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LETTER OF COMMENT NO. 89



May 31, 2006

Ms. Suzanne Bielstein  
Director – Major Projects and Technical Activities  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

Subject: File Reference No. 1025-300

Dear Ms. Bielstein:

The Edison Electric Institute (EEI) appreciates the opportunity to comment on the Financial Accounting Standards Board's (FASB or the Board) Exposure Draft of proposed Statement of Financial Accounting Standards (SFAS), *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans — an amendment of FASB Statements No. 87, 88, 106, and 132(R)*.

EEI is the association of the United States shareholder-owned electric companies, international affiliates and industry associates worldwide. Our U.S. members serve 97 percent of ultimate customers in the shareholder owned segment of the industry, and 71 percent of ultimate electric utility customers in the nation. They generate almost 60 percent of the electricity produced by United States electric generators.

We support the Board's objective of improving transparency for financial reporting and agree with its objective of improving the understandability and representational faithfulness of amounts reported on the balance sheet. We also recognize the challenges inherent in developing a standard that accomplishes those objectives. While we welcome the Board's effort to achieve its objectives, we have serious concerns about the significant financial statement changes and the implementation timing proposed in this Exposure Draft.

We are concerned that the proposed changes presuppose outcomes in the Board's more comprehensive reconsideration of measurement and recognition issues slated for the second phase of this project. The changes in accounting prescribed in the current Exposure Draft could be overturned by conclusions in the second phase. This would lead to a second revision of financial statements, the doubling of implementation costs and added confusion for the users of the financial statements. For these reasons, we strongly recommend that the pension project be a **single comprehensive project** that addresses all desired objectives and not a two-phase project as proposed. As we will discuss further below, there are key issues that would be more appropriately addressed in a single comprehensive project.

We understand that the Board does not, and should not, take policy issues into consideration when determining appropriate accounting. However, the concept of "neutrality" as discussed in Statement of Financial Accounting Concepts No. 2, *Qualitative Characteristics of Accounting Information*<sup>1</sup>, implies that the Board will have completed the steps necessary to ensure that proposed changes in accounting are supported by the conceptual framework and enhance the relevance, reliability and representational faithfulness of the financial information presented. For example, the Board is proposing a change in the measurement of the balance sheet liability but will not address which method of measurement is most appropriate until the second phase of the project. This approach could lead to unwarranted management decisions regarding funding, investment and plan design that would be dramatically different following the outcomes of a second phase, resulting in confusion and complexity rather than clarity and transparency. We recognize the importance of providing accurate, transparent and timely information to financial statement users; however, until the measurement and recognition issues are fully deliberated and resolved in a single comprehensive project, we believe any changes would be premature and would not benefit investors, creditors or the financial community.

**Projected Benefit Obligation (PBO) vs. Accumulated Benefit Obligation (ABO)**

Use of the PBO to measure a company's over- or underfunded status at the balance sheet date is inconsistent with other Board standards and does not meet the definition of a liability as discussed in Statement of Financial Accounting Concepts No. 6, *Elements of Financial Statements* (Concept 6).

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<sup>1</sup> See Statement of Financial Accounting Concepts No. 2, paragraphs 98 and 100

In its proposed standard entitled *Fair Value Measurements*, the Board defines fair value as "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." That definition of fair value is consistent with the discussion of fair value in Statement Nos. 133<sup>2</sup> and 143<sup>3</sup> in that fair value represents a value at the measurement date (or in this case the balance sheet date). The ABO appears to be a more appropriate measure of the obligation than the PBO because it represents a value at a current point in time that could be settled between parties. As an example, annuity contracts based on the ABO could be purchased to settle a pension liability but an insurer would not undertake an obligation to settle a pension liability contingent on future actions by the employer (i.e., the PBO).

In addition, the PBO does not satisfy the criteria for recognition of a liability. As discussed in paragraph 36 of Concept 6, a liability has three essential characteristics: (a) it embodies a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, (b) the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and (c) the transaction or other event obligating the entity has already happened. With respect to criterion (a), an employer's present duty is to provide retirement benefits up to the ABO amount because that is the *earned* portion of the retirement benefits at the balance sheet date. With respect to criterion (b), employers can unilaterally cancel the portion of the plan related to future compensation levels. With respect to criterion (c), the events (i.e., pay increase and service to the company) have not occurred and may not occur unless the employer chooses to grant such an increase to the employee and the employee remains with the company. Using an example from the planned major maintenance project, the FASB and the Securities and Exchange Commission (SEC) have preliminarily agreed to eliminate the accrue-in-advance method for planned major maintenance. Both bodies acknowledged that the accrue-in-advance method does not meet the Concept 6 definition of a liability. In a letter from the SEC to the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants, the SEC has stated that "the staff believes that it is inappropriate to

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<sup>2</sup> Statement No. 133, Appendix F, Definition of fair value - 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.

<sup>3</sup> Statement No. 143, paragraph B32 - 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 of the duties, uncertainties, and risks inherent in the entity's obligation

apply the 'accrue-in-advance' method and recognize a liability for the *future costs* expected to be incurred in connection with the next planned major maintenance activity." Similarly, using the PBO would recognize a liability for *future costs* that may be incurred, with such costs not fully complying with the current definition of a liability. In addition, unlike some planned costs for a major maintenance activity, there is generally no contractual obligation for future salary increases — the employer/employee arrangement is "at will."

However, recognition using the ABO is a reasonable extension of accounting under SFAS No. 87, *Employers' Accounting for Pensions*. In accordance with Statement 87, the excess, if any, of the value of the ABO above the fair value of the pension assets is recognized on the balance sheet. Using this measure to recognize amounts on the balance sheet would be a natural extension of current practice and be consistent with the Concept No. 6 definition of a liability in that the ABO represents an entity's obligation to provide benefits based on compensation levels and years of service up to the reporting date.

