



**National Rural Electric  
Cooperative Association**

A Touchstone Energy® Cooperative



LETTER OF COMMENT NO. 82

Via email to [director@fasb.org](mailto:director@fasb.org) File Reference No. 1025-300

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Technical Director  
Financial Accounting Standards Board  
401 Merritt 7  
P. O. Box 5116  
Norwalk, CT 06856-5116

**Project: Pensions**  
**Reference Number: 1025-300**  
**Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R)**

Dear Sir or Madam:

The National Rural Electric Cooperative Association "NRECA" is the not-for-profit national service organization representing approximately 930 not-for-profit, member-owned rural electric cooperatives. The great majority of these cooperatives are distribution cooperatives that provide retail electric service to over 39 million consumer-owners in 47 states. NRECA members also include 65 generation and transmission cooperatives that supply wholesale electric power to their distribution cooperative member-owners. Rural electric cooperatives were formed by their member-owners to provide electric service to their members at the lowest reasonable cost consistent with adequate and reliable service standards.

NRECA appreciates the opportunity to provide the Financial Accounting Standards Board "FASB" with our comments on the Exposure Draft of the Proposed Statement of Financial

*Accounting Standards Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R).*

NRECA agrees with FASB's desire to develop accounting standards that will make employer's financial statements "more complete and understandable." However, we respectfully submit that for the reasons set forth in this comment letter and the comment letters of others such as the American Benefits Council, the positions taken in the FASB Exposure Draft would have the opposite effect. Moreover, if the Exposure Draft is implemented, we request the Board reconsider (in the case of underfunded plans) the implications of the debit side of this entry to entities such as rural electric cooperatives and their consumer member owners.

**The Proposed Accounting of the Exposure Draft will have a Disproportionate Impact on Rural Electric Cooperatives**

Based on a preliminary analysis of a small sample of postretirement benefit data, it appears that equity levels of rural electric cooperatives could be significantly reduced if the Exposure Draft were implemented as proposed. In addition, we believe that significant volatility could be introduced to the financial statements without any corresponding benefit to the users of the financial statements.

The Exposure Draft specifically requests examples that relate to Issue 3(b) in which an entity may have contractual covenants other than for debt service that may reference financial statement amounts. There is one such area that will have a significant impact upon the operations

of rural electric cooperatives in a regional transmission organization "RTO" or independent system operator "ISO" with organized wholesale energy markets.

The operating rules of an RTO/ISO require that market participants subject themselves to a credit determination by the RTO/ISO based on certain criteria, one of which includes the equity level of the entity. If the Exposure Draft proposals were made permanent, they would dramatically distort the financial status of companies like rural electric cooperatives, and would unfairly and improperly make these entities appear less credit worthy. While our members have been successful in getting market administrators to consider other elements of credit quality such as the all-requirements contracts that rural electric cooperatives have with their members, equity is still an important element in the credit analysis. Any action by the FASB that has the effect of reducing equity levels of rural electric cooperatives could compromise their ability to participate in wholesale energy markets and possibly jeopardize their ability to fulfill the goal of enhancing our national energy policy and security by making all of our generating resources available to the markets to facilitate the efficient and reliable operation of the energy markets and the regional transmission grid.

### **The Exposure Draft's Proposed Accounting may Have a Negative Effect on Vendor Relationships in Rural America**

One additional area which should be addressed is the disproportionate impact on entities such as rural electric cooperatives in their vendor relationships. Unlike investor owned enterprises that seek to maximize the return on capital for their stockholders, rural electric cooperatives, as non-

for-profit entities, are operated to minimize the cost of providing safe, reliable energy to their consumer member owners. As a consequence, the cooperative business model neither requires nor encourages the accumulation of significant amounts of retained equity. While lenders to rural electric cooperatives may understand generally accepted accounting principles as they apply to not-for-profit, member owned enterprises; it is unlikely that many of our vendors in rural America will have such a refined view in the face of the apparent deterioration in our financial statements. This could place entities such as rural electric cooperatives at a distinct competitive disadvantage should we experience a loss of credit (or enjoy credit on less favorable terms), not because any element of our business had changed, but because of the application of accounting standards which reduced equity levels yet did not mandate the use of cash from current operations.

