to be measured at amounts determined by the insurance company. It also provides for disclosing in a single amount the net change during the year in the fair value of investments.

275. Rather extensive changes were made to the initial Exposure Draft's requirements relating to benefit information and the changes therein. In response to concerns that determination of end-of-year benefit information would impose a substantial cost burden for many plans, this

Statement permits a benefit information date that is either the beginning or the end of the year. Because of the cooperative effort between the Board and the Department of Labor, it appears that the benefit information determined pursuant to this Statement should serve both financial reporting purposes and, for ERISA plans, Form 5500 reporting purposes. The Board's desire to avoid unnecessary differences between those requirements was a significant factor that influenced its conclusion regarding the benefit information date.

276. Another concern regarding the benefit information was the requirement that certain plans use PBGC interest and mortality rates in determining that information. Some viewed that requirement as creating timing problems and causing plans to incur additional costs. They indicated that issuance of PBGC rates has, in the past, generally been subject to a lag of several months. If those rates were not available when other aspects of the benefit information were determined, plans might incur additional costs when the determination process was completed at a later date. For that reason and others previously discussed, this Statement does not require use of PBGC rates.

277. Many respondents objected to the complexity and resulting expense relating to the initial Exposure Draft's requirement that the benefit information be segmented beyond certain categories if that would provide information particularly useful to a significant class of participants in their assessment of the security for their benefits. Although some objections were apparently based on a misinterpretation that such further segmentation would be required annually for all plans, that requirement has been deleted upon consideration of respondents' concerns and other reasons indicated in paragraph 219.

278. Many respondents contended that it would be complex and costly to comply with the initial Exposure Draft's requirement for a statement of changes in benefit information that identified the effects of all significant factors. As an alternative, this Statement permits disclosing only the significant effects of certain factors affecting the year-to-year change in the benefit information.

279. The Board believes that the changes discussed in the preceding paragraphs, on an individual and aggregate basis, should significantly reduce the perceived incremental costs that were of concern to respondents. The Board believes that the implementation of this Statement will have a favorable cost/benefit relationship. The Board recognizes that neither all benefits from nor all costs of financial information can be measured objectively; different persons may honestly disagree about whether the benefits of providing certain information justify the related costs.

Appendix C: GLOSSARY

280. This appendix defines certain terms, acronyms, and phrases used for convenience in this Statement.

Accumulated plan benefits

Benefits that are attributable under the provisions of a pension plan to employees' service rendered to the benefit information date.

Act

The Employee Retirement Income Security Act of 1974.

Actuarial asset value

A value assigned by an actuary to the assets of a plan generally for use in conjunction with an actuarial cost method.

Actuarial cost method

A recognized actuarial technique used for establishing the amount and incidence of employer contributions or accounting charges for pension cost under a pension plan.

Actuarial present value of accumulated plan benefits

The amount as of a benefit information date that results from applying actuarial assumptions to the benefit amounts determined pursuant to paragraphs 16-18 of this Statement (that is, the accumulated plan benefits), with the actuarial assumptions being used to adjust those amounts to reflect the time value of money (through discounts for interest) and the probability of payment (by means of decrements such as for death, disability, withdrawal, or retirement) between the benefit information date and the expected date of payment.

Allocated contract

A contract with an insurance company under which related payments to the insurance company are currently used to purchase immediate or deferred annuities for individual participants.

Benefit information

The actuarial present value of accumulated plan benefits.

Benefit information date

The date as of which the actuarial present value of accumulated plan benefits is presented.

Benefit security

The plan's present and future ability to pay benefits when due.

Benefits

Payments to which participants may be entitled under a pension plan, including pension benefits, disability benefits, death benefits, and benefits due on termination of employment.

Contract value

The value of an unallocated contract that is determined by the insurance company in accordance with the terms of the contract.

Contributory plan

A pension plan under which participants bear part of the cost.

Defined benefit pension plan

A pension plan that specifies a determinable pension benefit, usually based on factors such as age, years of service, and salary. Even though a plan may be funded pursuant to periodic agreements that specify a fixed rate of employer contributions (for example, a collectively bargained multiemployer plan), such a plan may nevertheless be a defined benefit pension plan as that term is used in this Statement. For example, if the plan prescribes a scale of benefits and experience indicates or it is expected that employer contributions are or will be periodically adjusted to enable such stated benefits to be maintained, this Statement considers such a plan to be a defined benefit pension plan. Further, a plan that is subject to ERISA and considered to be a defined benefit pension plan under the Act is a defined benefit pension plan for purposes of applying this Statement.

Employee

A person who has rendered or is presently rendering service.

ERISA

The Employee Retirement Income Security Act of 1974.

ERISA plan

A plan that is subject to ERISA.

Funding agency

An organization or individual, such as a specific corporate or individual trustee or an insurance company, that provides facilities for the accumulation of assets to be used for paying benefits under a pension plan; an organization, such as a specific life insurance company, that provides facilities for the purchase of such benefits.

Funding policy

The program regarding the amounts and timing of contributions by the employer(s), participants, and any other sources (for example, state subsidies or federal grants) to provide the benefits a pension plan specifies.

General account

An undivided fund maintained by an insurance company that commingles plan assets with other assets of the insurance company for investment purposes. That is, funds held by an insurance company that are not maintained in a separate account are in its general account.

Net asset information
Information regarding the net assets available for benefits.

Net assets available for benefits
The difference between a plan's assets and its liabilities. For purposes of this definition, a plan's liabilities do not include participants' accumulated plan benefits.

Noncontributory plan
A pension plan under which participants do not make contributions.

Nonvested benefit information
The actuarial present value of nonvested accumulated plan benefits.

Participant
Any employee or former employee, or any member or former member of a trade or other employee association, or the beneficiaries of those individuals, for whom there are accumulated plan benefits.

Participating contract
An allocated contract that provides for plan participation in the investment performance and experience (for example, mortality experience) of the insurance company.

Participation right
A plan's right under a participating contract to receive future dividends from the insurance company.

PBGC
The Pension Benefit Guaranty Corporation.

Pension benefits
Periodic (usually monthly) payments made to a person who has retired from employment.

Pension fund
The assets of a pension plan held by a funding agency.

Pension plan
See **defined benefit pension plan**.

Plan

See **defined benefit pension plan**.

