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November 8 2001

Marc Simon
Technical Manager, Accounting Standards
File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York NY 10036-8775

Regarding Exposure Draft - Proposed Statement of Position, "Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment"

Western Cooperative Electric Association Inc appreciates the opportunity to submit written comments regarding the above captioned Proposed Statement of Position ***(PP&E Accounting Proposal)*** to the Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants (AICPA).

Western is a rural electric cooperative in the state of Kansas providing electricity to 2,205 rural consumer-owners using 4,575 meters in eight northwestern counties. Western holds the dubious honor of having the state's lowest density of service: 1.5 meters per mile of line. Operating within the capital-intensive electric utility industry, the PP&E Accounting Proposal would significantly impact accounting policy, practices, and Western's members.

Western is required to follow accounting requirements established by the Rural Utilities Service (RUS) of the United States Department of Agriculture. The PP&E Accounting Proposal raises significant ratemaking, operational, and accounting concerns. The most significant of these concerns arise due to accounting inconsistencies between the RUS Uniform System of Accounts and attendant RUS regulations and interpretations (collectively, ***Electric Cooperative Accounting Requirements***), and the PP&E Accounting Proposal. The PP&E Accounting Proposal and the attendant detrimental impacts to Western Cooperative Electric Association Inc include the following:

- Electric Cooperative Accounting Requirements specify capitalization of overheads in support of construction projects and permit capitalization of an

appropriate portion of administrative and general (A&G) costs. In addition, Electric Cooperative Accounting Requirements specify capitalization of Preliminary Investigation and Survey (PI&S) charges. The PP&E Accounting Proposal would prohibit capitalization of overheads, PI&S charges, and A&G costs.

Implementation of these provisions would result in the unfavorable outcome of increased earnings volatility, as these overhead, PI&S charges, and A&G costs are expensed, rather than capitalized. Furthermore, from the standpoint of ratemaking fairness, failure to capitalize these costs would inequitably shift the burden of recovery of these costs from customers using the plant asset over its useful life, to customers during the construction of the plant asset.

- Electric Cooperative Accounting Requirements prescribe use of the group method of depreciation for plant assets. The PP&E Accounting Proposal would require use of depreciation accounting by component, defined as "a tangible part or portion of [plant] that can be separately identified as an asset and depreciated or amortized over its own separate expected useful life". The PP&E Accounting Proposal generally prohibits the use of a group method of depreciation, unless it can be shown by the entity that the asset balances and operating results under the group method is not materially different from that obtained under the component method.

  Implementation of this provision would require administrative reorganization to comply with the data collection requirements, as well as installation, and revisions of software and expensive automated accounting systems. In addition, determination of material differences between the component and group accounting methods would require record keeping for both methods, adding significantly to plant record-keeping costs. This appears to be a requirement unduly burdensome, time-consuming, and complex for this small rural, "farmer-owned" cooperative, and all other electric cooperatives in the same position.

- Electric Cooperative Accounting Requirements, consistent with group depreciation accounting convention, generally prescribe that gains and losses on normal dispositions of mass assets be closed to the accumulated depreciation account, under the theory that over time gains and losses will net out. The PP&E Accounting Proposal would require that gains and losses be reflected in results of operations in the current accounting period. Implementation of this provision would result in increased earnings volatility, as gains and losses on plant disposition are reflected in the current results of operations. Electricity rates would likely require upward adjustment to provide for this increased uncertainty of earnings.

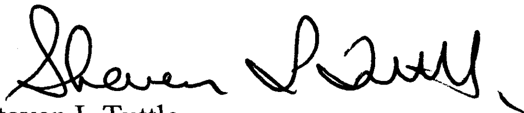
- Electric Cooperative Accounting Requirements generally recognize the cost of removal of a plant asset over the useful life of that asset, as a component of

the depreciation rate. The PP&E Accounting Proposal would require that cost of removal be reflected in the results of operations in the accounting period in which such cost was incurred. Implementation of this provision would result in increased earnings volatility, as cost of removal is reflected in a single accounting period. Furthermore, from the standpoint of ratemaking fairness, failure to recognize cost of removal over the asset's life would inequitably shift the burden of collection of these costs from customers using the plant asset to customers during the retirement of the plant asset.