Similar to the PBO, the accumulated postretirement benefit obligations (APBO) does not represent the current fair value of the liability for other postemployment benefits (OPEB) as of the balance sheet date. There is no equivalent to the ABO measure for OPEB. The FASB should not default to the APBO simply because of the absence of a better measure to record pension liability amounts in the financial statements.

#### **Balance Sheet Recognition of Funded Status and Unrecognized Costs**

The public policy issue relative to pension and other postretirement plans is focused on the level of underfunding relative to the PBO and the APBO. With the required pension and OPEB disclosure, Congress and the general public may be under the impression that these amounts represent the current fair value of the benefit obligations, yet as noted above, there is overwhelming evidence to suggest that these are not the best measures of a company's current obligations. The accounting relative to funded status should be based on the correct measurement and recognition of the pension and OPEB obligations. The issue of underfunded pension and OPEB plans is not an accounting issue.

The central accounting issue that needs to be addressed relates to unrecognized costs. The proposed standard would require two companies, with equal amounts of unrecognized costs but with different levels of plan funding to recognize the same charges to equity for the unrecognized amounts. Because the unrecognized amounts assume the PBO and the APBO are the correct measures of the benefit obligations, companies will charge equity for costs that

have not been incurred. The value of the benefit obligations determines the amount of unrecognized costs. The level of unrecognized costs varies based on plan changes, assumption changes and asset performance. Prematurely setting the PBO and APBO as the appropriate measures of benefit obligations in the first phase of this project will not encourage companies to fully fund their plans but will encourage them to reduce plan benefits. This action may be taken to avoid or reduce the equity charge that would be incurred upon implementation.

#### **Costs versus Benefits**

It is true that the cost to gather the necessary information to comply with the proposed standard is not significant in most cases; however, we do not believe that the benefits of the proposed standard outweigh all of the costs. The Board has not addressed the incremental indirect costs that would result from implementation of the Exposure Draft and not all of those costs would be one-time charges. Such costs could include legal fees to negotiate and amend contracts or agreements that rely on certain financial information that would be affected by the proposed statement; increased financing costs and fees for compliance with contracts and agreements due to the accounting changes (e.g., a company's interest rate might increase because, as a result of a lower equity balance the company would be considered more risky than before the adoption of changes); and for a rate-regulated company, the additional costs to update rate structures within each jurisdiction in which it operates. In the absence of updating the regulated rate structures within each jurisdiction, the reduction in equity could result in lower allowed earnings in some cases where allowed earnings are based on return on equity calculations.

With respect to the benefits, the FASB has indicated that one of the chief results from this proposed standard would be improved clarity about the funded status of a company's pension plans. As discussed previously, the proposed standard would not necessarily provide that clarity and could in fact prove to be more confusing. In addition, this is a two-phase project that will in effect double the costs (examples of those costs are discussed above) to implement changes and add to the confusion through a second revision of financial statements. Given this lack of clarity in combination with the direct and indirect incremental costs described above, the benefits of the proposed standard do not outweigh the costs of implementation.

### **Elimination of Early Measurement Date**

Eliminating a company's ability to use a measurement date that is earlier than its company's fiscal year end could impair the company's ability to prepare accurate financial statements on a timely basis. The Exposure Draft proposes eliminating the provisions of SFAS 87 and SFAS 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, that allow a company to measure and report plan assets and benefit obligations as of a date not more than three months prior to the company's fiscal year end. While it may conceptually appear desirable to use the fiscal year end as the measurement date, we strongly believe that practical considerations outweigh the perceived benefits. The early measurement date serves to facilitate the process of gathering reliable information and evaluating the results for fiscal year end reporting. The process of selecting assumptions, performing calculations and gathering and verifying information about the fair value of plan assets and the current measure of the benefit obligations is time consuming. An early measurement date allows the additional time that may be necessary to ensure that financial information relating to the pension and other postretirement benefit plans is reliable and accurately reflects transactions and events occurring during the measurement period.

### **Implementation Timing**

Within the Exposure Draft's implementation timeline, rate-regulated entities would face significant challenges in implementing this proposed Standard while securing recovery through rates that would support recognition under SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*. As you are aware, rate-regulated entities recover their costs of providing service through rates approved by their state public service commissions. Considering the complexities of pension accounting and the due processes associated with rate changes to which all rate-regulated entities are subject, the proposed effective date for the new standard is impractical for rate-regulated companies. A longer implementation timeframe is needed to seek costs recovery in a regulated environment. As an illustration, the transition obligation is currently included in a rate-regulated entity's costs as part of its rate structure. Under the proposed standard this cost would be immediately charged to retained earnings, thus eliminating rate recovery unless an action by the regulator occurs. Regulators have certain processes that rate-regulated entities must follow in order to obtain specific accounting orders for items such as the proposed change in accounting for transition obligations. If the Board issues a final Statement late in 2006 and requires calendar year-end companies to implement it by the end of 2006, rate-regulated companies would not be provided adequate time to educate their regulators, and allow them to perform their due diligence and issue orders before

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the end of the year. Pending the outcomes of a second phase of this project, this entire due diligence process would be repeated with the regulators.

In conclusion, we support the Board's efforts. We agree that the current disclosure requirements could be improved. However, as indicated by our comments, there are several key issues that require further consideration that can only occur through a **single comprehensive project**. EEI appreciates the opportunity to respond to the proposed Statement. We hope that our comments will be helpful and look forward to working with the Board in the future.

Sincerely,

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David K. Owens  
Executive Vice President  
Business Operations

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