Plan administrator

The person or group of persons responsible for the content and issuance of a plan's financial statements in much the same way that management is responsible for the content and issuance of a business enterprise's financial statements.

Prior service costs

See **supplemental actuarial value**.

Reporting date

The date as of which information regarding the net assets available for benefits is presented.

Retired life fund

That portion of the funds under an immediate participation guarantee contract that is designated as supporting benefit payments to current retirees.

Separate account

A special account established by an insurance company solely for the purpose of investing the assets of one or more plans. Funds in a separate account are not commingled with other assets of the insurance company for investment purposes.

Service

Periods of employment taken into consideration under a pension plan.

Sponsor

In the case of a pension plan established or maintained by a single employer, the employer; in the case of a plan established or maintained by an employee organization, the employee organization; in the case of a plan established or maintained jointly by two or more employers or by one or more employers and one or more employee organizations, the association, committee, joint board of trustees, or other group of representatives of the parties who have established or who maintain the pension plan.

Supplemental actuarial value

The amount assigned under the actuarial cost method in use to years before a given date.

Unallocated contract

A contract with an insurance company under which related payments to the insurance company are accumulated in an unallocated fund to be used to meet benefit payments when employees retire, either directly or through the purchase of annuities. Funds in an unallocated contract may also be withdrawn and otherwise invested.

Vested benefit information

The actuarial present value of vested accumulated plan benefits.

Vested benefits

Benefits that are not contingent on an employee's future service.

Appendix D: ILLUSTRATION OF FINANCIAL STATEMENTS

281. This appendix illustrates certain applications of the requirements of this Statement that are applicable for the 1981 annual financial statements of a hypothetical plan, the C&H Company Pension Plan. It does not illustrate other requirements of this Statement that might be applicable in circumstances other than those assumed for the C&H Company Pension Plan. The formats presented and the wording of accompanying notes are only illustrative and do not necessarily reflect a preference of the Board. Further, the circumstances assumed for the C&H Company Pension Plan are designed to facilitate illustration of many of this Statement's requirements. Therefore, the notes to the illustrative financial statements probably are more extensive than would be expected for a typical plan.

282. Included are illustrations of the following alternatives permitted by paragraphs 6, 8, 25, and 26:

a. An end-of-year vs. beginning-of-year benefit information date
b. Separate vs. combined statements for presenting information regarding (a) the net assets available for benefits and the actuarial present value of accumulated plan benefits and (b) changes in the net assets available for benefits and changes in the actuarial present value of accumulated plan benefits
c. A separate statement that reconciles the year-to-year change in the actuarial present value of accumulated plan benefits vs. presenting the effects of a change in actuarial assumptions on the face of the statement of accumulated plan benefits.

Although not illustrated, paragraph 8 of this Statement permits the information regarding the actuarial present value of accumulated plan benefits and changes therein to be presented as notes to the financial statements.

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I. Illustrations Assuming an End-of-Year Benefit Information Date

Exhibit D-4 Statement of Changes in Accumulated Plan Benefits
Exhibit D-5 Statement of Accumulated Plan Benefits and Net Assets Available for Benefits [An alternative for Exhibits D-1 and D-3]
Exhibit D-6 Statement of Changes in Accumulated Plan Benefits and Net Assets Available for Benefits [An alternative for Exhibits D-2 and D-4]

II. Illustrations Assuming a Beginning-of-Year Benefit Information Date

Exhibit D-7 Statement of Net Assets Available for Benefits
Exhibit D-8 Statement of Changes in Net Assets Available for Benefits
Exhibit D-9 Statement of Accumulated Plan Benefits

Exhibit D-1

C&H COMPANY PENSION PLAN
STATEMENT OF NET ASSETS AVAILABLE FOR BENEFITS

	December 31 1981
Assets	
Investments, at fair value (Notes B(1) and E)	
United States government securities	$ 350,000
Corporate bonds and debentures	3,500,000
Common stock	
C&H Company	690,000
Other	2,250,000
Mortgages	480,000
Real estate	270,000
	7,540,000
Deposit administration contract, at contract value (Notes B(1) and F)	1,000,000
Total investments	8,540,000
Receivables	
Employees' contributions	40,000
Securities sold	310,000
Accrued interest and dividends	77,000
	427,000
Cash	200,000
Total assets	9,167,000
Liabilities	
Accounts payable	70,000

Accrued expenses	85,000
Total liabilities	155,000
Net assets available for benefits	$9,012,000

The accompanying notes are an integral part of the financial statements.

Exhibit D-2

C&H COMPANY PENSION PLAN
STATEMENT OF CHANGES IN NET ASSETS AVAILABLE FOR BENEFITS

	Year Ended December 31, 1981
Investment income	
Net appreciation in fair value of investments (Note E)	$ 207,000
Interest	345,000
Dividends	130,000
Rents	55,000
	737,000
Less investment expenses	39,000
	698,000
Contributions (Note C)	
Employer	780,000
Employees	450,000
	1,230,000
Total additions	1,928,000
Benefits paid directly to participants	740,000
Purchases of annuity contracts (Note F)	257,000
	997,000
Administrative expenses	65,000
Total deductions	1,062,000
Net increase	866,000
Net assets available for benefits	
Beginning of year	8,146,000
End of year	$9,012,000

The accompanying notes are an integral part of the financial statements.

Exhibit D-3

C&H COMPANY PENSION PLAN
STATEMENT OF ACCUMULATED PLAN BENEFITS

December 31

	1981
Actuarial present value of accumulated plan benefits (Notes B(2) and C)	
Vested benefits	
Participants currently receiving payments	$ 3,040,000
Other participants	8,120,000
	11,160,000
Nonvested benefits	2,720,000
Total actuarial present value of accumulated plan benefits	$13,880,000

The accompanying notes are an integral part of the financial statements.

Exhibit D-4

C&H COMPANY PENSION PLAN
STATEMENT OF CHANGES IN ACCUMULATED PLAN BENEFITS

	Year Ended December 31 1981
Actuarial present value of accumulated plan benefits at beginning of year	$11,880,000
Increase (decrease) during the year attributable to:	
Plan amendment (Note G)	2,410,000
Change in actuarial assumptions (Note B(2))	(1,050,500)
Benefits accumulated	895,000
Increase for interest due to the decrease in the discount period (Note B(2))	742,500
Benefits paid	(997,000)
Net increase	2,000,000
Actuarial present value of accumulated plan benefits at end of year	$13,880,000

The accompanying notes are an integral part of the financial statements.