Each of the above accounting inconsistencies poses operational problems for Western. The detrimental impacts of each item should be carefully considered and weighed against any identifiable benefits before the AICPA AcSEC implements the attendant provision of the PP&E Accounting Proposal for electric utilities. We strongly object to these proposed PP&E changes.

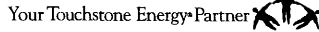
Western appreciates the opportunity to provide comments on the PP&E Accounting Proposal and respectfully urges the AICPA AcSEC to consider its views.

Yours Truly



Steven L Tuttle
Assistant Manger

Consolidated Electric Cooperative, Inc.

Your Touchstone Energy® Partner 

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Mr. Marc Simon, CPA
Technical Manager, Accounting Standards, File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

RE: Comment on Proposed AICPA Statement of Position on Accounting for Certain Costs and Activities Related to Property, Plant and Equipment (June 29, 2001)

Dear Mr. Simon:

Please accept this letter as our comment and response to your organization's above referenced exposure draft.

To better understand our response, please understand that we operate principally as a rural electric cooperative, owned by our member / consumers to distribute and deliver electricity to our member / consumers. We are subject to regulatory reporting requirements. Within the industry, common, historical and traditional practice has been to view the Rural Utilities Service of the US Department of Agriculture as the regulating entity. We are a not for profit organization. Profit is not a motivation in our operations, but rather minimizing costs to insure we are able to provide our service to our member / consumers at a reasonable rate is our primary financial driver. Any change in operations or reporting that increases costs can and will have an impact on the revenues we require from our members to cover those costs.

Further, any change in computing earnings in excess of expenses and/or in computing our gross margins from the provisioning of electric utility service to our members necessarily has an impact on our rate making process for our member / consumers.

With regard to the specific issues you request comment on beginning on page 3 under the general area entitled AREAS REQUIRING PARTICULAR ATTENTION BY RESPONDENTS:

Issue 1 – We have no significant practice issues or concerns related to the accounting for contractually recoverable expenditures that should be addressed in the SOP. Further, we do not believe there are other areas addressed in the SOP that would create conflicts with existing lease accounting standards.

Issue 2 – We agree with your project stage approach should this SOP be adopted, however, we do not believe a change to the project stage approach will result in significantly different treatment than is now normal in our industry.

Issue 3 – We disagree with Paragraph 22 of the proposed SOP that states that, other than the costs of options to acquire PP& E, all costs incurred during the preliminary stage should be charged to expense as incurred. We propose that the guidance should be modified to allow for accumulation of preliminary stage costs invested on multiple projects, with the total accumulation of costs relating to preliminary stage enterprises allocated across those projects that progress to the

Consolidated Electric's subsidiary companies: Bright Choice® Bright Energy **Levering Brothers** Plumbing, Heating & Electrical, Inc.

preacquisition stage. A substantial portion of the activities of our organization as well as those of most rural electric cooperatives involves conducting long duration (often two or three years) engineering and feasibility studies in preparation for adoption of a long range construction plan that may take an additional two to four years to complete. Often, all the components of a project are needed by our member / consumers, however, limited resources of the member / consumers means that only a portion of the needs can be met within these constraints. The evaluation of the economic viability of all projects under consideration is a significant component of our entire service process – the success of selected projects is highly dependent on the evaluation of all projects under consideration. Allocation of all costs associated with these alternative analyses better reflects the true financial condition and performance of the organization and allows our member / consumers to better evaluate the performance of the organization.

Additionally, traditional creditors for the rural electric industry are often constantly advised and updated on the progress of the analysis phase and frequently contribute to the feasibility of the various projects under consideration.

Issue 4 – We disagree with paragraphs 24, 25, 29 and 30 of the proposed SOP relating to the requirement to expense general and administrative costs and costs not specifically directed to the project. Our objection is based primarily in the same argument as we presented above for issue 3. A substantial portion of our overall operations are devoted to long range development of multiple, potential fixed asset expansions. Further implementation of those expansions, once chosen, also involves an across the board effort from our entire organization. These efforts are so pervasive that, were we not obligated to produce these fixed asset expansions, general and administrative costs would be significantly lower. Not providing for capitalization of a proportionate share of general and administrative expenditures misstates the true administrative burden of the operation.

