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LETTER OF COMMENT NO. 147

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

Subject: File Reference No. 1025-300

Dear Director:

Eaton Corporation appreciates the opportunity to respond to the Financial Accounting Standards Board's (the Board) Exposure Draft (ED) on *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R)*. Eaton Corporation is a global company having annual sales of \$11.1 billion with over 60,000 employees in over 27 countries serving the electrical, fluid power, truck and automotive markets.

Recognition of Funded Status

We recognize the objective of the ED is to improve the financial reporting of liabilities related to pension and other postretirement benefit plans by requiring plan sponsors to report the current economic status for the plans in the balance sheet. However, we believe the current accounting convention of reporting the net unfunded accumulated benefit pension obligation in the balance sheet meets the spirit of recognizing the impact of potential pension liabilities to a company as of the date of the most recent balance sheet. Expanding this reporting to include the net unfunded projected benefit obligation (PBO) in the balance sheet will overstate pension liabilities in the balance sheet, since a portion of the unfunded PBO relates to projected compensation increases that are projected to occur in future years, but have not occurred at the date of the most recent balance sheet. Likewise, a change to recognize the full accumulated postretirement benefit obligation (APBO) for other postretirement plans in the balance sheet will further overstate liabilities on the balance sheet, since the obligation for other postretirement liabilities can be changed or eliminated at any time on the behalf of the employer.

Elimination of Early Measurement Date

We are very concerned with the elimination of the early measurement date. The Board should retain the current three-month early measurement date, or at least allow for up to a one-month early measurement date. The benefit obligation associated with retirement plans is such that it would not materially differ within a

short period of time and, accordingly, the cost of implementing the Board's proposal, as described below, would far outweigh any benefit achieved.

For multinational organizations like Eaton, the requirements for the completion and company review of the actuarial calculations as of the date of the balance sheet, on top of the new and extensive requirements for Sarbanes-Oxley 404 that have recently been added to the finance staff burdens, will make it extremely difficult and costly to meet internal and external financial reporting deadlines. In addition, many non-qualified benefits or benefits without a funded trust arrangement are processes from local payroll or benefit systems, which require a standard closing cycle to quantify benefit payments. It will be costly to adjust the local payroll or benefit systems, collect actual trust returns, actual benefit payments for non-qualified plans, and retiree medical payments from third party administrators, in sufficient time to meet financial reporting deadlines. In order to meet these time constraints, companies may be forced to estimate these components, which would in turn force the estimation of other components, thereby reducing the precision of the reported results.

An additional concern related to the elimination of the early measurement date is that defined benefit and other post retirement plans require significant actuarial calculations provided by outside consultants, and subsequent review by outside auditors. The requirement to measure these liabilities as of year-end will create significant pressure on actuaries to be able to meet year-end reporting deadlines of public companies, which deadlines will be further accelerated for year-end 2006 reporting, and additional pressure on outside auditors to complete the year-end audit. One consequence is that companies will incur additional costs to obtain scarce actuarial and audit resources, in order to still maintain timely reporting to outside constituents.

Effective Date of the New Standard

We are also very concerned with the effective date of the new standard. The new standard is not expected to be issued in final form until sometime in September 2006 and it would have to be implemented by calendar year-end companies effective December 31, 2006. It is not appropriate to have a standard issued so near to the end of the year and to require implementation by the end of that same year. We believe that more time will be necessary to ensure the appropriate processes have been put in place, training has been conducted and analyses have been performed, to ensure the information is complete and accurate.

Additionally, implementation so close to the end of the year will result in a change in the internal control environment related to the Sarbanes-Oxley processes, which will require additional testing and validation of internal controls related to the new accounting and reporting requirements.

Interim Reporting Requirements

As written, it is unclear whether the requirement that the measurement date of pension and other postretirement plans be equal to the balance sheet reporting date, would apply to only annual balance sheets. A possible interpretation of paragraph 5 of the ED is that the assets and liabilities be remeasured each quarter. For

multinational organizations such as Eaton, the cost and time associated with the remeasurement each quarter will be exorbitant.