Exhibit D-5

C&H COMPANY PENSION PLAN
STATEMENT OF ACCUMULATED PLAN BENEFITS AND NET ASSETS AVAILABLE FOR BENEFITS
[An alternative for Exhibits D-1 and D-3]

	December 31 1981
Accumulated Plan Benefits (Notes B(2) and C)	
Actuarial present value of vested benefits	
Participants currently receiving payments	$ 3,040,000
Other participants	8,120,000

	11,160,000
Actuarial present value of nonvested benefits	2,720,000
Total actuarial present value of accumulated plan benefits	13,880,000
Net Assets Available for Benefits	
Investments, at fair value (Notes B(1) and E)	
United States government securities	350,000
Corporate bonds and debentures	3,500,000
Common stock	
C&H Company	690,000
Other	2,250,000
Mortgages	480,000
Real estate	270,000
	7,540,000
Deposit administration contract, at contract value (Notes B(1) and F)	1,000,000
Total investments	8,540,000
Receivables	
Employees' contributions	40,000
Securities sold	310,000
Accrued interest and dividends	77,000
	427,000
Cash	200,000
Total assets	9,167,000
Accounts payable	70,000
Accrued expenses	85,000
Total liabilities	155,000
Net assets available for benefits	9,012,000
Excess of actuarial present value of accumulated plan benefits over net assets available for benefits	$ 4,868,000

The accompanying notes are an integral part of the financial statements.

Exhibit D-6

C&H COMPANY PENSION PLAN
STATEMENT OF CHANGES IN ACCUMULATED PLAN BENEFITS
AND NET ASSETS AVAILABLE FOR BENEFITS
[An alternative for Exhibits D-2 and D-4]

	Year Ended December 31 1981
Net Increase in Actuarial Present Value of Accumulated Plan Benefits	

Increase (decrease) during the year attributable to:	
Plan amendment (Note G)	$ 2,410,000
Change in actuarial assumptions (Note B(2))	(1,050,500)
Benefits accumulated	895,000
Increase for interest due to the decrease in the discount period (Note B(2))	742,500
Benefits paid	(997,000)
Net increase	2,000,000
Net Increase in Net Assets Available for Benefits	
Investment income	
Net appreciation in fair value of investments (Note E)	207,000
Interest	345,000
Dividends	130,000
Rents	55,000
	737,000
Less investment expenses	39,000
	698,000
Contributions (Note C)	
Employer	780,000
Employees	450,000
	1,230,000
Total additions	1,928,000
Benefits paid directly to participants	740,000
Purchases of annuity contracts (Note F)	257,000
	997,000
Administrative expenses	65,000
Total deductions	1,062,000
Net increase	866,000
Increase in excess of actuarial present value of accumulated plan benefits over net assets available for benefits	1,134,000
Excess of actuarial present value of accumulated plan benefits over net assets available for benefits	
Beginning of year	3,734,000
End of year	$ 4,868,000

The accompanying notes are an integral part of the financial statements.

Exhibit D-7

C&H COMPANY PENSION PLAN
STATEMENT OF NET ASSETS AVAILABLE FOR BENEFITS
[If a beginning-of-year benefit information date is selected]

	December 31	
	1981	**1980**
Assets		
Investments, at fair value (Notes B(1) and E)		
United States government securities	$ 350,000	$ 270,000
Corporate bonds and debentures	3,500,000	3,670,000
Common stock		
C&H Company	690,000	880,000
Other	2,250,00	1,860,000
Mortgages	480,000	460,000
Real estate	270,000	240,000
	7,540,000	7,380,000
Deposit administration contract at contract value (Notes B(1) and F)	1,000,000	890,000
Total investments	8,540,000	8,270,000
Receivables		
Employees' contributions	40,000	35,000
Securities sold	310,000	175,000
Accrued interest and dividends	77,000	76,000
	427,000	286,000
Cash	200,000	90,000
Total assets	9,167,000	8,646,000
Liabilities		
Accounts payable		
Securities purchased	—	400,000
Other	70,000	60,000
	70,000	460,000
Accrued expenses	85,000	40,000
Total liabilities	155,000	500,000
Net assets available for benefits	$9,012,000	$8,146,000

The accompanying notes are an integral part of the financial statements.

Exhibit D-8

C&H COMPANY PENSION PLAN
STATEMENT OF CHANGES IN NET ASSETS AVAILABLE FOR BENEFITS
[If a beginning-of-year benefit information date is selected.]

	Year Ended December 31	
	1981	**1980**
Investment income		
Net appreciation (depreciation) in air value of investments (Note E)	$ 207,000	$ (72,000)
Interest	345,000	320,000
Dividends	130,000	110,000
Rents	55,000	43,000
	737,000	401,000
Less investment expenses	39,000	35,000
	698,000	366,000
Contributions (Note C)		
Employer	780,000	710,000
Employees	450,000	430,000
	1,230,000	1,140,000
Total additions	1,928,000	1,506,000
Benefits paid directly to participants	740,000	561,000
Purchases of annuity contracts (Note F)	257,000	185,000
	997,000	746,000
Administrative expenses	65,000	58,000
Total deductions	1,062,000	804,000
Net increase	866,000	702,000
Net assets available for benefits		
Beginning of year	8,146,000	7,444,000
End of year	$9,012,000	$8,146,000

The accompanying notes are an integral part of the financial statements.

Exhibit D-9

C&H COMPANY PENSION PLAN
STATEMENT OF ACCUMULATED PLAN BENEFITS
[If a beginning-of-year benefit information date is selected.]

	December 31 19X0
Actuarial present value of accumulated plan benefits (Notes B(2) and C)	
Vested benefits	
Participants currently receiving payments	$ 2,950,000
Other participants	6,530,000
	9,480,000
Nonvested benefits	2,400,000
Total actuarial present value of accumulated plan benefits	$11,880,000

At December 31, 1979, the total actuarial present value of accumulated plan benefits was $10,544,000. During 19X0 the actuarial present value of accumulated plan benefits increased $700,000 as a result of a change in actuarial assumptions (Note B(2)). Also refer to Note G.

The accompanying notes are an integral part of the financial statements.