Issue 7 – We disagree with the proposed SOP as it relates to accounting for costs incurred in removal of assets. This treatment directly conflicts with long standard industry practices that focus on the nature of the industry as being one that provides services to a limited territory within a limited market. Costs associated with removal of assets in our industry (delivering electricity) necessarily always involve incurring new costs as a result of the need to continue providing services to that territory. Perhaps, if assets were being removed, with no new or replacement assets being required for that service territory, the approach presented in the SOP might make sense. However, in reality, removal of assets is most always necessary to introduce new assets into service in our industry. Our industry's traditional practice of including costs of removal as a component of the costs of introducing new assets in a service territory best reflects the costs of bringing upgraded services to the territory.

Issue 8 – We do not have any objections to the SOP with regard to this issue.

Issue 9 – We do not have any objections to the SOP with regard to this issue.

Issue 10 – We do not believe the guidance on redetermination of costs of inventory that may be incorporated into PP&E as set forth in the proposed SOP is appropriate. The time, effort and expense relating to any such required redetermination is not merited by the issue. As our rates for service are directly impacted by costs of doing business, this redetermination would necessitate an increase in rates for services with no concurrent benefit for our customer / members.

Issue 11 – We have no comment on this issue as we are not presently impacted by it.

Issue 12 – We strongly object to the proposal to require component accounting for PP&E. We, and our industry, have traditionally used group depreciation and composite lives methods and rates. These group and composite lives are as established by a primary user of our financial statements, the Rural Utilities Service of the United States Department of Agriculture. We believe these methods and composite lives approximate currently acceptable, common methods of depreciation.

Our objections are multiple, as follows:

- Changing to the methods proposed would require a substantial administrative, organizational and record-keeping processes and procedures. These changes would have a negative impact on the costs for these components, possibly to such an extent that increases in revenues might have to be sought to cover the costs. Any increase in revenues must come from our member / consumers, thereby placing the economic burden of the change and future conformity squarely on the backs of our consumer / members.
- Multiple projects we complete frequently incur a substantial number of common costs. The efforts required to segregate those costs across components of a project would be prohibitive in many cases.
- We do not believe that uniformity can be obtained within our industry with respect to component allocation. Engineering of projects is diverse enough in the country that there likely would not be any routine commonality of treatment of which individual items might be combined to represent a specific component.
- Any attempt to componetize costs of projects does not yield any noticeable improvement in the information or data about the financial condition of the organization, nor does it yield any improvement in the delivery of our services to our member / consumers. In total, we would not expect overall depreciation expense to vary with present policies. Accordingly, no impact would be made by the change on our profitability other than the increased expenses resulting from attempting to comply with this change.

Issue 13 – We have no comment on this issue as we are not presently impacted by it.

Issue 14 – While on the surface, paragraph A48 might allow for our continued use of group and composite depreciation. However, we still would be required, if the proposed SOP is adopted, to substantiate that the group and composite methods approximate the same results as those that would be generated by using the methods proscribed in the SOP. In essence, we would still be required to maintain substantially the same records and information to comply with the SOP so that substantiation of the approximation could be evaluated. In effect, paragraph A48 only creates confusion about the need to maintain data at a level that would at least allow for evaluation of the approximation.

Issue 15 - We have no comment on this issue as we are not presently impacted by it.

Issue 16 – Should the SOP be implemented and applicable to us, we concur with the use of either method for implementation and transition. Due to the anticipated high cost of compliance, we would not envision responding to the proposed SOP on any basis other than the "go forward" basis.

Issue 17 – Should the SOP be implemented, we would encourage the use of any of the methods, without regard to ordering. Development of allocations based on historical costs simply is not economically feasible in our industry. Any approach utilizing relative fair values will be so

subjective as to be ineffectual and provide unwanted opportunities for misallocation. Frankly, we can think of no reasonable method to allocate these old costs.

Issue 18 – We have no comment on this issue as we are not presently impacted by it.

