

April 25, 2016

Technical Director  
File Reference No. 2016-200  
Financial Accounting Standards Board  
401 Merritt 7  
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**File Reference: 2016-200: Compensation – Retirement Benefits (Topic 715) –  
Improving the Presentation of Net Periodic Pension Cost and Net Periodic  
Postretirement Benefit Cost**

Dear Ms. Cospers:

The Edison Electric Institute (EEI) and the American Gas Association (AGA) appreciate the opportunity to comment on the Financial Accounting Standards Board's (FASB or Board) Exposure Draft referenced above regarding improving the presentation of net period benefit costs (hereafter the "Exposure Draft").

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 directly employ more than 500,000 workers. With more than \$90 billion in annual capital expenditures, the electric power industry is responsible for millions of additional jobs. EEI has 70 international electric companies as Affiliate Members and 250 industry suppliers and related organizations as associate Members. Organized in 1933, EEI provides public policy leadership, strategic business intelligence, and essential conferences and forums.

The AGA, founded in 1918, represents 202 local energy companies that deliver clean natural gas throughout the United States. 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 United States' energy needs.

EEI and AGA regularly work together on projects of mutual interest and impact to the energy utility sector broadly, and the comments expressed herein represent the majority

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view of each organization's member companies and respond only to certain questions that are most relevant to our members.

### **Overall Comments**

As discussed in our comments below, this Exposure Draft proposes a fundamental change in the presentation of net benefit cost for pension and other postretirement plans for all companies, including those in the electric and gas utilities industry. We believe that the net benefit cost for these plans should continue to be recognized in operating expenses as compensation costs. This treatment, which is the historical accounting and reporting of these costs under GAAP, is consistent with the underlying nature of such costs, the longstanding (and unchanged) definition of what constitutes such costs and the associated obligation to pay benefits, and the appropriately comparable treatment afforded other types of costs that include multiple components that may be measured in different ways.

Furthermore, with respect to the electric and gas utility industry, the presentation proposed by the Exposure Draft would be inconsistent with the economic effects of cost of service rate regulation and regulatory accounting principles.

While we support the Board's efforts to simplify and improve U.S. GAAP, we do not believe that the Exposure Draft's proposal to change the way that net benefit costs are presented accomplishes either objective. The information that the proposal is intended to provide is currently readily available from the existing disclosure requirements of ASC 715-20-50-1, under which companies have been disclosing the various components of these costs in the footnotes to the financial statements for nearly 30 years. Separately presenting the components of the cost of a single benefit plan in more than one income statement category is not representationally faithful, is not conceptually supportable, and introduces unnecessary complexity for financial statement users rather than the simplification intended.

We strongly disagree with making such a change based on the assertion that "this presentation has less predictive value and requires users to incur greater costs in analyzing financial statements." To the extent that financial statement users believe the components of net benefit cost "are distinctly different in their persistence and character," the existing, readily available information easily enables them to adjust their analysis of the company's financial statements. Similarly, the claim of "reduced transparency" does not appear to be supportable given the fact that, as already stated, the information has been disaggregated in the footnotes to the financial statements for the past 29 years and will continue to be disclosed in the footnotes under the proposed changes to the 2016-210: Compensation – Retirement Benefits – Defined Benefit Plans – Changes to Disclosure Requirements for Defined Benefit Plans.

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We discuss the reasons for these views in detail below, and we recommend that the Board not adopt the changes proposed in this Exposure Draft. However, should the Board choose to proceed with the changes that have been proposed, we believe an exception should be granted to regulated utilities under ASC 980 for the reasons discussed below in response to Question 5.

***Question 1: Should the service cost component be reported in the income statement apart from the other components of net benefit cost as defined in paragraphs 715-30-35-4 and 715-60-35-9 and be the only component eligible to be capitalized in assets? Why or why not?***

We do not believe that the components of net benefit cost should be reported separately nor do we believe that only the service cost component should be capitalized in assets. We object to the proposed changes for the reasons detailed below.