C&H COMPANY PENSION PLAN

NOTES TO FINANCIAL STATEMENTS [46]

A. Description of Plan

The following brief description of the C&H Company Pension Plan (*Plan*) is provided for general information purposes only. Participants should refer to the Plan agreement for more complete information.

1. *General*. The Plan is a defined benefit pension plan covering substantially all employees of C&H Company (*Company*). It is subject to the provisions of the Employee Retirement Income Security Act of 1974 (*ERISA*).

2. *Pension Benefits*. Employees with 10 or more years of service are entitled to annual pension benefits beginning at normal retirement age (65) equal to 1 1/2% of their final 5-year average annual compensation for each year of service. The Plan permits early retirement at ages 55-64. Employees may elect to receive their pension benefits in the form of a joint and survivor annuity. If employees terminate before rendering 10 years of service, they forfeit the right to receive the portion of their accumulated plan benefits attributable to the Company's contributions. Employees may elect to receive the value of their accumulated plan benefits as a lump-sum distribution upon retirement or termination, or they may elect to receive their benefits as a life annuity payable monthly from retirement. For each employee electing a life annuity, payments will not be less than the greater of (a) the employee's accumulated contributions plus interest or (b) an annuity for five years.
3. *Death and Disability Benefits*. If an active employee dies at age 55 or older, a death benefit equal to the value of the employee's accumulated pension benefits is paid to the employee's beneficiary. Active employees who become totally disabled receive annual disability benefits that are equal to the normal retirement benefits they have accumulated as of the time they become disabled. Disability benefits are paid until normal retirement age at which time disabled participants begin receiving normal retirement benefits computed as though they had been employed to normal retirement age with their annual compensation remaining the same as at the time they became disabled.

B. Summary of Accounting Policies

The following are the significant accounting policies followed by the Plan:

1. *Valuation of Investments*. If available, quoted market prices are used to value investments. The amounts shown in Note E for securities that have no quoted market price represent estimated fair value. Many factors are considered in arriving at that fair value. In general, however, corporate bonds are valued based on yields currently available on comparable securities of issuers with similar credit ratings. Investments in certain restricted common stocks are valued at the quoted market price of the issuer's unrestricted common stock less an appropriate discount. If a quoted market price for unrestricted common stock of the issuer is not available, restricted common stocks are valued at a multiple of current earnings less an appropriate discount. The multiple chosen is consistent with multiples of similar companies based on current market prices.

   Mortgages have been valued on the basis of their future principal and interest payments discounted at prevailing interest rates for similar instruments. The fair value of real estate investments, principally rental property subject to long-term net leases, has been estimated on the basis of future rental receipts and estimated residual values discounted at interest rates commensurate with the risks involved.

The Plan's deposit administration contract with the National Insurance Company (*National*) (Note F) is valued at contract value. Contract value represents contributions made under the contract, plus interest at the contract rate, less funds used to purchase annuities and pay administration expenses charged by National. Funds under the contract that have been allocated and applied to purchase annuities (that is, National is obligated to pay the related pension benefits) are excluded from the Plan's assets.

2. *Actuarial Present Value of Accumulated Plan Benefits*. Accumulated plan benefits are those future periodic payments, including lump-sum distributions, that are attributable under the Plan's provisions to the service employees have rendered. Accumulated plan benefits include benefits expected to be paid to (a) retired or terminated employees or their beneficiaries, (b) beneficiaries of employees who have died, and (c) present employees or their beneficiaries. Benefits under the Plan are based on employees' compensation during their last five years of credited service. The accumulated plan benefits for active employees are based on their average compensation during the five years ending on the date as of which the benefit information is presented (the *valuation date*). Benefits payable under all circumstances—retirement, death, disability, and termination of employment—are included, to the extent they are deemed attributable to employee service rendered to the valuation date. Benefits to be provided via annuity contracts excluded from plan assets are excluded from accumulated plan benefits.

   The actuarial present value of accumulated plan benefits is determined by an actuary from the AAA Company and is that amount that results from applying actuarial assumptions to adjust the accumulated plan benefits to reflect the time value of money (through discounts for interest) and the probability of payment (by means of decrements such as for death, disability, withdrawal, or retirement) between the valuation date and the expected date of payment. The significant actuarial assumptions used in the valuations as of December 31, 1981 [1980] and December 31, 1980 [1979] were (a) life expectancy of participants (the 1971 Group Annuity Mortality Table was used), (b) retirement age assumptions (the assumed average retirement age was 60), and (c) investment return. The 1981 [1980] and 1980 [1979] valuations included assumed average rates of return of 7% [6.25%] and 6.25% [6.75%], respectively, including a reduction of .2% to reflect anticipated administrative expenses associated with providing benefits. The foregoing actuarial assumptions are based on the presumption that the Plan will continue. Were the Plan to terminate, different actuarial assumptions and other factors might be applicable in determining the actuarial present value of accumulated plan benefits.

C. Funding Policy

As a condition of participation, employees are required to contribute 3% of their salary to the Plan. Present employees' accumulated contributions at December 31, 1981 [1980] were $2,575,000 [$2,325,000], including interest credited at an interest rate of 5% compounded annually. The Company's funding policy is to make annual contributions to the Plan in amounts that are estimated to remain a constant percentage of employees' compensation each year (approximately 5% for 1981 [and 1980]), such that, when combined with employees' contributions, all employees' benefits will be fully provided for by the time they retire. Beginning in 1982, the Company's contribution is expected to increase to approximately 6% to provide for the increase in benefits attributable to the Plan amendment effective July 1, 1981 (Note G). The Company's contributions for 1981 [and 1980] exceeded the minimum funding requirements of ERISA.

Although it has not expressed any intention to do so, the Company has the right under the Plan to discontinue its contributions at any time and to terminate the Plan subject to the provisions set forth in ERISA.

D. Plan Termination

In the event the Plan terminates, the net assets of the Plan will be allocated, as prescribed by ERISA and its related regulations, generally to provide the following benefits in the order indicated:

a. Benefits attributable to employee contributions, taking into account those paid out before termination.
b. Annuity benefits former employees or their beneficiaries have been receiving for at least three years, or that employees eligible to retire for that three-year period would have been receiving if they had retired with benefits in the normal form of annuity under the Plan. The priority amount is limited to the lowest benefit that was payable (or would have been payable) during those three years. The amount is further limited to the lowest benefit that would be payable under plan provisions in effect at any time during the five years preceding plan termination.
c. Other vested benefits insured by the Pension Benefit Guaranty Corporation (*PBGC*) (a U.S. governmental agency) up to the applicable limitations (discussed below).
d. All other vested benefits (that is, vested benefits not insured by the PBGC).
e. All nonvested benefits.