Issue 19 – We have no comment on this issue as we are not presently impacted by it.

In addition to the above issue specific comments, we offer the following for your consideration:

A. The proposed SOP is silent with respect to the applicability of the Statement of the Financial Accounting Standards Board No. 71 and the exclusion granted therein for regulated businesses. Paragraph 8 of the proposed SOP indicates that the SOP would be applicable to regulated entities, which would presumably be in direct conflict with the hierarchy of GAAP. Any proposal relating to changes in property, plant and equipment specifically should address the applicability of SFAS No. 71.
B. Paragraph 4 of the proposed SOP comments that "... In practice, the composite life may not be determined with a high degree of precision, ..." thus implying that composite life accounting is therefore generally not acceptable. Regulators, and industry specialists, including agencies of the federal government have invested years of experience and effort into providing the investing public as well as consumers of public utilities that composite lives are in fact appropriate for recognition of the costs of property, plant and equipment. Data computed using industry conventions and the related historical methods are used extensively in setting rates for consumers to acquire the services provided by the utilities. Introduction of significant changes in these lives and methods will have an undetermined impact on the rate making process, and, by extension, on rates charged to consumers.
C. Methods proposed in the proposed SOP will generate uncommon and abnormal fluctuations in gross margins for electric utilities. While, on the surface this may seem innocuous, AcSec should be aware that any resulting instability in margins will likely transfer to instability into the market for electricity via instability in the pricing of electricity to consumers.
D. Paragraph 27 of the proposed SOP incorporates the phrase "rebuttable presumption," a disconcerting use of legalese that we believe would tend to detract from the use of informed judgement on these matters by management and from the professional opinion of independent auditors. Use of such language should be avoided in today's litigious society.
E. The proposed SOP represents a major departure from accepted, traditional and historical practice within the electric utility industry. Accounting standards directly impact, in most cases, the rate making process and charges for services rendered by public utilities. Various components of the SOP will a) require an increase in the costs of electric utilities, resulting in increased costs of electric service to consumers, b) introduce unwarranted fluctuations in margins and profits, possibly resulting in instability in the prices for electricity, and c) require utility regulators to consider the impact of the changes introduced into accepted industry practice as a result of the SOP. If AcSec provides for the use of Statement 71 of the Financial Accounting Standards Board for these regulated businesses, then many, if not all, electric utilities will find it necessary to maintain two separate sets of financial books and records to satisfy the needs of regulators while also meeting the requirements of the SOP. We do not believe a requirement to maintain separate sets of financial records for application of this SOP to be cost effective or beneficial.
F. In conversations and consultations with our industry partners and regulators, it is evident that AcSec has not consulted with the industry or with regulators on the impact of this proposed SOP. We believe that consultation should have occurred prior to any draft proposal being prepared – doing so would have been not only appropriate, but would have allowed AcSec to make a more informed initial analysis of the impact of their proposals.

G. The National Rural Electric Cooperative Association (NRECA), our trade association, has concurrently filed comments with AcSec with regard to this proposed SOP. We strongly support the position of the NRECA and join in the specific recommendations contained in their correspondence to you.

We appreciate this opportunity to respond to your proposal, and trust that you will consider the objections of our entire industry to your proposal. If questions arise concerning our comments, please feel free to contact Dan Hammond, Director of Finance and Administration at 419-947-3055.

Sincerely,

Brian Newton,
President

Maquoketa Valley
Electric Cooperative

November 5, 2001

Mr. Marc Simon
Technical Manager, Accounting Standards
File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Exposure Draft - Proposed Statement of Position, "Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment"

Dear Mr. Simon:

Maquoketa Valley Electric Cooperative appreciates the opportunity to submit written comments regarding the above-referenced Proposed Statement of Position (PP&E Accounting Proposal) to the Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants (AICPA).

Maquoketa Valley Electric Cooperative is an electric cooperative in Iowa, providing electricity to approximately 13,000 consumers-owners in 9 counties. Since Maquoketa Valley Electric Cooperative operates within the capital-intensive electric utility industry, the PP&E Accounting Proposal would significantly impact Maquoketa Valley Electric Cooperative accounting policies.