### **Income Statement Presentation**

#### **The nature of compensation costs**

Employers promise pension and other postretirement benefits as part of the compensation package earned by employees in exchange for services they perform over their period of employment. The obligation to pay such benefits to employees after they retire relates solely to a compensation plan; therefore, the total cost of those benefits is by nature compensation earned by employees as they perform services for the employer. We believe this conclusion is supported by ASU 715-10-05-6 which states:

“The guidance in this Topic is derived from the basic idea that a benefit plan is an exchange between the employer and the employee. In exchange for services provided by the employee, the employer promises to provide, in addition to current wages and other benefits, an amount of retirement income or benefit. It follows from that basic view that benefits are not gratuities but instead are part of an employee’s compensation, and because payment is deferred, the benefit plan is a type of deferred compensation. It also follows that the employer’s obligation for that compensation is incurred when services are rendered.”

While several of the cost components making up that obligation are measured using different methods, we strongly believe that the nature of each component comprising the total obligation fundamentally represents and always remains a *compensation* obligation. The proposal to report only service cost as compensation costs and report the other components of the net benefit cost separately from compensation costs is inconsistent with the nature of the obligations incurred by the employer. We believe that all of the components of net benefit cost for a compensation plan should be reflected as

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compensation costs in order to be consistent with the reason that these obligations exist and to reflect the fundamental essence of those costs in the most transparent way.

We note that the Exposure Draft's presentation proposal is a significant change in the historical view of the nature of these costs. Specifically, we note the FASB staff's view expressed in Question no. 6 of the FAS87 Q&A which stated that "in the aggregate, net periodic pension cost is viewed as an element of employee compensation." We agree with the view that all costs incurred to fulfill promises made to employees regarding post-retirement benefits should be presented as compensation expense. We also note that the Basis for Conclusions in FASB Statement No. 87, paragraph 84, highlighted three fundamentals of pension accounting that had existed *prior to* the issuance of FASB Statement No. 87 and that were continued in that standard: 1) delaying recognition of certain events, 2) reporting net cost, and 3) offsetting liabilities and assets. Paragraph 86 further discusses the "net cost" feature indicating that it "means that the recognized consequences of events and transactions affecting a pension plan are reported as a single net amount...[t]hat approach aggregates at least three items that might be reported separately for any other part of an employer's operations."

Financial statements users understood and accepted this presentation prior to the issuance of FASB Statement No. 87 and we believe it continues to represent the best presentation for users. In fact, the Exposure Draft continues to refer to all of the components of these costs as benefit (i.e., compensation) costs. The Exposure Draft also contains no discussion of or support for a change in the understanding of the fundamental nature of any of the components of these costs. Therefore, we do not believe that such a significant change in the conceptual understanding of these costs for accounting purposes or the rationale for how they are proposed to be presented in the income statement ("predictive value") should be implemented via a simplification initiative.

Service cost alone is insufficient to adequately provide for the obligation to actually pay the promised pension and other postretirement benefits to employees once they retire since service cost is determined based on the actuarial present value of benefits estimated at the beginning of the year. The other components of the net benefit cost are necessary to accrue an adequate amount for the obligation to actually pay the promised benefits. No individual component, such as service cost, should be singled out as compensation cost since all of the components are required to appropriately accrue the entire obligation to pay the amount of benefits promised to retirees. Interest cost is necessary to grow the actuarial present value of benefits accrued as service cost due to the passage of time. Amortization of prior service cost is necessary to recognize the impact of any plan amendments. Amortization of gains and losses is necessary to recognize the differences during the year between actual results and expected results, including any differences that would impact service cost (e.g., expected versus actual pay increases for the year). Despite the fact that these components are each measured in different ways, they all represent a portion of the total cost of the

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associated benefits; the use of different underlying measurement methods does not change their fundamental nature. By excluding the non-service cost components, we believe that the compensation costs reflected in the income statement would not truly reflect the cost of providing the benefits that retirees will receive.

