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Accounting Procedure

American Institute of Accountants

COMMITTEE ON ACCOUNTING PROCEDURE

270 MADISON AVENUE, NEW YORK 16, N. Y.

March 26, 1951

To the Members of the Committee
on Accounting Procedure

Gentlemen:

Re: Pension Plans

This letter is in lieu of the memorandum referred to under Item VII of the agenda of the next meeting of the committee. It is hoped that the following questions include most of the problems that arise in connection with pension accounting.

I Procedures Currently in Use

Each of the following procedures for accounting for pension costs is currently in use by companies of some prominence. It is difficult to see how all of them could be considered to be in conformity with generally accepted (or sound) accounting principles. Should the committee approve:

a. Charging income with current-service costs only, although no provisions have been made to cover past-service costs?

b. Charging income with current-service costs, plus an amount equivalent to the interest which would be earned upon investment of a sum equal to the past-service costs, although no such sum has been set aside?

c. Charging income with current-service costs plus 10% of past-service costs (the maximum tax deduction for past-service costs)?

d. Charging income with current-service costs, and accruing past-service costs on an employee-group basis over the average estimated remaining period to retirement?

e. Charging income with current-service costs plus some portion of past-service costs (other than as in "c" and "d")?

f. Charging income with only the amount required to fund with a trustee the pensions payable over the estimated remaining lives of eligible workers retiring during the current year?

g. Where, for example, five-year negotiated contracts are in force, charging income of the year with one-fifth of the estimated cost of funding pensions payable over the estimated lives of employees who will become eligible to retire within the five-year period?

h. When pensions are not funded, charging pension costs to income on a pay-as-you-go or cash disbursements basis?

i. Charging "funding payments" to income when and as made to pension trustees or insurance companies, irrespective of the relation of such payments to current and past-services?

II Relating Pension Cost to Workers' Productive Years

a. Should the cost of providing an employee's pension be accrued ratably over his period of active service beginning either with the date of his employment or the date a pension plan is adopted, whichever is later, and ending with the date the employee retires from productive service?

b. Is there sound accounting justification for allocating the costs to either earlier or later periods?

III Relation Between Funding or Tax Procedures and Accounting Procedures

a. Should the method of accruing pension costs be governed by the funding method followed?

b. Is it proper for the charges to income to "follow" the funding whether or not the funding is uneven in its incidence?

c. Should the principle be recognized that pension costs accrue currently regardless of what funding steps are taken?

d. Should the method of accruing pension costs be governed by the treatment permitted for tax purposes?

e. Should the charge to income for pension costs, if not accompanied by actual payment to a trustee or insurance company, be made net of prospective tax benefits?

IV Unilateral vs. Negotiated Plans

In establishing accounting standards for the treatment of pension costs, is it necessary that a differentiation be made between (1) so-called employer unilateral pension plans (whether or not contributory), and (2) union-negotiated plans with a specifically limited term?

V Recognition of Liability

a. Where an employer unilateral plan is involved, are accounting requirements adequately met if a minimum liability is accrued in the accounts sufficient to actuarially provide in full for all employees who have retired?

b. Or should there be as a minimum, an amount sufficient to actuarially provide in full for pensions for both retired and eligible to retire but not yet retired employees?

c. Should an accrual be mandatory for any excess of the actuarial liability to retired employees over funding payments or accruals made to date?

d. Even if management follows a policy of leaving an amount of past-service costs permanently unfunded, should the full actuarially estimated past-service costs be accrued in the accounts over a reasonable period of years?

e. Is it proper not to give accounting recognition to pension liabilities based on a plan presently in operation simply because the possibility exists that such plan may be discontinued in the future, either arbitrarily or in consideration of a guaranteed annual wage, large wage increases, or greatly increased Social Security benefits?

f. Should a company refrain from reflecting its liability for pensions on an actuarial basis merely because, in the event of insolvency, certain of the employees' pensions would not be vested and their claims would have no binding legal status?

g. Should recognition be given in the accounts to the costs of pensions for employees presently excluded from coverage because they will not reach the specified retirement age before expiration of present union-negotiated pension plans?

h. Should the committee on accounting procedure adhere to its previous position in opposition to a requirement of disclosure in the financial statements of the estimated amount of unfunded or unaccrued past-service cost? (See Rule 3-19 (e)(3) of revised Regulation S-X).

Possibly a refinement of these questions would eliminate some of them as repetitious or as opposits of each other. However, it is hoped that they cover the ground sufficiently to afford a common basis for a thorough discussion of pension accounting. While no request is being made for answers to these questions in writing, it is hoped they will be given sufficient consideration in advance to make it possible at the meeting to decide the committee's course of action with respect to issuing a bulletin on this controversial subject.

Very truly yours,

Carman G. Blough

Director of Research

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