Accounting
for Defined Benefit Plans

The Principal currently provides actuarial services on approximately 1,100 defined benefit plans. The information that follows provides details on pension accounting results prepared for plan sponsors of The Principal.

Companies using Generally Accepted Accounting Principles (GAAP) accounting must reflect defined benefit pension plan benefits in their financial statements. The Financial Accounting Standards Board (FASB) has issued rules, Statement of Financial Accounting Standards (FAS No. 87) regarding this pension expense. These pension accounting standards were set to provide greater comparability among companies. Actuaries at The Principal prepare the required accounting disclosure reports for plan sponsors of The Principal.

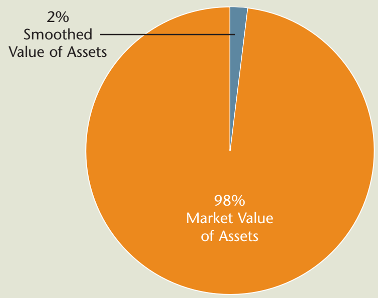
Assumptions are made regarding a discount rate, expected long-term rate of return on plan assets, turnover, expected compensation increases, retirement rates, and mortality. The discount rate and the expected return on plan assets have the most significant impact on the level of expense.

Asset Values

Asset values are as of the measurement date, which is the GAAP statement date (fiscal year end) or any date not more than three months prior to the GAAP statement date. The date is chosen by the plan sponsor and must be used consistently. FAS No. 87 allows the use of the market value of assets or a smoothed value of assets, which smoothes out the variability of gains or losses. Most of our plans use the market value of assets. It is possible, due to potential pension accounting reform, that the smoothing method will not be allowed in the future. This possible change would affect very few of our plans.

Ninety eight percent (98%) of plans use the market value.

ALL OTHER PLANS
to Plan Asset Method

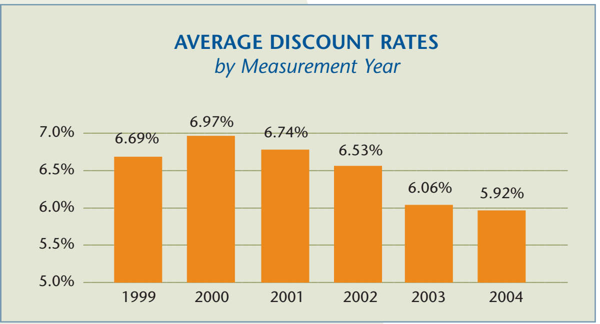


Fast Facts

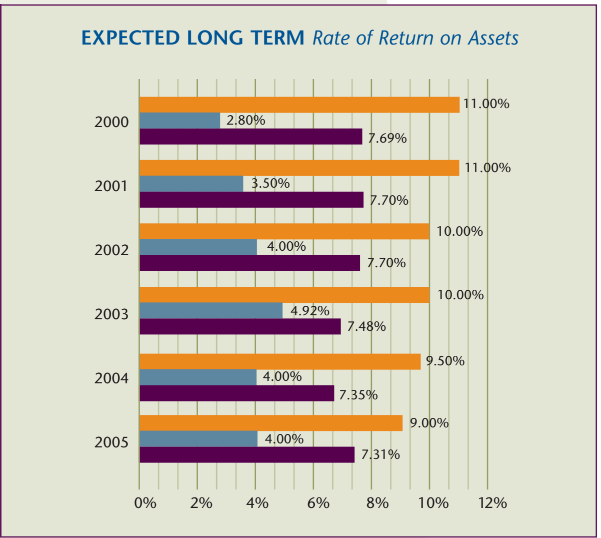
The average discount rate for 2004 is 5.92 percent; however, it ranged from 4.50 to 8.50 percent. The most frequent discount rate for 2004 measurement dates is 5.5 percent, the same as the most frequent rate used in 2003.