Maquoketa Valley Electric Cooperative is required to follow accounting requirements promulgated by the Rural Utilities Service (RUS). The PP&E Accounting Proposal raises significant rate-making, operational, and accounting concerns for Maquoketa Valley Electric Cooperative. The most significant problem is the accounting inconsistencies between this proposal and the RUS Uniform System of Accounts and attendant RUS regulations and interpretations (collectively, Electric Cooperative Accounting Requirements). The PP&E Accounting Proposal and the attendant detrimental impacts to Maquoketa Valley Electric Cooperative include the following:

- Electric Cooperative Accounting Requirements specify capitalization of overheads in support of construction projects and permit capitalization of an appropriate portion of administrative and general (A&G) costs. In addition, Electric Cooperative Accounting Requirements specify capitalization of preliminary investigation and survey (PS&I) charges. The PP&E Accounting Proposal would prohibit capitalization of overheads, PS&I charges, and A&G costs.

A Touchstone Energy® Cooperative

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Implementation of these provisions would result in the unfavorable outcome of increased earnings volatility, as these overhead, PS&I charges, and A&G costs are expensed, rather than capitalized. We estimate the impact to our financial statements for these items to be approximately $501,180 on an annual basis. Approximately 46.5% of this amount relates to overheads, and 53.5% relates to A&G costs. Furthermore, from the standpoint of rate-making fairness, failure to capitalize these costs would inequitably shift the burden of collection of these costs from customers using the plant asset over its useful life to customers during the construction of the plant asset.

- Electric Cooperative Accounting Requirements prescribe use of the group method of depreciation for plant assets. The PP&E Accounting Proposal would require use of depreciation accounting by component, defined as "a tangible part or portion of [plant] that can be separately identified as an asset and depreciated or amortized over its own separate expected useful life." The PP&E Accounting Proposal generally prohibits the use of a group method of depreciation, unless it can be shown by the entity that the asset balances and operating results under the group method is not materially different from that obtained under the component method. Implementation of this provision would require administrative reorganization to comply with the data collection requirements, as well as installation of expensive automated accounting systems. In addition, determination of material differences between the component and group accounting methods would require record-keeping for both methods, adding significantly to plant record-keeping costs. The estimated costs to upgrade automated systems and provide additional administrative record-keeping and data input is approximately $125,000 in one-time costs (1000 hours at $125/hr) and $56,000 on an annual basis (loaded cost of one additional accountant), respectively.

- Electric Cooperative Accounting Requirements, consistent with group depreciation accounting convention, generally prescribe that gains and losses on normal dispositions of mass assets be closed to the accumulated depreciation account, under the theory that over time gains and losses will net out. The PP&E Accounting Proposal would require that gains and losses be reflected in results of operations in the current accounting period. Implementation of this provision would result in increased earnings volatility, as gains and losses on plant disposition are reflected in the current results of operations.

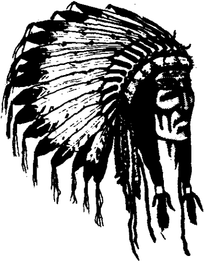
- Electric Cooperative Accounting Requirements generally recognize the cost of removal of a plant asset over the useful life of that asset, as a component of the depreciation rate. The PP&E Accounting Proposal would require that cost of removal be reflected in the results of operations in the accounting period in which such cost was incurred. Cost of removal incurred over the past five years has averaged about $150,000 per year. Implementation of this provision would result in increased earnings volatility, as cost of removal is reflected in a single accounting period. Furthermore, from the standpoint of rate-making fairness, failure to recognize cost of removal over the asset's life would inequitably shift the burden of collection of these costs from customers using the plant asset to customers during the retirement of the plant asset.

Each of the above accounting inconsistencies poses operational problems for Maquoketa Valley Electric Cooperative. The detrimental impacts of each item should be carefully considered and weighed against any identifiable benefits before the AICPA AcSEC implements the attendant provision of the PP&E Accounting Proposal for electric utilities.

Maquoketa Valley Electric Cooperative appreciates the opportunity to provide comments on the PP&E Accounting Proposal and respectfully urges the AICPA AcSEC to consider our views. If you have any questions on our comments, please feel free to contact Mike Johnson 319 462-3542.