We also believe that it remains appropriate to reflect the return on plan assets as a reduction of the net benefit cost included in compensation costs since it is consistent with the measurement of pension and other postretirement benefit obligations, which are reported net of plan assets. Just as the plan assets are an offset to the obligation recognized, the return on the plan assets mitigates the recognition of the net benefit cost. This accounting results in symmetry in amounts reported on the balance sheet and the income statement. This symmetry was the position of the FASB staff when FASB Statement no. 87 was issued.

### **Inconsistencies with existing GAAP**

We have also noted the Exposure Draft's proposed presentation of the non-service cost components of the net benefit cost as nonoperating costs is inconsistent with existing GAAP regarding asset retirement obligations (ARO) and stock compensation as discussed below.

***Asset Retirement Obligations.*** With respect to the proposal to reflect the interest component of net benefit cost as nonoperating expense, we note the current requirement in ASC 410-20-45-1 for the classification of accretion expense related to asset retirement obligations states [emphasis added]:

Accretion expense shall be classified as an ***operating*** item in the statement of income. An entity may use any descriptor for accretion expense so long as it conveys the underlying nature of the expense.

We believe the nature of interest cost associated with the net benefit cost and accretion of the ARO liability are essentially identical from an accounting perspective. In each instance, the company is accreting a discounted future liability to its estimate of the ultimate settlement amount. We note that, in the deliberation of FASB Statement No. 143, commenters raised concerns about the Board's proposal in its final exposure draft to require the presentation of accretion expense as *interest expense* in the income statement, indicating that "financial statement users view interest expense as a financing cost arising from borrowing and lending transactions." To address these concerns, the Board ultimately reversed its position, with the only requirement being that the accretion of the liability is to be presented in the *operating* portion of the income statement (refer to ¶B57 of FASB Statement No. 143). We believe that investors are best served when similar costs are

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presented in the same manner in the income statement; the current proposal would require an inconsistent presentation of substantially identical cost components.

***Stock Compensation.*** When considering what types of compensation costs represent operating expenses, we note that current GAAP requires the change in fair value of liability awards under ASC 718-30-35-3 to be reflected in compensation (operating) expense. We note that these costs are “distinctly different in their persistence and character,” similar to the non-service components of net benefit costs, given that the amount of expense recorded (or reversed) during the period is based solely on fluctuations in the company’s stock price without any consideration of the employees’ performance. Nevertheless, GAAP requires these fluctuations to be recorded as compensation expense because they are considered part of the total obligation arising from a compensation plan.

While the Exposure Draft argues that presenting all components as a net benefit cost “is not useful in financial statement users’ analyses of an entity’s core operating performance,” we believe the same is true with respect to the change in fair value for liability awards recognized as compensation expense as noted above. The fact that one or more components of a cost are volatile or not necessarily predictive of the future provides no indication of the underlying nature of the cost, nor does it provide sufficient justification for an income statement presentation that differs from the nature of the underlying obligation. These same considerations affect many other costs included in the income statement, and it is not appropriate to single out one cost to institute such a substantive philosophical change.

### **Capitalization in Assets**

We believe that net benefit cost recorded in the income statement should continue to include all components of the cost of such plans and that the capitalization of net benefit cost components in assets should continue to be based upon the total cost of those plans. Therefore, we do not agree with the Exposure Draft’s proposed change to limit the capitalization of net benefit costs to the service cost component.

***Question 2: Would it be useful to require presentation of the prior service cost or credit component separately from the other components? Should all of the components of net benefit cost other than the service cost component (for example, the prior service cost or credit component) be presented outside a subtotal of income from operations, if one is presented? Why or why not?***

As indicated above, we believe employee compensation consists of ***all*** the components of net benefit cost. As such, all components of net benefit cost should be reflected as such and included in operating income.

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***Question 3: Would it be useful to require presentation of the net amount of the interest cost component and expected return on plan assets separately from the other components of net benefit cost to improve convergence with International Financial Reporting Standards (IFRS) or for other purposes? Why or why not?***

As indicated above, we believe employee compensation consists of **all** the components of net benefit cost. As such, all components of net benefit cost should be reflected as compensation costs and included in operating income.