Restatement of Financial Statements

We question the benefits of the requirement to restate financial statements for prior years for these new rules. Retrospective application of the rules will be costly, especially for multinational organizations such as Eaton with many U.S. and international plans, since the actuarial calculations for each plan would need to be re-worked. Also, the restated financial information will not be comparable with information previously reported to users of the financial statements.

We appreciate the Board's consideration of these important matters and welcome the opportunity to discuss any and all issues with the Board at its convenience. Comments requested by the Board on selected issues contained in the Exposure Draft are included below. If you have questions regarding this letter, please call me at (216) 523-4175.

Sincerely,

Billie K. Rawot

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Vice President & Controller
Eaton Corporation

Comments on Specific Proposed Disclosure Issues

Our comments on the Board's specific proposed disclosures (paraphrased in italics) are as follows:

Issue 1: Costs of Implementing the Proposed Statement's Requirement to Recognize a Plan's Overfunded or Underfunded Status in the Employer's Statement of Financial Position

The Board concluded that the costs of implementing the proposed requirement to recognize the overfunded or underfunded status of a defined benefit postretirement plan in the employer's statement of financial position would not be significant. That is because the amounts that would be recognized are presently required to be disclosed in notes to financial statements, and, therefore, new information or new computations, other than those related to income tax effects, would not be required.

We believe the non-economic costs of the Board's proposals are significant, since it will lead to the overstatement of pension and other postretirement benefit liabilities on the balance sheet, resulting in the presentation of less meaningful information to users of the financial statements. These costs are in addition to the potentially increased out-of-pocket costs that companies will incur to obtain scarce actuarial and audit resources, especially those companies that may be required to move their measurement date, in order to still maintain timely reporting to outside constituents, as further described below.

The current accounting convention of reporting the net unfunded accumulated benefit pension obligation in the balance sheet meets the spirit of recognizing the impact of potential pension liabilities to a company as of the date of the most recent balance sheet. Expanding this reporting to include the net unfunded projected benefit obligation (PBO) in the balance sheet will overstate pension liabilities in the balance sheet, since a portion of the unfunded PBO relates to projected compensation increases that are projected to occur in future years, but have not occurred at the date of the most recent balance sheet. Likewise, a change to recognize the full accumulated postretirement benefit obligation (APBO) for other postretirement plans in the balance sheet will further overstate liabilities on the balance sheet, since the obligation for other postretirement liabilities can be changed or eliminated at any time on the behalf of the employer.

Issue 2: The Employer's Measurement Date

The Board believes that unless a plan is sponsored by a subsidiary that is consolidated using a fiscal period that differs from the parent's, this proposed Statement would require that plan assets and benefit obligations be measured as of the date of the employer's statement of financial position. This proposed Statement would eliminate the provisions in Statements 87 and 106 that permit measurement as of a date that is not more than three months earlier than the date of the employer's statement of financial position.

We are very concerned with the elimination of the early measurement date. The Board should retain the current three-month early measurement date, or at least allow for up to a one-month early measurement date. The benefit obligation associated with retirement plans is such that it would not materially differ within a short period of time and, accordingly, the cost of implementing the Board's proposal, as described below, would far outweigh any benefit achieved.

For multinational organizations like Eaton, the requirements for the completion and company review of the actuarial calculations as of the date of the balance sheet, on top of the new and extensive requirements for Sarbanes-Oxley 404 that have recently been added to the finance staff burdens, will make it extremely difficult and costly to meet internal and external financial reporting deadlines. In addition, many non-qualified benefits or benefits without a funded trust arrangement are processes from local payroll or benefit systems, which require a standard closing cycle to quantify benefit payments. It will be costly to adjust the local payroll or benefit systems, collect actual trust returns, actual benefit payments for non-qualified plans, and retiree medical payments from third party administrators, in sufficient time to meet financial reporting deadlines. In order to meet these time constraints, companies may be forced to estimate these components, which would in turn force the estimation of other components, thereby reducing the precision of the reported results.

