United Technologies Corporation
United Technologies Building
Hartford, CT 06101
(860) 728-6246

Gregory J. Hayes
Vice President
Accounting and Control

United Technologies

May 31, 2006

LETTER OF COMMENT NO. 170

Technical Director – File Reference No. 1025-300
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Re: 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)

Dear Mr. Herz:

On behalf of United Technologies Corporation (UTC), I appreciate the opportunity to comment on the proposed amendment of FASB Statements No. 87, 88, 106, and 132(R), *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*.

UTC, based in Hartford, Connecticut, is a diversified company that provides a broad range of high technology products and support services to the building systems and aerospace industries. We are located in over 60 countries worldwide and sponsor a large number of funded and unfunded domestic and foreign defined benefit pension and postretirement benefit plans. More than half of our revenues are generated outside the United States and more than 60 percent of our employees work outside the United States.

I support the FASB's effort to revisit the accounting and reporting for defined benefit pension and postretirement benefit plans. I understand that in issuing the proposed amendments the Board has as its primary objective improving the "understandability and representational faithfulness" of financial statements. I agree with this objective, however, I offer the following comments for your consideration.

Recognition of Overfunded or Underfunded Status of Defined Benefit Plans

The Exposure Draft requires companies to recognize in their statement of financial position the overfunded or underfunded status of a defined benefit postretirement plan measured as the difference between the fair value of plan assets and the benefit obligation. For defined benefit pension plans, the benefit obligation is the Projected

Benefit Obligation (PBO)[1]. For other plans, such as postretirement employee health care plans, the benefit obligation is the Accumulated Postretirement Benefit Obligation (APBO)[2].

In the context of pension plans, I believe that PBO is in conflict with the fundamental definition and characteristics of a liability. Accordingly, I believe that it would be inappropriate to recognize a liability in the statement of financial position based on a plan's PBO.

FASB Statement of Concepts No. 6 *Elements of Financial Statements* (CON No. 6) defines liabilities as probable future sacrifices of economic benefits arising from present obligations of a particular entity ... as a result of past transactions or events. CON No. 6 further provides that liabilities have three essential characteristics: (a) a present duty or responsibility..., (b) the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid future sacrifices, and (c) the transaction or other event obligating the entity has already happened.

PBO includes an assumption of future compensation increases that can be unilaterally changed or eliminated. In fact, of late, we have seen several large multi-national companies make unilateral changes in their defined benefit pension plans that have significantly reduced their obligations under the plan. Therefore, the future compensation component of PBO, which is earned only if the company chooses to provide this benefit and if the employee renders future service, does not represent an obligation that a company has "little or no discretion to avoid." Accordingly, use of PBO as a basis for liability recognition significantly overstates a company's liability as of a particular date.

An alternative measure of the amount of a company's liability could be the obligation's fair value. In the current working draft of FASB Statement No. 15X *Fair Value Measurements* fair value is defined as the price that would be received for an asset or paid to transfer a liability in a transaction between market participants at a particular date. A fair value measurement assumes an orderly transaction between market participants. FASB No. 15X indicates further that valuation techniques shall be consistent with the market approach, income approach, and/or cost approach. Of particular relevance to benefit obligations are the market approach, which uses observable prices or other relevant market information to measure fair value, and the income approach, which uses valuation techniques to measure fair value.

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[1] PBO is defined in FASB Statement No. 87 *Employers' Accounting for Pensions* as the actuarial present value as of a date of all benefits attributed by the pension benefit formula to employee service rendered prior to that date. The PBO is measured using assumptions as to future compensation levels if the pension benefit formula is based on those future compensation levels.

[2] APBO is defined by FASB Statement No. 106 *Employers' Accounting for Postretirement Benefits Other Than Pensions* as the actuarial present value of benefits attributed to employee service rendered to a particular date. Prior to an employee's full eligibility date, the APBO as of a particular date for an employee is the portion of the expected postretirement benefit obligation attributed to that employee's service rendered to that date.

The most appropriate representation of fair value, in my view, is the amount that the benefit obligation could be settled in a current transaction between willing parties, for example, by purchasing annuity contracts to settle the benefit obligation. This is effectively a market approach. In the context of pension obligations, that amount is not the PBO because the issuer of an annuity would not assume an obligation for future compensation growth. Rather, the amount is effectively the Accumulated Benefit Obligation which, as you know, is the actuarial present value of the obligation based on service and compensation rendered prior to a particular date.

I appreciate the FASB's desire to implement short-term, timely improvements in the accounting and reporting for postretirement benefit plans. However, it is imperative that any action undertaken by the FASB to require recognition of amounts in financial statements must be done in a theoretically appropriate manner. Expediency must not result in the recognition of misleading financial information. PBO overstates a company's liability as of a particular date and misleads financial statement users as to the liabilities of a company and, therefore, should not be the basis for liability recognition.

