

December 7, 2001

FLOYD NORRIS

The Fiction of Pension Accounting

Here's one explanation for the rising stock market as 2001 nears an end: Some companies are locking in profits for next year by buying stocks this year.

If that sounds ridiculous, it is. Whether profits will be made on stocks bought now is unknowable. No reasonable accounting system would let you book profits just because you bought the stocks.

But we are not dealing with a reasonable accounting system. We are dealing with pension accounting, American style. The amount of expense, or profit, that companies report from their pension systems are not based on the actual profits earned by investments in the pension fund. Instead, companies report profits as if the pension investments earned what was assumed when the year began.

That's where the current buying comes from. Many companies assume they will make 9 percent or more on pension investments, with some forecasting more than 11 percent. With interest rates as low as they are now, they clearly can't make anything like that on investment-grade bonds, which make up a significant proportion of most pension portfolios. Adding more stocks is the only way to make such an optimistic number possibly believable. Otherwise, they would have to reduce the assumption — and next year's reported profits.

Whether pension plans will earn those returns over the long term is debatable. They did better during the late 1990's bull market. Warren E. Buffett, the chairman of Berkshire Hathaway ([news/quote](#)), says in the current issue of Fortune magazine that he would love to "make a large bet" that returns will be lower.

A survey by Bear Stearns ([news/quote](#)) shows that in 2000 the median company in the Standard & Poor's 500-stock index assumed that its pension assets would earn 9.2 percent, with some much higher. In fact, the average return was 5 percent.

That means corporate profits were overstated in 2000. If companies are assuming similar returns now, as Patricia McConnell, the Bear Stearns accounting guru, says is likely, there are more overstatements this year.

Over the long run, corporate books will show the reality of what the pension plans really earn. But with the various smoothing mechanisms built into the accounting rule, that can take decades. By then, the bosses making the current optimistic assumptions will have



Need one last gift?



The Starbucks Card is the perfect stocking stuffer.



starbucks.com

collected bonuses based on those assumptions and retired.

"It's a coming flash point in accounting," Thomas E. Jones, the vice chairman of the International Accounting Standards Board and a retired executive vice president of Citicorp ([news/quote](#)), said this week. "We're kidding ourselves" by reporting results under the American rule, he added.

This is a case where accounting clearly does affect behavior. In Britain, a new accounting rule forces companies to show the actual results of their pension plan investments. Boots, a big drugstore chain, responded by selling all the stocks in its pension plans.

A new international rule would probably require companies to show actual returns on their pension fund investments, although the returns would be reported on a different line from operating profits.

Opponents will say that would discourage stock market investments and therefore reduce long-term returns for the funds. But if companies believe that stocks are good investments, they should be willing to report the real results and to explain to investors why the risks are worth taking. There is no good reason to report fictional profits.

[Home](#) | [Back to Business](#) | [Search](#) | [Help](#)

[Back to Top](#)

[Copyright 2001 The New York Times Company](#) | [Privacy Information](#)