Benefits to be provided via contracts under which National (Note F) is obligated to pay the benefits would be excluded for allocation purposes.

Certain benefits under the Plan are insured by the PBGC if the Plan terminates. Generally, the PBGC guarantees most vested normal age retirement benefits, early retirement benefits, and certain disability and survivor's pensions. However, the PBGC does not guarantee all types of benefits under the Plan, and the amount of benefit protection is subject to certain limitations. Vested benefits under the Plan are guaranteed at the level in effect on the date of the Plan's termination. However, there is a statutory ceiling on the amount of an individual's monthly benefit that the PBGC guarantees. For plan terminations occurring during 1981 and 1980, that ceiling which is adjusted periodically was $ X,XXX.XX and $1,159.09 per month, respectively. That ceiling applies to those pensioners who elect to receive their benefits in the form of a single-life annuity and are at least 65 years old at the time of retirement or plan termination (whichever comes later). For younger annuitants or for those who elect to receive their benefits in some form more valuable than a single-life annuity, the corresponding ceilings are actuarially adjusted downward. Benefit improvements attributable to the Plan amendment effective July 1, 1981 (Note G) may not be fully guaranteed even though total benefit entitlements fall below the aforementioned ceilings. For example, none of the improvement would be guaranteed if the plan were to terminated before July 1, 1982. After that date the PBGC would guarantee 20% of any benefit improvements that resulted in benefits below the ceiling, with an additional 20% guaranteed each year the plan continued beyond July 1, 1982. If the amount of the benefit increase below the ceiling is also less than $100, $20 of the increase (rather than 20%) becomes guaranteed by the PBGC each year following the effective date of the amendment. As a result, only the primary ceiling would be applicable after July 1, 1986.

Whether all participants receive their benefits should the Plan terminate at some future time will depend on the sufficiency, at that time, of the Plan's net assets to provide those benefits and may also depend on the level of benefits guaranteed by the PBGC.

E. Investments Other Than Contract with Insurance Company

Except for its deposit administration contract (Note F), the Plan's investments are held by a bank-administered trust fund. The following table presents the fair values of those investments. Investments that represent 5% or more of the Plan's net assets are separately identified.

	December 31, 1981		December 31, 1980	
	Number of Shares or Principal Amount	Fair Value	Number of Shares or Principal Amount	Fair Value
Investments at Fair Value as Determined by Quoted Market Price				
United States government securities		$ 350,000		$ 270,000
Corporate bonds and debentures				
National Locomotive 6% series C bonds due 1990	$600,000	480,000	$600,000	492,000
General Design Corp. 5 1/2% convertible debentures due 1993	$700,000	520,000	$350,000	250,000
Other		2,260,000		2,618,000
Common stocks				
C&H Company	25,000	690,000	25,000	880,000
Reliable Manufacturing Corp.	12,125	625,000	9,100	390,000
American Automotive, Inc.	5,800	475,000	6,800	510,000
Other		680,000		500,000
		6,080,000		5,910,000
Investments at Estimated Fair Value				
Corporate bonds and debentures		240,000		310,000
Common stocks		470,000		460,000
Mortgages		480,000		460,000
Real estate		270,000		240,000
		1,460,000		1,470,000
		$7,540,000		$7,380,000

During 1981 [and 1980], the Plan's investments (including investments bought, sold, as well as held during the year) appreciated [(depreciated)] in value by $207,000 [and ($72,000), respectively], as follows:

Net Appreciation (Depreciation) in Fair Value

	Year Ended December 31 1981	Year Ended December 31 1980
Investments at Fair Value as Determined by Quoted Market Price		
United States government securities	$ (10,000)	$ 8,000
Corporate bonds and debentures	(125,000)	50,000
Common stocks	228,000	(104,000)
	93,000	(46,000)
Investments at Estimated Fair Value		
Corporate bonds and debentures	(11,000)	9,000
Common stocks	100,000	(49,000)
Mortgages	(5,000)	4,000
Real estate	30,000	10,000
	114,000	(26,000)
	$ 207,000	$ (72,000)

F. Contract with Insurance Company

In 1978, the Company entered into a deposit administration contract with the National Insurance Company under which the Plan deposits a minimum of $100,000 a year. National maintains the contributions in an unallocated fund to which it adds interest at a rate of 8%. The interest rate is guaranteed through 1983 but is subject to change for each succeeding five-year period. When changed, the new rate applies only to funds deposited from the date of change. At the direction of the Plan's administrator, a single premium to buy an annuity for a retiring employee is withdrawn by National from the unallocated fund. Purchased annuities are contracts under which National is obligated to pay benefits to named employees or their beneficiaries. The premium rates for such annuities to be purchased in the future and maximum administration expense charges against the fund are also guaranteed by National on a five-year basis. The annuity contracts provide for periodic dividends at National's discretion on the basis of its experience under the contracts. Such dividends received by the Plan for the year[s] ended December 31, 1981 [and 1980] were $25,000 [and $24,000, respectively]. In reporting changes in net assets, those dividends have been netted against amounts paid to National for the purchase of annuity contracts.

G. Plan Amendment

Effective July 1, 1981, the Plan was amended to increase future annual pension benefits from 1 1/4% to 1 1/2% of final 5-year average annual compensation for each year of service, including service rendered before the effective date. The retroactive effect of the Plan amendment, an increase in the actuarial present value of accumulated plan benefits of $2,410,000, was accounted for in the year ended December 31, 1981. [The actuarial present values of accumulated plan benefits at December 31, 1980 and December 31, 1979 do not reflect the effect of that Plan amendment. The Plan's actuary estimates that the amendments retroactive effect on the actuarial present value of accumulated plan benefits at December 31, 1980 was an increase of approximately $1,750,000, of which approximately $1,300,000 represents an increase in vested benefits.]

