



Harvey L. Wagner
Vice President, Controller
and Chief Accounting Officer

Letter of Comment No: 10
File Reference: FSPFAS13-B
Date Received:

August 18, 2005

Lawrence Smith
Director of Technical Application and
Implementation Activities and EITF
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Dear Mr. Smith:

FirstEnergy appreciates the opportunity to respond to the Financial Accounting Standards Board's Exposure Draft of Proposed FASB Staff Position No. FAS 13-b, *Accounting for Rental Costs Incurred during a Construction Period* (FSP).

FirstEnergy is a diversified energy services holding company with \$31 billion of assets and \$12 billion in annual revenues. Our electric utility operating companies comprise the nation's fifth largest electric system, serving 4.4 million electric customers in Ohio, Pennsylvania and New Jersey.

We disagree with the FSP that rental costs associated with ground or building operating leases that are incurred during a construction period should be recognized as rental expense. We comment below where our conclusions differ from those proposed in the FSP.

FASB Technical Bulletin No. 85-3, *Accounting for Operating Leases with Scheduled Rent Increases*, paragraph 2, states that lessees should recognize lease expense on a "straight-line basis over the lease term unless another systematic and rational allocation basis is more representative of the time period in which the leased property is physically employed." Expensing rental costs during the construction period is not a rational allocation representative of the time period in which the leased property is physically employed as it ignores the fundamental principle of recognizing expenses in the period in which related revenues are derived.

Statement of Financial Accounting Standards (SFAS) No. 34, *Capitalization of Interest Cost*, paragraph 6, requires capitalization of interest costs associated with construction of a long-lived asset as part of that asset's historical cost. Specifically, paragraph 6 states:

"The historical cost of acquiring an asset includes the costs necessarily incurred to bring it to the condition and location necessary for its intended use. If an asset requires a period of time in which to carry out the activities necessary to bring it to that condition and location, the interest cost incurred during that period as a result of expenditures for the asset is a part of the historical cost of acquiring the asset."

Similarly, rental costs incurred during the construction of a long-lived asset should be capitalized if such costs are part of the historical cost of readying a long-lived asset for its intended use.

SFAS No. 34, paragraph 18 further states that, "the capitalization period shall end when the asset is substantially complete and ready for its intended use." Consistent application would suggest that once the asset is substantially complete, capitalization of rental costs incurred during the construction period should cease (e.g., rental costs paid prior to a store opening and while store personnel are being trained but after the store becomes substantially completed, should be expensed). Requiring rental costs to be expensed during the construction period would contradict this guidance.

SFAS No. 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects*, paragraphs 6 and 7, provides for the capitalization of certain costs incurred during construction of real estate projects to be sold or rented. The costs covered by SFAS No. 67 include real estate and property taxes, insurance and other project costs that are clearly associated with the acquisition, construction, and development of real estate projects. Even though SFAS No. 67 excludes from its scope the cost of real estate developed for an entity's own use, an analogy can be made in practice that the costs covered by SFAS No. 67 are similar to rental costs related to ground leases incurred during construction of buildings on leased land.

EITF No. 97-10, *The Effect of Lessee Involvement in Asset Construction*, requires a lessee to include ground rental costs incurred during the construction period in determining whether the lessee is considered the owner of a real estate project for accounting purposes because these costs "are considered to be part of total project costs, consistent with GAAP." *Total project costs*, as defined in EITF No. 97-10, "include the amount capitalized in the project by the owner-lessor in accordance with generally accepted accounting principles (GAAP) plus other costs related to the project paid to third parties other than lenders or owners."

SOP 98-5, *Reporting on the Costs of Start-Up Activities*, requires the cost of start-up activities to be expensed as incurred. However, paragraph 8 of SOP 98-5 excludes "costs of acquiring or constructing long-lived assets and getting them ready for their intended uses." Therefore, rental costs related to both ground and building leases are outside the scope of SOP 98-5.

In conclusion, we believe that current accounting standards clearly support the continued capitalization of rental costs associated with ground or building operating leases incurred during a construction period and the proposed FSP should not be adopted. Thank you for considering FirstEnergy's views on this important issue.

Sincerely,

