Edison Electric INSTITUTE

American Gas Association

November 1, 2016

Technical Director
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

File Reference No. 2016-290
Invitation to Comment – Agenda Consultation

Dear Ms. Cosper:

The Edison Electric Institute (EEI) and the American Gas Association (AGA) appreciate the opportunity to respond to the Financial Accounting Standards Board's (FASB or Board) Invitation to Comment – Agenda Consultation, File Reference No. 2016-290.

EEI is the association that represents all U.S. investor-owned electric companies. EEI members provide electricity for 220 million Americans, operate in all 50 states and the District of Columbia, and directly and indirectly employ more than one million workers. Safe, reliable, affordable, and clean energy powers the economy and enhances the lives of all Americans. EEI has dozens of international electric companies as International Members and hundreds of industry suppliers and related organizations as Associate Members. Organized in 1933, EEI provides public policy leadership, strategic business intelligence, and essential conferences and forums.

AGA, founded in 1918, represents 202 local energy companies that deliver clean natural gas throughout the U.S. There are more than 70 million residential, commercial and industrial natural gas customers in the U.S., of which almost 93 percent – more than 65 million customers – receive their gas from AGA members. AGA is an advocate for natural gas utility companies and their customers and provides a broad range of programs and services for member natural gas pipelines, marketers, gatherers, international gas companies and industry associates. Today, natural gas meets almost one-fourth of the energy needs in the U.S.

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EEI and AGA regularly work together on projects of mutual interest and impact to the energy utility sector broadly. We provide our comments below on certain specific questions in the Invitation to Comment that are most relevant to our members.

Intangibles

Question 1.1: Is the accounting for intangible assets (including research and development) a major financial reporting issue that the FASB should consider for improvement? Please explain why.

There has been significant change in the nature and extent of information technology used by organizations since the development of the authoritative literature that addresses the accounting for these costs. When SOP 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use* (ASC 350-40), was issued in 1998, the cloud computing business model was in its infancy and was not addressed within the SOP. Although license fees in cloud computing arrangements were subsequently addressed in the FASB's simplification guidance, Accounting Standards Update No. 2015-05, *Customer's Accounting for Fees Paid in a Cloud Computing Arrangement*, the complete cloud computing business model was not addressed.

Given the significant evolution of information technology over the last decade, and specifically the emergence of an entirely new business model for cloud computing, we believe that any modification to existing practice should involve a more comprehensive approach to software, specifically cloud computing arrangements. We acknowledge that there is diversity in practice in accounting for cloud computing expenditures as well as presentation and disclosure of software intangibles.

For these reasons, we continue to recommend a more comprehensive approach to software intangibles, including cloud computing expenditures, consistent with our prior comment letter dated November 18, 2014, File Reference: 2014-230. We understand that the FASB Staff is undertaking research on this topic, and we encourage that effort.

Question 1.2: If yes, should the issue be addressed broadly for all intangible assets or should it first be addressed for a subset of intangibles (for example, research and development)? Please explain why.

We believe the FASB should take a comprehensive approach to addressing the accounting for intangibles. The FASB should then review intangibles by subgroup to ensure the broad accounting is appropriate for each of the subgroups.

<u>Pensions and Other Postretirement Benefit Plans</u>

Question 2.1: Is the accounting for pensions and other postretirement benefit plans a major financial reporting issue that the FASB should consider for improvement? Please explain why.

We do not believe accounting for pensions and other postretirement benefit plans should be changed at this time. For the reasons mentioned below, we do not believe that the alternatives to benefit plan accounting outlined in the Invitation to Comment would improve the usefulness of financial information provided to users.

Elimination of the smoothing concept would increase volatility in current year earnings for today's economic transactions and events even though pension and OPEB obligations are generally settled over a long-term, future time period. Immediate recognition of a change in value of the PBO or plan assets in earnings introduces potentially irrelevant volatility if the obligation is not planned to be settled in the near term.

Users of financial information focus on costs that are reported in accordance with the reporting entity's elected and stated accounting policies, so mandating the elimination of smoothing would not necessarily provide better information than current guidance. One company in the utility industry, for example, has an immediate earnings recognition policy for benefit costs but excludes that impact via a non-GAAP adjustment for earnings calls and analyst use. This implies that investors may not view the elimination of smoothing as a change that would provide more relevant information.

<u>Income Statement</u>

Question 4.1: Is income statement presentation a major financial reporting issue that the FASB should consider for improvement? Please explain why. In making your assessment, what criteria were used?

Income statement presentation is not a financial reporting issue that the FASB should consider for improvement at a holistic level. Operating activities vary significantly between industries and specific companies, making it overly difficult to create a comprehensive definition or description that applies to all entities. The current practice of allowing management to define operating income based on its judgment and internal practices is the most effective method of providing decision-useful information to users. Specific prescriptions on the classification of transactions in the income statement should continue to be addressed through standard setting activities on individual topics.

