Letters to the Editor

The FASB's Pension Proposals

The Editorial Viewpoint in the November/December 1984 issue of *Financial Analysts Journal* ("Will the FASB's Pension Proposals Hurt U.S. Capital Markets?" page 7) is misleading to your readers in two ways. First, it states incorrectly a key aspect of the Board's "Preliminary Views" on employers' accounting for pension costs published more than two years ago. Second, it fails to acknowledge significant changes in the Board's views that have occurred since then as a result of several hundred comment letters, five days of public hearings, and a full year of intense deliberations on the subject.

A major focus of the piece is a supposed requirement for "all plan sponsors . . . to amortize their unfunded liabilities or surpluses over an average remaining service life for *all plans*" (emphasis added). That has never been proposed. In fact, one of the objectives of the project is to relate cost recognition to the service periods of an individual company's employees. Thus the proposal in "Preliminary Views" would avoid, rather than cause, the result the author says "would mask underlying differences between plans whose remaining service lives are much above or below average."

The article also states that "the major consequence . . . would be a vast increase in the volatility of plan asset valuations from year to year, with attendant swings in annual pension expense. The reported annual earnings of many companies would be materially affected." There is no mention of the fact that, in 1984, the Board agreed on modifications to its "Preliminary Views" that would significantly reduce the extent to which short-term changes in the value of plan assets are reflected in pension costs.

The author goes on to predict higher costs of long-term capital for American companies that would handicap them in competing with the Japanese. Predictions of economic catastrophe have preceded almost all the FASB's major standards. Such predictions do not sway the Board, but tightly reasoned arguments based on hard evidence often do. We expect that by the time this letter appears in print, an exposure draft of a proposed standard incorporating significant modifications to "Preliminary Views" will be published and distributed to more than 40,000 interested persons for comment. I urge your readers to study that exposure draft and comment on the conclusions in it.

The FASB follows an extensive "due process" that is open to participation by all interested parties. In the end, the Board seeks only to establish standards that bring about the reporting of objective information about the results of economic decisions.

Should financial analysts expect anything less?

—Donald J. Kirk, Chairman
Financial Accounting Standards Board
Stamford, Connecticut

David Dodd on Benjamin Graham

The front cover of the September/October issue of *Financial Analysts Journal* very properly shows me in Ben Graham's shadow. Ben was my mentor in our profession from the time in September 1928 when I joined him as a junior colleague in what proved to be a very popular late-afternoon course in security analysis offered by Columbia's School of Business.

Ben was my mentor from the start, and continued in that role for the rest of his life, despite his move to California in 1956. Most of what I know about our profession I got from him firsthand. I did see him six or eight times each year at the GEICO board meetings and those of GEICO's several affiliate companies. In the early 1940s until 1956 I was able to see him as a shareholder and board member of Graham-Newman Corporation, a highly successful regulated investment company, and as a partner in a couple of investing partnerships. Thus my debt to him is very great, indeed.

When, in May 1984, I was awarded an honorary degree by Columbia University for my part in the preparation of *Security Analysis,* I had moments of sadness that it was I rather than Ben who was being so honored.

I thank you for the concise and perceptive editorial comment on page six of the September/October issue, as well as for the editorial wisdom in persuading Roger Murray to give his impressions and informed appraisal of what Ben and I contributed to the development of ideas about a sector of money management. As our successor at Columbia for over 20 years, no other whom you might have chosen could have done a better job than Roger.

—David L. Dodd
Falmouth, Maine

Earnings vs. Dividends in the Simplified Common Stock Valuation Model

In a letter to the editor in the January/February issue of *Financial Analysts Journal,* Gordon Bishop suggests a modification to the simplified common stock valuation model described by Russell Fuller and myself in the September/October 1984 *Journal.* Bishop suggests that the initial dividend growth rate, g_a, can be substituted by the expression:

$$g_e + \frac{PO_n - PO_o}{(2H)(PO_o)}(1 + g_e), \quad (1)$$

where

g_e = current earnings growth estimate,
PO_o = payout ratio over past 12 months,
PO_n = steady-state payout ratio estimate, and
PO_o is assumed to change linearly towards PO_n over 2H years.

The purpose of Equation (1) is to relate stock prices to earnings, rather than dividends, "since the prevailing analytical focus is overwhelmingly on *earnings* growth."

In order to evaluate the implications of Equation (1), let us trace out the derivations omitted by Mr. Bishop.