H. Accounting Changes

In 1981, the Plan changed its method of accounting and reporting to comply with the provisions of Statement of Financial Accounting Standards No. 35 issued by the Financial Accounting Standards Board. Previously reported financial information pertaining to 1980 [and 1979] has been restated to present that information on a comparable basis.

Appendix E: ILLUSTRATION OF MEASUREMENT OF ACCUMULATED PLAN BENEFITS [47]

283. It is assumed that the actuary uses a full range of decrements including termination rates and disablement rates at ages below age 65, early retirement rates at ages when eligible below age 65, and normal retirement rates at ages 65 and over.

a. Given:
   i. Benefit rate of $10 per month per year of service.
   ii. Normal retirement at age 65, irrespective of service. Retirement not compulsory.
   iii. Unreduced immediate benefit upon early retirement from active employment at age 62 with 20 years of service.
   iv. Unreduced immediate benefit upon early retirement from active employment before age 62 with 30 years of service. Social Security make-up benefit of $200 per month payable until age 62.
   v. Reduced immediate benefit upon early retirement from active employment after age 55 and before age 62 with 20 years of service. Reduction is 4% for each year by which retirement precedes age 62.
   vi. Unreduced immediate benefit upon total and permanent disability before age 65 with 10 years of service.
   vii. Deferred vested benefit, commencing at age 65, upon termination with 10 years of

service. Benefit payments (at full actuarially reduced value) may also be elected to commence as early as age 55 if 20 or more years of service have been completed.

viii. Spouse's benefit upon death in service after meeting eligibility requirements for early or normal retirement (30 years of service, age 55 and 20 years of service, or age 65) equal to $5 per month per year of service.

b. [Follows below.]

	Type of Benefit	Payable upon Separation from Service at Ages	Amount of Benefit	Benefit Starts at	Duration of Benefit
			Age 25 and 5 Years of Service		
(1)	Deferred Vested	30-49	$ 50	Age 65	Life
(2)	Unreduced Early	50-64	50	Retirement	Life
(3)	Social Security Makeup	50-61	33*	Retirement	To Age 62
(4)	Normal	65 and Over	50	Retirement	Life
(5)	Spouse	50 and Over	25	Death in Service	Life of Spouse
(6)	Disability	30-64	50	Disablement	Life
			Age 40 and 5 Years of Service		
(1)	Deferred Vested	45-54	$ 50	Age 65	Life
(2)	Reduced Early	55-61	36 at Age 55 Increasing $2 a Year to age 65	Retirement	Life
(3)	Unreduced Early	62-64	50	Retirement	Life
(4)	Normal	65 and Over	50	Retirement	Life
(5)	Spouse	55 and Over	25	Death in Service	Life of Spouse
(6)	Disability	45-64	50	Disablement	Life
			Age 45 and 10 Years of Service		
(1)	Deferred Vested	45-54	$100	Age 65	Life
(2)	Reduced Early	55-61	72 at Age 55 Increasing $4 a Year to Age 61	Retirement	Life
(3)	Unreduced Early	62-64	100	Retirement	Life
(4)	Normal	65 and Over	100	Retirement	Life
(5)	Spouse	55 and Over	50	Death in Service	Life of Spouse
(6)	Disability	45-64	100	Disablement	Life
			Age 50 and 20 Years of Service		
(1)	Deferred Vested	50-54	$200	Age 65	Life

(2)	Reduced Early	55-59	144 at Age 55 Increasing $8 a Year to Age 59	Retirement	Life
(3)	Unreduced Early	60-64	200	Retirement	Life
(4)	Social Security Makeup	60-61	133*	Retirement	To Age 62
(5)	Normal	65 and Over	200	Retirement	Life
(6)	Spouse	55 and Over	100	Death in Service	Life of Spouse
(7)	Disability	50-64	200	Disablement	Life
			Age 50 and 30 Years of Service		
(1)	Unreduced Early	50-64	$300	Retirement	Life
(2)	Social Security Makeup	50-61	200*	Retirement	To Age 62
(3)	Normal	65 and Over	300	Retirement	Life
(4)	Spouse	50 and Over	150	Death in Service	Life of Spouse
(5)	Disability	50-64	300	Disablement	Life
			Age 60 and 10 Years of Service		
(1)	Deferred Vested	60-64	$100	Age 65	Life
(2)	Normal	65 and Over	100	Retirement	Life
(3)	Spouse	65 and Over	50	Death in Service	Life of Spouse
(4)	Disability	60-64	100	Disablement	Life

c. If, in the example, there were a maximum service limit of 30 years applicable at normal or early retirement or disablement, with a pro-rata portion of the expected normal retirement benefit payable on vested termination, the only changes in the amount of benefit would be for the deferred vested benefit:

Age 25 and 5 Years of Service	$ 33 (5/45 of $300)
Age 50 and 20 Years of Service	171 (20/35 of $300)

Footnotes

FAS35, Footnote *--Terms defined in the Glossary (Appendix C) are in boldface type the first time they appear in this Statement.

FAS35, Footnote 1--The Board recognizes that (a) information in addition to that contained in a plan's financial statements is needed in assessing the plan's present and future ability to pay benefits when due and (b) financial statements for several plan years can provide information more useful in assessing the plan's future ability to pay benefits than can the financial statements for a single plan year (paragraphs 58-63).

FAS35, Footnote 2--Financial information presented as of the beginning of the year shall be the amounts as of the end of the preceding year.

FAS35, Footnote 3--The accrual basis requires that purchases and sales of securities be recorded on a trade-date basis. However, if the settlement date is after the reporting date and (a) the fair value of securities purchased or sold just before the reporting date does not change significantly from the trade date to the reporting date, and (b) the purchases or sales do not significantly affect the composition of the plan's assets available for benefits, accounting on a settlement-date basis for such sales and purchases is acceptable.

FAS35, Footnote 4--The existence of accrued pension costs does not, by itself, provide sufficient support for recognition of a contribution receivable (paragraph 92).

FAS35, Footnote 5--For an indication of factors to be considered in determining the discount rate, see paragraphs 13 and 14 of APB Opinion No. 21, *Interest on Receivables and Payables*. If significant, the fair value of an investment shall reflect the brokerage commissions and other costs normally incurred in a sale.

FAS35, Footnote 6--For 1979 plan years, the pertinent governmental reporting requirements relate to item 13 of either Form 5500 or Form 5500-C.