Question 4.2: How should the components of net income be categorized, if at all? If the FASB were to develop an operating activities category and display a subtotal for operating income, how should the category be defined or described?

As noted above, EEI and AGA do not believe that operating activities can be comprehensively defined or described to consistently apply to all types of reporting entities. However, if the FASB determines that it should consider ways to improve the presentation of net income, we believe alternative A is the most likely of the three alternatives presented in the Invitation to Comment to provide useful information to users of financial statements. A principles-based description of operating activity would leave management the flexibility necessary to account for the unique structure and circumstances of their business so as to present the most decision-useful information to the users of their financial statements.

We do not believe that alternative B is likely to result in a workable solution due to the difficulty inherent in defining clearly distinct groups of reporting entities. As described in our response to Question 4.3 below, there are significant differences in the business model of entities within the same industry that cause entities with nearly identical operations to have significantly different drivers of operating income. Further, the difficulty of determining which definition of operating activities should be applied to entities involved in multiple operations would also cause this alternative to be complex and likely unworkable.

We do not believe that alternative C is consistent with the emphasis or needs of our users as it treats operating income as a residual. As stated in the proposed Concept Statement 8, users have historically focused on the likelihood that transactions or events represented in the financial statements will recur. A prescriptive definition of non-operating income is likely to result in unusual transactions that may not relate to the recurring operations of the business to be classified as operating income merely because they fail to meet the definition of non-operating income. Thus, this approach is inconsistent with the needs of financial statement users.

Question 4.3: Could an operating activity category be defined or described consistently and effectively for all types of reporting entities (for example, entities involved in financial services, investing, banking, and financing)

EEI and AGA do not believe that operating activities can be defined or described consistently and effectively for all reporting entities. Previous standard-setting efforts to prescribe a comprehensive definition of operating income as distinct from non-operating income have been unduly complex, and ultimately proved unworkable. The difference in business structure and operating environment do not allow for a comprehensive definition of operating activity.

For example, even within the utility industry, the diversity in the business structure of regulated and unregulated power companies changes the emphasis placed on the various types of activities included in operating income. A regulated power company is primarily affected by the amount of allowable property plant and equipment, the amount of operating and maintenance costs included in base rates, and the approved return on equity. However, the operating income of an unregulated power company is primarily affected by the market price of energy within its market area and its cost to produce or purchase power. Thus, while the operating activities of the two entities are nearly identical, it becomes unclear whether operating activities should be defined in reference to regulatory process and approval of regulated rate changes or solely in reference to the delivery of services to the end-use customers.

The definition may be further complicated by other elements of the business model and environment, such as whether the entity owns its own generating plants, and whether it uses financial instruments to hedge power prices. Such differences make it difficult to develop and apply a single definition of operating income even within a single industry. This difficulty would only increase when considering entities involved in different industries, making it excessively difficult to define or describe a single definition of operating activity.

Question 4.4: How should the FASB evaluate the benefits of a standardized definition versus a management determination of an entity's operating activities?

The benefits of various methods of determining what constitutes operating activities should be evaluated based on their ability to help users of financial statements understand the nature of the various transactions as they relate to the overall operating results of the reporting entity. A standard definition of operating activities is unlikely to accurately represent the operations of reporting entities in different, and possibly multiple, industries. It is also unlikely to accurately address the diversity in business structure and operating environment. Management is in the best position to determine how operating activities should be defined for its specific reporting entity. That determination can be disclosed in the accounting principles note to the financial statements.

Segment Reporting

Question 4.7: Is segment disclosure a major financial reporting issue that the FASB should consider for improvement? In making your assessment, what criteria were used?

We do not believe that segment disclosure is a major financial reporting issue that the FASB should consider for improvement at a holistic level. EEI and AGA are concerned that users of financial statements will always request more information related to segments even when that information is not useful in making investment decisions. The ensuing revisions could become onerous for financial statement preparers and/or could expose sensitive or competitive information. We recommend that no changes be made to segment disclosure requirements at this time.

Question 4.9: Would the described improvements to (a) reexamine the aggregation criteria and (b) apply the segment standard from a governance perspective provide more useful information to users of financial statements and why?

We do not believe the described improvements to reexamine the aggregation criteria would provide more useful information to users of financial statements. Greater standardization is inherently difficult when the same principles must be applied to entities across all industries. Increased standardization could result in segment aggregation that conforms to GAAP but would not provide the most decision-useful information to users of financial statements.

We also do not believe the described improvements to apply the segment standard from a governance perspective would provide more useful information to users of financial statements. We believe the most useful perspective for users of financial statements is the perspective of an entity's business activities through the eyes of management. We agree that applying the segment standard from a governance perspective may potentially result in less segment information than a Chief Operating Decision-Maker perspective. This would happen because segments would be identified from a higher level within the entity's hierarchy, which would be in conflict with the assumption that users of financial statements want more detailed information.

