8/13/84 Sampson called from home + indicated that the other four Comrs have approved the staff's recommendation. I had reviewed OCA's 7/13/84 memo, but not Coulson's 8/9/84 memo, after reading Coulson's memo I called + discussed it with him, + indicated I concurred with the staff's recommendation.

JS

MEMORANDUM

August 8, 1984

TO: Chairman Shad
Linda Quinn

FROM: David Martin

RE: Advice Memorandum from the Office of the Chief Accountant regarding a request by AMAX Inc. that the Commission review accounting treatment of the reversion of excess pension plan assets to AMAX.

ISSUES PRESENTED

(1) Whether the reversion of excess pension plan assets should be amortized over future periods as an actuarial gain or recognized immediately as an extraordinary gain.

(2) Whether the Commission should consider the accounting issues presented in a Commission meeting or whether the Commission should decline to take an action on the question and rely instead upon the staff's handling of the matter. Related to this issue is the question of whether, assuming the Commission elects to consider this matter in a meeting, that meeting should provide an opportunity to AMAX to present oral arguments to the Commission as a supplement to its written submission.

STAFF POSITIONS

OCA, with the concurrence of the Divisions of Enforcement and Corporation Finance, is of the opinion that the asset reversion should be amortized as an actuarial gain over future periods. As to the procedural question, the Office of the General Counsel believes that it is preferable that the Commission decline to review the staff's proposed position. This recommendation is based upon the view that the proposed OCA position is a staff action on a routine matter and that Commission review of that staff action elevates the matter to one which would be a judicially reviewable agency action.

RECOMMENDATION

I agree with the recommendations of the Chief Accountant.

DISCUSSION

A. The Accounting Question

AMAX is restructuring its pension plan for salaried employees. The restructuring involves the termination of a defined benefit plan, the transfer of all active salaried employees from the terminated plan to a new defined benefit plan, the purchase of annuities to cover pension benefits accruing up to the date of termination of the original plan, the transfer of $59 million to the new plan to provide for the estimated future increase in accrued benefits, and the reversion of $100 million in pension plan assets to AMAX. The issue presented to the staff by AMAX is what should be the appropriate accounting treatment for the asset reversion. AMAX is of the view that the reversion may be accounted for as an extraordinary gain in the second fiscal quarter ending June 30, 1984. The staff disagrees. Based on Staff Accounting Bulletin No. 52 ("SAB 52") and Accounting

Principals Board Opinion No. 8 ("APB 8"), the staff is of the view that GAAP requires the asset reversion to be accounted for as an actuarial gain spread over future periods.

B. AMAX's Position _/

AMAX believes that the asset reversion may be recognized as an immediate extraordinary gain for four reasons: (1) all obligations under the original plan up to the date of termination have been funded; (2) immediate gain recognition would avoid distortion of future pension expense and better reflect the economic substance of the transaction; (3) immediate gain recognition is consistent with APB 8, SAB 52, and current accounting; and (4) immediate gain recognition in situations like AMAX would effectuate sound public policy.

C. Staff Position

The staff position is that the asset reversion should be showed in full as a deferred credit in AMAX's balance sheet and then reflected in the income statement as a reduction of pension expense over a period consistent with the company's existing policy on the amortization of actuarial gains and losses. (APB 8 considers a period of 10 to 20 years to be reasonable for spreading actuarial gains and losses.) This position is based on the view that, in substance, AMAX has only amended its original defined benefit plan. Under GAAP, as interpreted in APB 8 and SAB 52,

_/ AMAX's auditors, Coopers & Lybrand, has not taken a position on the matter.

recognition of an immediate extraordinary gain is specifically prohibited because the active employee group continues to be covered by a defined benefit plan.

APB 8 prescribes how actuarial gain and losses should be given effect in the provisions for pension cost. The Opinion provides that certain actuarial gains and losses should be recognized in the year that occur when they "arise from a single occurrence not directly related to the operation of the pension plan and not in the normal course of the employer business." The examples given in the Opinion are those resulting from plant closings and business purchase acquisitions.

In SAB 52, the staff interpreted the general provisions of APB 8 and GAAP in the context of pension plan terminations. In the release, the staff concluded that a reversion of assets from the terminated pension plan should be treated as extraordinary gain only if all obligations under the terminated plan are fully funded and the substituted employee benefits arrangements are not linked to the prior plan. The staff of the FASB agreed with SAB 52.

Here, AMAX has not terminated its defined benefit promise to the active employees, because the company will continue to provide a defined benefit plan for those employees. The staff, therefore, does not view extraordinary gain recognition as the correct approach. _/ In summary, the staff argues that GAAP

_/ This view has been supported in a letter from the FASB staff agreeing with our staff's proposed position. The FASB letter notes that "the establishment of the new defined benefit plan covering essentially the same active employees, with an <u>improved</u> benefit formula, indicates that the previous plan, in substance, continues for accounting purposes."

does not permit recognition of actuarial gains as immediate, extraordinary gains when the employer has not completely eliminated its risk relating to the cost of future benefits associated with past services for active employees.

D. Interest of the Pension Benefit Guarantee Corporation

By letter dated July 25, 1984, the Pension Benefit Guarantee Corporation ("PBGC") expressed interest in AMAX's issue. Members of the staff met with David Walker, Deputy Executive Director for Insurance Operations of the PBGC, on August 7, 1984 to discuss his agency's interest. In that meeting Mr. Walker indicated that the issue of pension plan terminations involving asset reversions has been a topic of in-depth review by the Administration (specifically, the Departments of Treasury, and Labor, and the PBGC). Further the method of plan termination employed by AMAX has become increasingly popular. As a result of the Administration's review of pension plan termination issues, a policy has been formulated by which there is to be greater neutrality as between regulatory coverage of defined benefit and defined contribution plans. The review of pension plan termination issues, however, has not involved any consideration or formulation of an appropriate policy regarding proper accounting for terminations, AMAX's or any others. _/

_/ Of course, it is possible that, to the extent an accounting treatment favored one kind of plan versus another, the Administration may, as a public policy matter, wish to adopt a more neutral treatment. Neither Mr. Walker nor the the staff believes that the accounting treatment proposed here tips the balances towards a particular kind of plan. In fact, the sense was that AMAX's proposal might not be acceptable to all plans sponsors.

E. Procedural Issues

The question presented by AMAX is one which is routinely handled by the staff in considering the appropriate application of GAAP to the financial presentations of issuers. Just as with a no action letter request, it is, as a policy matter, probably not desirable for the Commission to consider these kinds of issues on an individual, case-by-case basis. As pointed out by OGC, case-by-case Commission consideration of such requests would subject routine handling of these matters to possible judicial review. For this reason, OGC has recommended that this matter be handled by way of an Advice Memorandum in which the Commission is asked by the staff to decline to review the staff's position.