An additional concern related to the elimination of the early measurement date is that defined benefit and other post retirement plans require significant actuarial calculations provided by outside consultants, and subsequent review by outside auditors. The requirement to measure these liabilities as of year-end will create significant pressure on actuaries to be able to meet year-end reporting deadlines of public companies, which deadlines will be further accelerated for year-end 2006 reporting, and additional pressure on outside auditors to complete the year-end audit.

In addition, plan sponsors will face additional costs during the initial year of the elimination of the early measurement date due to the requirement to recognize any curtailment or settlement (gain)/loss, the change in the net actuarial (gain)/loss, and the additional net periodic pension cost incurred between the measurement date and fiscal year-end. For plan sponsors with multiple plans in multiple countries, these requirements will be costly to implement.

Issue 3(a): Effective Dates and Transition - Recognition of the Overfunded or Underfunded Status

The Board's goal is to issue a final Statement by September 2006. The proposed requirement to recognize the over- or underfunded statuses of defined benefit postretirement plans would be effective for fiscal years ending after December 15, 2006. Retrospective application would be required unless it is deemed impracticable for the reason discussed below. An entity would be exempt from retrospective application only if the entity determines that it is impracticable to assess the realizability of deferred tax assets that would be recognized in prior periods as a result of applying the proposed Statement.

We are very concerned with the effective date of the new standard. The new standard is not expected to be issued in final form until sometime in September 2006 and it would have to be implemented by calendar year-end companies effective December 31, 2006. It is not appropriate to have a standard issued so near to the end of the year and to require implementation by the end of that same year. We believe that more time will be necessary to ensure the appropriate processes have been put in place, training has been conducted and analyses have been performed, to ensure the information is complete and accurate.

Additionally, implementation so close to the end of the year will result in a change in the internal control environment related to the Sarbanes-Oxley 404 processes, which will require additional testing and validation of internal controls related to the new accounting and reporting requirements.

We question the benefits of the requirement to restate financial statements for prior years for these new rules. Retrospective application of the rules will be costly, especially for multinational organizations such as Eaton with many U.S. and international plans, since the actuarial calculations for each plan would need to be re-worked. Also, the restated financial information will not be comparable with information previously reported to users of the financial statements.

Issue 4: Effective Dates and Transition - Measurement Date

This proposed Statement would require a public entity that currently measures plan assets and benefit obligations as of a date other than the date of its statement of financial position to implement the change in measurement date as of the beginning of the fiscal year beginning after December 15, 2006. If that entity enters into a transaction that results in a settlement or experiences an event that causes a curtailment in the last quarter of the fiscal year ending after December 15, 2006, the gain or loss would be recognized in earnings in that quarter. Net periodic benefit cost in the year in which the measurement date is changed would be based on measurements as of the beginning of that year.

Eaton agrees with the Board's conclusion that if an entity enters into a transaction that results in a settlement or experiences an event that causes a curtailment in the last quarter of the fiscal year ending after December 15, 2006, the gain or loss would be recognized in earnings in that quarter. However, as described in Issue 3(a), we are very concerned with the effective date of the new standard (i.e., year-end 2006 for calendar year-end companies). As described in Issue 2, we are also very concerned with the elimination of the early measurement date. Delaying the effective date to fiscal years ending after December 15, 2007, while allowing more time to develop new processes, would not eliminate the significant problems associated with the elimination of the early measurement date.

As written, it is unclear whether the requirement that the measurement date of pension and other postretirement plans be equal to the balance sheet reporting date, would apply to only annual balance sheets. A possible interpretation of paragraph 5 of the ED is that the assets and liabilities be remeasured each quarter. For

multinational organizations such as Eaton, the cost and time associated with the remeasurement each quarter will be exorbitant.