The Employers' Measurement Date

Under current practice, measurements of plan assets and obligations are made as of the date of the financial statements or, if used consistently from year to year, as of a date not more than three months prior to that date. UTC presently uses a November 30 measurement date for a majority of our pension and postretirement benefit plans. However, for all of our international benefit plans, we currently use a September 30 measurement date. We have found that additional time for international plans is required due to the additional logistical complexities associated with gathering all information required to perform an actuarial valuation for plans outside of the United States. The Exposure Draft requires that benefit plan assets and obligations be measured as of the date of an employer's statement of financial position (December 31 for UTC).

While I agree that having a measurement date as of the date of the statement of financial position is theoretically desirable, there are practical reasons for retaining current practice.

Need for More Timely Financial Reporting

In today's environment, companies are facing increasing external pressure to publish accurate financial results as early as possible. For public registrants, this is evidenced most recently by the Securities and Exchange Commission's (SEC) 2005 rule to accelerate the filing deadlines for certain reports required under the Securities Exchange Act of 1934, including Annual Reports on Form 10-K. To meet the accelerated reporting calendar, financial results must be completed internally within a few business days following a fiscal year-end. Sufficient time must be allowed for adequate management review and to prepare for communication of results to the

Board of Directors and the investor community. The delay in measuring benefit plan obligations that will result if the Exposure Draft is adopted is inconsistent with the desire for more timely financial reporting.

Complicated and Time Consuming Process

Unlike most other financial statement information, pension and postretirement benefit disclosures require gathering extensive information and subjecting it to complicated calculations, together with thorough analysis and management review. The process of selecting assumptions, gathering data, performing calculations and rigorously reviewing the outcome is a significant effort involving company and external resources. While this process may be manageable for companies with a small number of domestic plans, it is a very time consuming effort for companies, like UTC, with a large number of plans located throughout the world. For this reason, we currently have an early measurement date to make certain that there is sufficient time to gather the necessary data and perform a thorough review to ensure that financial statement information is accurate and reflects all transactions occurring during the reporting period. Elimination of a company's ability to have an early measurement date will undoubtedly lead to delays in financial reporting.

From a practical perspective, I share some specific concerns:

1. Availability of asset data – In our experience, information about the fair market value of plan assets for domestic benefit plans is not available until approximately three to four weeks following the reporting period. For international plans, this reporting lag may exceed one month. The inability to use a measurement date earlier than a company's fiscal year-end would result in unacceptable delays in the availability of critical information. This is unrealistic in the present environment where companies are faced with accelerated reporting calendars.

2. Establishing assumptions – During 2005, the SEC's Division of Corporation Finance issued its views on the accounting for pension and postretirement benefit plans, particularly with respect to the selection of discount rate assumptions. To meet the SEC's expectations, companies have rigorous and time consuming processes to determine the appropriate plan-specific discount rates. Other significant assumptions are subject to a similar rigorous process. It is unrealistic to expect that this assumption setting process can continue in this environment of accelerated financial reporting without an early measurement date.

Benefit Obligation is an Estimate that is Sensitive to Significant Assumptions

By their nature, benefit plan obligations are estimates based on assumptions established at the measurement date, including discount rates, future compensation levels, projected benefit payments based on assumed mortality, and health care cost

trends. The measure of these benefit plan obligations is highly sensitive to the assumptions used. While having a consistent measurement date would appear to result in consistencies across companies, there will continue to be inherent inconsistencies due to differing assumptions. Further, as a practical matter, to continue to report financial information within the reporting calendar, companies may be required to use additional estimates and assumptions that are less reliable than had they been allowed to use an earlier measurement date. While the effort to establish a consistent measurement date is a noble one, I do not believe that this effort of precision will result in more useful and reliable financial statements.

For the reasons set forth above, I believe that it continues to be appropriate to permit companies to use a measurement date earlier than the financial statement date, provided that such earlier date should not be more than three months prior to year-end. Of course, full disclosure of a company's plan measurement date would continue to be appropriate in this environment.

If the FASB finds retaining existing practice no longer acceptable, an alternative approach would be to acknowledge the practical difficulties in obtaining timely information to value plan assets and obligations and to specifically permit measurement at an earlier date with a roll forward of the latest measurement to the financial statement date. The Exposure Draft does not specifically allow these estimation techniques. When using this alternative approach, companies would perform a full valuation of plan assets and obligations as of an earlier date and update the results to the financial statement date by considering all material transactions and market factors occurring between the earlier measurement date and the financial statement date.

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I appreciate your consideration of these comments. If I can provide any additional clarification or assistance, please feel free to contact me.

Yours truly,

Gregory J. Hayes
Vice President, Accounting and Control