Sincerely,

Mike Johnson
Director of Finance
Maquoketa Valley Electric Cooperative
109 North Huber St.
Anamosa, IA 52205



Indian Electric Cooperative, Inc.

Phone (918) 358-2514 •• P.O. Box 49 •• Cleveland, Oklahoma 74020

Terry M. Jech, General Manager

November 13, 2001

Mr. Marc Simon
Technical Manager
Accounting Standards, File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

RE: Proposed Statement of Position (SOP), *Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment*

Dear Mr. Simon:

The impact of the change in accounting requirements because of this proposed SOP would drastically increase the cost to the consumers of Indian Electric Cooperative (IEC). IEC is a rural electric cooperative with over 3,380 miles of distribution lines serving 12,600 members in a seven county area of northern Oklahoma. The mission of Indian Electric is to enhance rural living by delivering reliable electric power to its members at an affordable cost. Meeting the requirements of this proposed change in accounting standards would unfairly inflate the cost of electric service while providing no additional benefits to the membership.

Component Accounting

The cost of building and replacing utility plant may vary significantly due to timing of equipment purchases, labor, and differing locations. These cost driving factors will differ among like components. These components are basically identical in value to the cooperative for creating revenue.

The burden of record keeping for each component of utility plant would require attaching specific costs to literally thousands of like components, such as poles, circuit breakers, and transformers. No additional benefit would be gained by the cooperative and enormous costs would needlessly be added to the cost of power for its members.

Group accounting has been an accepted practice for the electric utility industry and it requires a fraction of the record keeping required for component accounting, while providing an accurate approximation of depreciation expense for utility plant.

Removal and Retirement of Plant

Retirement and removal of plant are important elements of upgrading an electric distribution system. This proposal would force removal and retirement costs to be recognized as they are incurred. To recognize these costs as they are incurred would produce immense fluctuations in expenses and would breach the principle of matching revenues and expenses. It would also force the current membership to absorb costs of plant improvements which will benefit cooperative members for many years in the future and should, therefore, be depreciated over the life of the distribution system.

The group accounting method allows any remaining un-depreciated costs of removed utility plant to remain in the cost of plant and be depreciated over the remaining life of the utility plant. This more appropriately matches the cost of the utility plant to the revenues collected during the life of the plant.

Capitalization of indirect costs of plant

Indirect costs, administrative and general costs, and overhead are legitimate costs for the construction and upgrading of an electric system. Even though these costs may not be attached to a specific item within the electric system, the reason for their existence is mostly, if not totally, attributed to PP&E. All costs of the construction of utility plant should be capitalized and depreciated over the life of the utility plant.

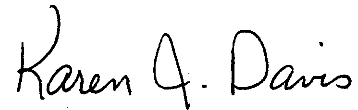
To expense these costs as they are incurred is a burden to the current membership, ignoring the benefit to any future members. It will skew the income statement and unfairly reduce margins to be allocated to the current membership.

This proposed SOP will be very detrimental to Indian Electric, as well as all rural electric cooperatives. The effect on TIER and DSC would make it impossible to meet IEC's loan covenants. The only option for survival for the cooperative would be a significant rate increase, which would be absolutely unfair to our consumers. Service would not be increased, become more reliable, or benefit the consumer in any way. It would only allow IEC to make changes in accounting procedures—procedures that have fairly stated our financial position for many, many years.

I respectfully ask this proposal be re-evaluated to recognize the damaging effect it would have on the electric industry. Deregulation is an issue the electric industry is struggling with nationwide. Consumers are unsure of future electric costs as each state faces the deregulation issue. The added burden imposed by this proposed SOP will

assuredly add unnecessary costs to an industry that supplies a basic service to the American public.