**Proposed Alternative Accounting Should the Rural Electric Cooperative's Board of Directors Decide to Fully Fund the Pension or Postretirement Benefit Plan**

One suggestion which we would advance as a possible solution to the problem of disproportionate impact upon rural electric cooperatives could be an alternative treatment of the debit side of the entry which would recognize the underfunded pension or postretirement benefit plan. We would propose that instead of a debit to other comprehensive income or beginning retained earnings in the case of a transition obligation, FASB could allow rural electric cooperatives the option of immediate recognition in the statement of operations of the amount that would otherwise have been placed in the equity section of the balance sheet if the Exposure Draft is implemented. This would ensure that rural electric cooperatives could have the ability to

obtain regulatory approval for recovery of the underfunded portion of defined benefit plans as well as postretirement benefit plans. This approach would also mitigate the collateral damage that could be caused by a significant reduction in equity that would result from a debit to other comprehensive income or retained earnings of rural electric cooperatives that operate on a book value basis which includes as a fundamental principal the subordination of capital.

**Does the Pension Benefit Obligation “PBO” and the Accumulated Postretirement Benefit Obligation “APBO” Meet the FASB’s Own Definition of a Liability?**

Statement of Financial Concepts 6, *Elements of Financial Statements* defines a liability as “probable future sacrifices (emphasis added) of economic events arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.” Paragraph 36 of Concepts Statement 6 provides, in part: “A liability has three essential characteristics..(b) the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the sacrifice, and (c) the transaction or other event obligating the entity has already happened.” Additionally, the FASB has proposed in the new standard relating to *Fair Value Measurements* that fair value is “the price that would be received for an asset or paid to transfer a liability in a transaction between market participants at the measurement date.” Additionally, Statement of Financial Accounting Standards (SFAS) 133 and SFAS 143 discuss fair value in a similar manner. Specifically, SFAS 133 Appendix F Definition of Fair Value provides that fair value is “The amount at which an asset (liability) could be bought (incurred) or sold (settled) in a current transaction between willing parties, that is, other than in a forced or liquidation sale.” SFAS 143, paragraph B32 provides

“Consequently, in its deliberations leading to the revised Exposure Draft, the Board concluded that the objective for the initial measurement of a liability for an asset retirement obligation is fair value, which is the amount that an entity would be required to pay in an active market to settle the asset retirement obligation in a current transaction in circumstances other than a forced settlement. In that context, fair value represents the amount that a willing third party of comparable credit standing would demand and could expect to receive to assume all the duties, uncertainties, and risks inherent in the entity’s obligation.” We believe that, based upon the FASB’s own definition of a liability, and what constitutes fair value, the Exposure Draft fails to provide additional or more relevant information in the following instances:

- The Accumulated Benefit Obligation “ABO”, as the present value of benefits actually earned by employees as of the date of the valuation of the defined benefit pension plan, is a better measure of the “probable future sacrifices” of the enterprise as opposed to the PBO. The PBO is, at best, a hypothetical measurement that has a tenuous relationship to what one would normally consider to be a true liability. We are aware of no other area of accounting in which the theoretical attribution of future costs which may or may not be incurred, results in the recognition of an actual liability on the balance sheet.

Accordingly, we believe that the use of the PBO is not an appropriate measurement and will, in fact, result in less comparable and useful financial statements. Since the PBO is a hypothetical theoretical construction, it has no reality outside of the documents which describe it. That is, since no other forms of liability have the characteristic of being valued by the assumed and imputed future actions of the enterprise, we do not believe that it is prudent of the FASB to mandate the use of such a “liability” that is devoid of economic substance. If the PBO did have economic substance, the marketplace would

have provided solutions in the form of insurance or other derivative products to facilitate the risk management of this "liability". Alternatively, the ABO, since it represents an amount that can be settled at a particular point in time, and could therefore have a fair value, would be the better approach to measurement of the defined benefit pension liability.

- Use of the APBO to measure the liability of a postretirement benefit plan does not meet the definition of a liability described in Concepts Statement No. 6. That is, the APBO cannot be said to result in a *probable* future sacrifice of assets if management has the discretion to modify or eliminate a postretirement benefit plan at will. The term "probable" as used in Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies* is widely understood to mean "the future event or events are likely to occur." Given the absolute discretion of management to make and enforce changes in a postretirement benefit plan, (except, perhaps, in the case of certain collective bargained agreements) we do not see how the APBO could be characterized as a liability that is "probable" of occurring. Additionally, the APBO cannot be considered to be the current fair value of a liability for benefits to be provided under a postretirement benefit plan.

It is ironic that the FASB is proposing, in the project related to planned major maintenance activities, to deny companies the option of accruing major maintenance costs in advance and recognizing a liability for future costs which may be incurred during the next planned major maintenance event. In this case, the FASB believes that the liability under the accrue-in-advance method does not meet the definition of a liability as provided by Concepts Statement No. 6. Yet, in this instance, the liability for planned major maintenance is the result of future costs yet to be

incurred, the same "problem" that exists with regard to using PBO and APBO as measurement of the liability under the Exposure Draft.