***Question 4: Would the proposed amendments improve the usefulness of financial information provided to users? Why or why not?***

We believe that all components of net periodic pension and other postretirement cost are compensation costs and should continue to be reflected as operating expenses in the income statement in order to appropriately reflect the costs of the benefits that retirees will receive. We also believe the current presentation of net benefit costs as compensation costs within operating expenses (accompanied by footnote disclosure of the components of net benefit cost) has provided users of financial statements with the information they have needed for nearly 30 years and will continue to do so. We believe this presentation is representationally faithful and consistent with the fundamental nature of the promise to pay the pension and other postretirement benefits to employees for services rendered during the period of employment.

***Question 5: Should the proposed amendments be different for rate-regulated entities? Why or why not?***

Should the Board adopt the proposed requirements for entities in general, we believe that specific guidance should be included in Topic 980 to allow rate-regulated entities to (1) classify all of the components of net benefit cost in operating expenses, and (2) capitalize a portion of all of the components of defined benefit cost and postretirement benefit cost (net benefit cost) as part of an asset, consistent with how these costs are treated in the rate-making process. Providing specific guidance for rate-regulated entities would better reflect the economic effect of the rate-making process, whereby rate-regulated entities receive recovery of all of the components of net benefit costs, including the portion of net benefit cost that is capitalized in property, plant, and equipment, along with a return on those capitalized costs, in operating revenue. All of the components of net benefit cost are included in operating expenses for regulatory accounting purposes, and therefore limiting the operating expense recognition to only service cost would result in a GAAP to regulatory reporting difference.

In addition, if rate-regulated entities are not allowed to capitalize a portion of all of the components of net benefit cost under new specific guidance in Topic 980, they would

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likely capitalize a portion of the non-service components as a regulatory asset in accordance with Topic 980-340. We do not believe that financial reporting that bifurcates the capitalization of net benefit cost components between property, plant and equipment and regulatory assets on the balance sheet provides the most meaningful presentation of the nature of those costs to financial statement users. Further, we believe that such a presentation is contrary to the overall simplification initiative these proposed changes are attempting to achieve. As noted above, we believe that all of the components of net benefit cost represent employee compensation costs, which is consistent with the treatment of these costs in the rate-making process for rate-regulated entities.

In addition to the conceptual and economic problems identified above, the incremental costs associated with separately identifying and tracking the service and non-service components of net benefit cost over the lives of the property, plant and equipment and regulatory assets would far exceed any benefits received by financial statement users. Currently, rate-regulated entities include all of the capitalized components of net benefit cost in the calculation of allowance for funds used during construction in accordance with Topic 980-360. Therefore, precluding capitalization of the non-service component of net benefit cost would add complexity to that calculation and potentially result in another GAAP to regulatory accounting difference.

Further, many rate-regulated entities use group or composite depreciation methods for property, plant and equipment, while regulatory assets are typically amortized over future periods consistent with the pattern of recovery through rates. Therefore, absent new guidance in Topic 980, rate-regulated entities would be required to separately depreciate and amortize the service and non-service components of net benefit cost. Essentially, this would require rate-regulated entities to keep two sets of depreciation records involving thousands of plant, property, and equipment assets to determine the amortization for the regulatory asset separate from the depreciation of the property, plant, and equipment.

In order to provide the most meaningful presentation of net benefit costs that reflects the actions of regulators in a representationally faithful way without significantly increasing recordkeeping costs for rate-regulated entities, we believe that specific guidance allowing for capitalization and presentation of all the components of the net benefit cost in operating expenses should be included in Topic 980 if the proposed presentation of net benefit cost becomes effective for entities in general.

EEl and AGA appreciate the opportunity to provide our input on the proposed Exposure Draft. We would be pleased to discuss our comments and to provide any additional information that you may find helpful.

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Very truly yours,

/s/ Richard F. McMahon, Jr.

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/s/ Patrick J. Migliaccio

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