<u>Other Comprehensive Income</u>

Question 4.11: Is the presentation of other comprehensive income a major financial reporting issue that the FASB should consider for improvement? In making your assessment, what criteria were used?

The presentation of other comprehensive income is not a financial reporting issue that the FASB should consider changing. The users of our financial statements continue to focus on the current definition of net income as their primary evaluation of income, and treat the theoretical concept of other comprehensive income as an additional disclosure. Broad changes in the reclassification of amounts out of other comprehensive income would be inconsistent with the needs of users. Specific prescriptions on the reclassification of other comprehensive income into realized net income should continue to be addressed through standard setting activities on individual topics, such as the recent projects on financial instruments and derivatives and hedge accounting.

Question 4.12: Considering the two alternatives described for minimizing the use of reclassification adjustments, which alternative provides more useful information to the users of financial statements and why?

As noted above, EEI and AGA do not believe the presentation of other comprehensive income or the related reclassification adjustments should be considered for improvement as a single issue. However, if the FASB determines it should perform research on the current items recognized in other comprehensive income, alternative B is more likely to provide useful information to the users of the financial statements as it accurately recognizes the diversity of items presented in other comprehensive income as separate and distinct issues.

Question 4.13: Do the described improvements to (a) remove the option for presenting comprehensive income over two statements and (b) emphasize other earnings per share measures improve the relevance of the performance information included in other comprehensive income?

Both the users of our financial statements and the management of companies in our industry continue to focus on net income as the primary indicator of financial performance, and treat the theoretical concept of OCI as an additional disclosure. Accordingly, we do not believe that either requiring other comprehensive income on a single statement or emphasizing other earnings per share measures would improve the relevance of the financial statement and disclosures for users.

Cash Flow Statement

Question 4.18: What specific cash payments and receipts are in need of additional classification guidance?

ASC 230-10-45-23 requires all cash inflows and outflows from derivative instruments that include an other-than-insignificant financing element at inception to be considered cash flows from financing activities by the borrower. The only explicit exception is a financing element inherently included in an at-the-market derivative instrument with no prepayments. The application of this provision in the energy industry, particularly the interpretation of the term “inception,” has produced cash flow statement presentations that are not representationally faithful.

Energy companies often agree to assume (acquire) pre-existing derivative contracts for the purchase or sale of electricity or other energy commodities from other entities. Typically, such contracts were executed at market prices and had a zero fair value when originated. However, due to market price movements subsequent to initial execution, those contracts generally have a non-zero fair value when they are later acquired. Accordingly, the parties agree to exchange cash to compensate for the fair value at the transfer date.

When the acquiring company assumes preexisting derivative contracts that are out of the money, they require a cash payment to compensate for the derivative liability they are assuming. Due to market price volatility, such payments may be significant. In these cases, the acquiring company has been deemed to be the “borrower” because it receives cash and assumes a liability. Further, because the contract is “new” to the acquirer, the date of the acquisition of these contracts is interpreted by some to be the “inception” of the contract from the perspective of the acquirer.

As noted above, all cash flows from such contracts must be accounted for as a financing cash inflow under ASC 230-10-45-23. Thus, at inception, the initial cash receipt is considered a financing cash inflow. If the contract is an agreement to sell an energy commodity, then the acquirer will also receive cash inflows (equal to the notional multiplied by the contract price) over the term of the contract.

As a result of these requirements, the cash flow statement presentation of the acquirer is distorted in several ways. First, the cash flow statement presents a financing activity that has only cash inflows and no cash outflows over its entire term; in other words, it is a “financing” that is never repaid. Additionally, although such contracts relate to the ongoing operating activities of the acquirer’s business, none of the cash inflows from selling such energy commodities are permitted to be classified as operating cash flows, while all cash outflows necessary to acquire or produce the commodities sold must be classified as operating. As a result, we believe that this interpretation of the term "inception" in the case of acquisition of pre-existing derivative contracts, along with the presumption that all such cash flows are financing, results in a cash flow statement that is not representationally faithful.

This interpretation is inconsistent with the purpose of the standard (to identify a contractual arrangement that is structured to be a financing) and fails to distinguish between transactions involving the assumption of pre-existing contracts that have not had any structuring nor are intended to be financings. Therefore, we recommend that the Board consider modifying this provision to clarify that it is intended to apply to transactions structured at inception as financings and does not apply to cash payments necessary to compensate for market price movements subsequent to inception.

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EEI and AGA appreciate the opportunity to provide our input on the Invitation to Comment. We would be pleased to discuss our comments and to provide any additional information that you may find helpful.

Very truly yours,

/s/ Richard F. McMahon, Jr.

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