**Deferral of the Effective Date Would be a Just and Reasonable Result**

Considering the likely significant impact of the proposed accounting of the Exposure Draft upon rural electric cooperatives as well as individuals in rural America, we respectfully request that the FASB consider delaying the implementation of any final statement to enable entities time to assess and plan for implementation. Specifically, we are concerned that the issuance of a final statement, possibly as early as the third quarter of 2006, with an effective date of the end of 2006, will not afford rural electric cooperatives time to properly measure and consider the impact of any final statement.

**The Business Model of Rural Electric Cooperatives Involves the Subordination of Capital  
Consequently Accounting Standards Designed for Investor-Owned Enterprises Can  
Disproportionately Impact the Cooperative and It's Member/Owners**

Rural electric cooperatives are unique in that they are businesses, yet they operate on a not-for-profit basis but, in accordance with FASB Concepts Statement 4 paragraph 7, still utilize generally accepted accounting principles that are applicable to enterprises in general. In recent years, the evolution of accounting standards toward a focus on debt and equity investors has resulted in the potential for increased and disproportionate collateral damage to entities such as rural electric cooperatives whose business model includes the concept of the subordination of

capital. That is, in a rural electric cooperative, a member typically has one vote, regardless of how much business is done with the cooperative. Therefore the interest of capital is subordinated, unlike an investor-owned enterprise in which voting rights are determined by reference to the number of shares of common stock owned by the shareholder. Cooperatives are the only form of business enterprise in which the interests of the owners of the business are totally aligned and synchronized with the interests of the customers of the business since they are one and the same.

Rural electric cooperatives obtain all of their equity from their members-owners. Equity to a rural electric cooperative represents the excess of cost over the price charged to the membership for the provision of electric service. Since rural electric cooperatives operate on a not-for-profit basis, rates are set at the lowest possible level which will enable the rural electric cooperative to maintain efficient and reliable electric service while paying for all of the costs of operation. Our debt covenants with our lenders typically require the equity margins supplied by our member-owners be collected in rates. Rural electric cooperatives are primarily financed with debt capital as opposed to equity capital. Since the equity of any one member in the rural electric cooperative is related to the excess of price charged to the individual member over the cost incurred by the cooperative to supply electricity, there is no incentive for a cooperative to increase its rates to collect more equity from each member (unless such action would be for the sole purpose of building reasonable reserves for a valid business purpose). The rates that rural electric cooperatives charge their member-owners are determined by a reasoned decision of the cooperative's board of directors which is comprised of member-owners and is duly elected by the entire membership.

**The Likely Societal Impact upon Rural America as a Result of the Proposed Accounting of the Exposure Draft may be Disproportionate and Severe**

As you might imagine, businesses in rural America have a difficult time recruiting and retaining human resources. Historically, rural electric cooperatives have offered lower salaries but better benefits than many investor-owned entities. Implementation of a final statement based on the Exposure Draft will likely have a disproportionate impact upon rural electric cooperatives as well as the rural communities they service across America.

The impact of a new accounting standard for postretirement benefit and pension plans will not be limited to financial statements only, but will be felt in every rural community and town in all regions of this country. One important function of rural electric cooperatives is their concern for community as evidenced by their involvement in all aspects of the culture and activities of their communities including local economic development efforts. Rural communities and towns that are struggling to attract and retain jobs and compete with the major metropolitan areas of the United States for intellectual capital and human resources will inevitably be further disadvantaged as the businesses in those communities including rural electric cooperatives are required to curtail or abandon benefits such as postretirement healthcare which are critical and essential in rural areas where personal income is lower and access to adequate healthcare is not always a given.

Any accounting standard that would reduce equity levels by the magnitude of the proposed accounting in the Exposure Draft will disproportionately impact the financial statements of the rural electric cooperative and the businesses they serve. Moreover, it could well have real and profound effect upon citizens all across rural America as companies of all types may curtail or abandon benefit plans and other postretirement benefit plans in response to the proposed accounting which is put forth in the Exposure Draft since this is the only element related to this issue over which companies may exercise any control.

### **Conclusion**

We greatly appreciate and applaud the efforts of the FASB to enhance transparency in financial reporting. We believe, however, that the PBO and the APBO are not appropriate measures of the liability of employers that provide defined benefit plans and/or other postretirement benefit plans. We also believe that the Exposure Draft may add significant liability and volatility to financial statements without adding increased value to the users of the statements. We continue to be very grateful to those on the FASB staff that have taken the time to listen to our concerns in the past. If we may be of additional assistance in any capacity, or if we may clarify any of our comments, please do not hesitate to call on us.

Sincerely,

s/Russell D. Wasson  
Director of Tax, Finance and Accounting Policy