FAS35, Footnote 7--Realized gains and losses on investments that were both bought and sold during the year shall be included.

FAS35, Footnote 8--A noncash contribution shall be recorded at fair value. The nature of noncash contributions shall be described, either parenthetically or in a note.

FAS35, Footnote 9--Paragraph 28(e) requires disclosure of the plan's dividend income related to excluded contracts and permits that income to be netted against item (g).

FAS35, Footnote 10--An example of the application of paragraphs 18(a) and 18(b) appears in

Appendix E.

FAS35, Footnote 11--Plans that measure the actuarial present value of accumulated plan benefits by insurance company rates pursuant to the alternative approach described in paragraph 21 shall, if practicable, disclose the effects of changes in actuarial assumptions reflected in changes in those insurance rates.

FAS35, Footnote 12--Actuarial experience gains or losses may be included with the effects of additional benefits accumulated rather than being separately disclosed. If the effects of changes in actuarial assumptions discussed in footnote 11 cannot be separately disclosed, those effects shall be included in benefits accumulated.

FAS35, Footnote 13--Due to the use of different actuarial assumptions, the amount paid by the plan to an insurance company may be different from the previous measure of the actuarial present value of the related accumulated plan benefits. That difference is an actuarial experience gain or loss (footnote 12).

FAS35, Footnote 14--See APB Opinion No. 22, *Disclosure of Accounting Policies*.

FAS35, Footnote 15--If a plan agreement or a description thereof providing this information is otherwise published and made available, the description required by paragraph 28(a) may be omitted provided that reference to such other source is made.

FAS35, Footnote 16--If material providing this information is otherwise published and made available to participants, the descriptions required by paragraph 28(c) may be omitted provided that (a) reference to such other source is made and (b) disclosure similar to the following is made in the financial statements: "Should the plan terminate at some future time, its net assets generally will not be available on a pro rata basis to provide participants' benefits. Whether a particular participant's accumulated plan benefits will be paid depends on both the priority of those benefits and the level of benefits guaranteed by the PBGC at that time. Some benefits may be fully or partially provided for by the then existing assets and the PBGC guaranty while other benefits may not be provided for at all."

FAS35, Footnote 17--If significant costs of plan administration are being absorbed by the employer(s), that fact shall be disclosed.

FAS35, Appendix A, Footnote 18--U.S. Government Printing Office, *House of Representatives Committee on Education and Labor Pension Task Force Report on Public Employee Retirement Systems* (Washington, D.C., 1978), p. 3.

FAS35, Appendix A, Footnote 19--H.R. 14138, *Public Employee Retirement Income Security Act of 1978*, September 20, 1978, and H.R. 6525, *Public Employee's Retirement Income Security*

Act of 1980, February 13, 1980.

FAS35, Appendix B, Footnote 20--This appendix identifies the specific document on which respondents commented only if such comments are limited in their application to that document. Otherwise, the term *respondents* refers to those who responded to one or more documents preceding this Statement, that is, the Discussion Memorandum and the initial and revised Exposure Drafts.

FAS35, Appendix B, Footnote 21--For example, Section 502(d)(1) includes the following statement: "An employee benefit plan may sue or be sued under this title as an entity." Any claims for pension benefits are enforceable against the pension plan as an entity, as provided for in Section 502(d)(2) of the Act: "Any money judgment under this title against an employee benefit plan shall be enforceable only against a plan as an entity and shall not be enforceable against any other person unless liability against such person is established in his individual capacity under this title." The view that the pension plan should be accounted for as if it were a separate accounting entity is also viewed as being compatible with reporting provisions of the Act. For example, Section 103(a)(3)(A) states, in part: "... the administrator of an employee benefit plan shall engage, on behalf of all plan participants, an independent qualified public accountant, who shall conduct such an examination of any financial statements of the plan, and of other books and records of the plan, as the accountant may deem necessary to enable the accountant to form an opinion as to whether the financial statements and schedules required to be included in the annual report by subsection (b) of this section are presented fairly in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year."

FAS35, Appendix B, Footnote 22--Most respondents commented from the perspective of an employer rather than an employee. Thus, those comments may not reflect the views of the "typical" plan participant. A recent nationwide study of attitudes toward pensions and retirement commissioned by Johnson & Higgins and conducted by Louis Harris and Associates surveyed the views of both employers and employees. It found that "... business leaders widely misjudge the importance employees place on certain types of information about their pension plans. Among employees who read their most recent pension report, substantial majorities believe it is 'very important' that they receive information about the current financial status of their plan (83%).... However, among business leaders whose employees receive annual reports, just 38% feel it is 'very important' that the report contain [that] information...." (Johnson & Higgins, *1979 Study of American Attitudes Toward Pensions and Retirement*, pp. vii and viii.)

FAS35, Appendix B, Footnote 23--Another project on the Board's technical agenda, accounting by employers for pensions, encompasses a reconsideration of present generally accepted accounting principles regarding employer accounting for pension plans.

FAS35, Appendix B, Footnote 24--That view of participants' informational needs appears to be supported by the results of the Harris survey. That survey found that 93 percent of the employees who read the last report thought it was very important that they know how certain it is that they will be paid their pension. (Johnson & Higgins, *1979 Study of American Attitudes Toward Pensions and Retirement*, p. 53.)

FAS35, Appendix B, Footnote 25--Concepts Statement 1, par. 34.

FAS35, Appendix B, Footnote 26--Ibid., par. 22.

FAS35, Appendix B, Footnote 27--The recent Harris survey (footnote 22) provides evidence of that interest. That survey found that public plan compliance with private plan regulations is favored by 68 percent of current and retired employees (14 percent opposed) and by 93 percent of business leaders. Moreover, such compliance is favored by a sizeable 65 percent majority of employees currently covered by public plans and opposed by only 18 percent. (Johnson & Higgins, *1979 Study of American Attitudes Toward Pensions and Retirement*, p. xi.)

FAS35, Appendix B, Footnote 28--U.S. Government Printing Office, *House of Representatives Committee on Education and Labor Pension Task Force Report on Public Employee Retirement Systems* (Washington, D.C., 1978).

FAS35, Appendix B, Footnote 29--Ibid., p. 3.

FAS35, Appendix B, Footnote 30--Ibid., p. 102.