The expected long-term rate of return on assets assumption used to develop the 2005 pension expense ranged from 4 percent to 9 percent, with an average value of 7.31 percent.

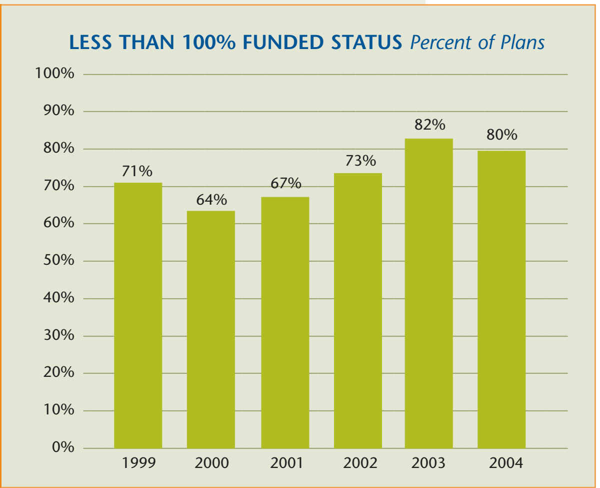
Discount rates over the past few years have been decreasing consistent with the interest rate decline in the market.



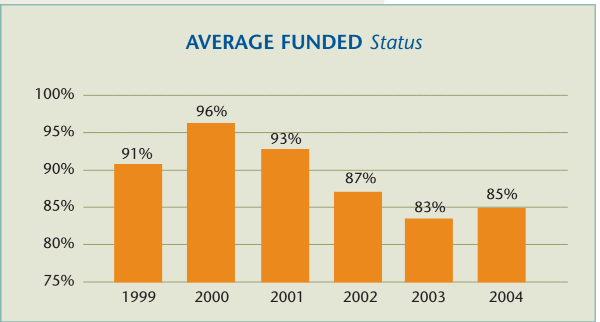
The Average Long Term Rate of Return has decreased slightly each year since 2002.



The percentage of plans with a funded status of less than 100% increased from 71% in 1999 to 80% in 2004. However, the average funded status increased from 83% in 2003 to 85% in 2004.



Average funded status increased to 85% in 2004. Since the measurement of both assets and liabilities are based on a market value basis, the funded status results are quite volatile.



Discount Rate

A discount rate is used to determine the value of plan liabilities. This rate is determined by the plan sponsor and is based on the economic conditions as of the measurement date. The discount rate should reflect rates at which benefits could be effectively settled. It is appropriate to look at rates of high quality investment bonds in determining the discount rate.

Given the interest rate declines over the last year, the average discount rate decreased to 5.92 percent for 2004 measurement dates. This is a 14 basis point decrease from the 6.06 percent discount rate used for 2003 year-end disclosures.

Expected Long Term Rate of Return on Assets

This rate is determined by the plan sponsor and should reflect the plan's investment strategy. In general, this rate does not vary much from year to year because it is a long-term assumption.

The average value of the expected long-term rate of return of 7.31 percent was used to develop the 2005 pension expense; 7.35 percent was used for the 2004 expense.

GAAP Funded Status

The GAAP funded status refers to the comparison of assets and liabilities. The GAAP liabilities for pension benefits are referred to as the Projected Benefit Obligation (PBO). The PBO is the value of all benefits based on service accrued to date along with a projection of future salary increases to the benefit commencement date. FAS No. 87 dictates that current market conditions, determined as of the same measurement day each year, must be taken into account when valuing plan liabilities and assets.

The decrease in funded status over the past five years can be primarily attributed to a decline in the discount rates used to measure liabilities along with the market equity downturn during the 1999 through 2002 years. However, the market return did improve for the 2003 year.

Solutions

Select accounting assumptions. Talk to your actuary annually when selecting the assumptions used to value your plan for accounting purposes.

Forecast. Consider a forecast of your plan's funded status or pension expense. Your actuary can model your accounting results under various economic and contribution scenarios.