FAS35, Appendix B, Footnote 31--U.S. Government Printing Office, *House of Representatives Committee on Education and Labor Task Force Report on Public Employee Retirement Systems*, p. 141.

FAS35, Appendix B, Footnote 32--Pension Benefit Guaranty Corporation [29 CFR Parts 2608 and 2611], *Federal Register*, Vol. 42 (April 18, 1977), pp. 20156-20162; Department of the Treasury, Internal Revenue Service [26 CFR Part 1], *Federal Register*, Vol. 43 (August 25, 1978), pp. 38027-38029. Shortly before the issuance of this Statement, the PBGC announced that it had dropped its proposals [*Federal Register*, Vol. 44 (December 20, 1979), pp. 75405 and 75406].

FAS35, Appendix B, Footnote 33--All approaches to determining benefit information discussed in this Statement utilize various assumptions to estimate the probability that benefits will be paid. The approaches differ somewhat with respect to which assumptions are recognized. For convenience, the discussion in paragraphs 140-168 refers to certain assumptions only when necessary to distinguish between approaches. Assumptions relating to the probability of payment of benefits are discussed in more detail in paragraphs 180-186.

FAS35, Appendix B, Footnote 34--In practice, the approach probably would be applied to all employees as a group, or to particular groups of employees, rather than on an individual employee basis.

FAS35, Appendix B, Footnote 35--See footnote 34.

FAS35, Appendix B, Footnote 36--For purposes of illustration, the discussion is in terms of an individual employee. In practice, such benefits would be recognized on an aggregate rather than individual basis because it is usually not possible to predict whether and when an individual employee will become disabled (or elect early retirement, die in active service, etc.). It is, however, possible to estimate the disability (or early retirement, death, etc.) benefits expected to become payable for a group of employees through the application of appropriate probability factors. The basic principle, however, is the same whether the computations are performed on an aggregate or an individual basis.

FAS35, Appendix B, Footnote 37--Footnote 36 discusses the estimation of benefits for a group of employees through application of appropriate probability factors. In determining the benefit information, such probability factors are used to estimate whether an employee will render at least 25 years of service, and whether and when that employee will elect early retirement.

FAS35, Appendix B, Footnote 38--See footnotes 36 and 37.

FAS35, Appendix B, Footnote 39--See footnote 23.

FAS35, Appendix B, Footnote 40--Interprofessional Pension Actuarial Advisory Group, *Pension Terminology Final Report*, January 1978, p. 17.

FAS35, Appendix B, Footnote 41--On September 26, 1978, the Department of Labor proposed such an approach for determining the benefit information to be reported by ERISA plans on the revised Schedule B ("Actuarial Information") of Form 5500.The Board testified in support of the method required by this Statement at hearings concerning the Schedule B proposals held by the Department on November 20, 1978; in that testimony the Board expressed its views regarding future salary increases. The Board is pleased that the revised Schedule B subsequently issued by the Department requires a method that is believed to be consistent with that required by this Statement.

FAS35, Appendix B, Footnote 42--A factor to consider in assessing the extent to which short-term and long-term interest rates should impact assumed rates of return is the degree to which the timing of cash inflows from related existing or potential investments matches the timing of payments of accumulated plan benefits.

FAS35, Appendix B, Footnote 43--Factors that may be directly or indirectly affected by future inflation are discussed in "Recognition of Inflation in the Calculation of Actuarial Present Values under Pension Plans," American Academy of Actuaries, *Bylaws, Guide to Professional Conduct, Standards of Practice, February 1, 1978* (Chicago: American Academy of Actuaries), pp. 98-103.

FAS35, Appendix B, Footnote 44--Board members did not focus on the issue of what is the appropriate measure of the employer's obligation. That issue is presently covered by Opinion 8 and will be reconsidered in another Board project (footnote 23).

FAS35, Appendix B, Footnote 45--An FASB revised Exposure Draft, *Elements of Financial Statements of Business Enterprises*, was issued on December 28, 1979.

FAS35, Appendix D, Footnote 46--The notes are for the accompanying illustrative financial statements that use an end-of-year benefit information date. Modifications necessary to accompany the illustrative financial statements that use a beginning-of-year benefit information date are highlighted.

FAS35, Appendix E, Footnote 47--This appendix illustrates the measurement of accumulated plan benefits pursuant to the provisions of paragraphs 18(a) and 18(b) of this Statement. The example has been reproduced from Interpretation 2: *Interpretation of Recommendations Concerning the Calculation of the Actuarial Present Value of Accrued Benefits under an Active Plan*, as presented in American Academy of Actuaries, *Bylaws, Guides to Professional Conduct, Standards of Practice, February 1, 1979* (Chicago: American Academy of Actuaries), pp. 106-113.

FAS35, Appendix E, Footnote *--Because this benefit type is one which is includible in the computation of the present value of vested benefits, the $200 monthly benefit is assumed to accrue uniformly over the first 30 years of service (see I(b) (ii)). If, on the other hand, there had been specified a benefit which never is includible in the computation of the present value of vested benefits, such as a $200 monthly benefit payable in the event of the employee's death after 30 years of service, the accrued death benefit to be valued in the age 25 and 5 years of service example would have been $33 (5/30 of $200) for death at age 50, $32 (5/31 if $200) for death at age 51, etc.

FAS35, Appendix E, Footnote *--Because this benefit type is one which is includible in the computation of the present value of vested benefits, the $200 monthly benefit is assumed to accrue uniformly over the first 30 years of service (see I(b) (ii)). If, on the other hand, there had been specified a benefit which never is includible in the computation of the present value of vested benefits, such as a $200 monthly benefit payable in the event of the employee's death after 30 years of service, the accrued death benefit to be valued in the age 25 and 5 years of service example would have been $33 (5/30 of $200) for death at age 50, $32 (5/31 if $200) for death at age 51, etc.

FAS35, Appendix E, Footnote *--Because this benefit type is one which is includible in the computation of the present value of vested benefits, the $200 monthly benefit is assumed to accrue uniformly over the first 30 years of service (see I(b) (ii)). If, on the other hand, there had been specified a benefit which never is includible in the computation of the present value of vested benefits, such as a $200 monthly benefit payable in the event of the employee's death after 30 years of service, the accrued death benefit to be valued in the age 25 and 5 years of service example would have been $33 (5/30 of $200) for death at age 50, $32 (5/31 if $200) for death at age 51, etc.