Sincerely,



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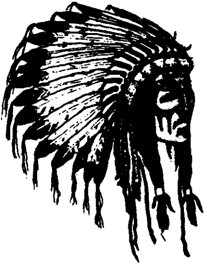

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Terry M. Jech, General Manager

November 13, 2001

Mr. Marc Simon
Technical Manager
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1211 Avenue of the Americas
New York, New York 10036-8775

RE: Proposed Statement of Position (SOP), *Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment*

Dear Mr. Simon:

Indian Electric Cooperative is a rural electric cooperative with over 3,380 miles of distribution lines serving 12,600 members in a seven county area of northern Oklahoma. The mission of Indian Electric is to enhance rural living by delivering reliable electric power to its members at an affordable cost. The impact of this change of accounting requirements would significantly increase the cost of electric service to our consumers and I would like to address specific issues with the proposed SOP.

Component Accounting

The cost of building and replacing utility plant may vary significantly; equipment purchases, labor, and remote locations are all cost driving factors which will differ among like components. These components are basically identical in value to the cooperative for creating revenue.

The burden of record keeping for each component of utility plant would require attaching specific costs to literally thousands of like components, such as poles and transformers. No additional benefit would be gained by the cooperative and enormous costs would needlessly be added to the cost of power for its members.

Group accounting has been an accepted practice for the electric utility industry and it requires a fraction of the record keeping required for component accounting, while providing an accurate approximation of depreciation expense for utility plant.

Removal and Retirement of Plant

This proposal would force removal and retirement costs to be recognized as they are incurred. Retirement and removal of plant are important parts of upgrading an electric distribution system. To recognize these costs as they are incurred would produce immense fluctuations in expenses and would violate the principle of matching revenues and expenses. It would also force the current membership to absorb costs of plant improvements which will benefit cooperative members for many years in the future and should, therefore, be depreciated over the life of the distribution system.

The group accounting method allows any remaining un-depreciated costs of removed utility plant to remain in the cost of plant and be depreciated over the remaining life of the utility plant. This more appropriately matches the cost of the utility plant to the revenues collected during the life of the plant.

Capitalization of indirect costs of plant

All costs of the construction of utility plant should be capitalized and depreciated over the life of the utility plant. Indirect costs, administrative and general costs, and overhead are legitimate costs for the construction and upgrading of an electric system. Even though these costs may not be attached to a specific item within the electric system, the reason for their existence is mostly, if not totally, attributed to PP&E.

Again, to expense these costs as they are incurred is a burden to the current membership, ignoring the benefit to any future members. It will skew the income statement and unfairly reduce margins to be allocated to the current membership.

This proposed SOP will be very detrimental to Indian Electric, as well as all rural electric cooperatives. The effect on TIER and DSC would make it impossible to meet IEC's loan covenants. The only option for survival for the cooperative would be a significant rate increase, which would be absolutely unfair to our consumers. Service would not be increased, become more reliable, or benefit the consumer in any way. It would only allow IEC to make changes in accounting procedures—procedures that have fairly stated our financial position for many, many years.

Deregulation is an issue the electric industry is struggling with nationwide. Consumers are unsure of future electric costs as each state faces the deregulation issue. The added burden imposed by this proposed SOP will assuredly add unnecessary costs to an industry that supplies a basic service to the American public.

It is with respect that I ask this proposal be re-evaluated to recognize the damaging effect it would have on the electric industry, as well as every American citizen.

Sincerely,

Terry M. Jech
General Manager

LOYOLA MARYMOUNT
UNIVERSITY

Office of the Controller

November 6, 2001

Mr. Marc Simon
Technical Manager
Accounting Standards
File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

Re: Exposure Draft – Proposed Statement of Position, Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment

Dear Mr. Simon:

This letter provides Loyola Marymount University's comments to the Accounting Standards Executive Committee's (AcSEC) on its June 29, 2001, Exposure Draft (ED) on property, plant and equipment (PP&E) accounting. Loyola Marymount University (LMU) is a medium sized comprehensive, private, not-for-profit university located in Los Angeles, California. LMU has a significant portion of its assets in PP&E. The buildings and their associated improvements would be subject to the componentization requirements under the ED. LMU's buildings serve a wide variety of purposes (e.g. residence halls, laboratories, athletic facilities, administrative offices, classrooms, and libraries). To develop a meaningful componentization of them would be a very difficult and very costly task that, in our judgment, would not add additional value to LMU's financial statements. Also, the ED does not give guidance concerning the best manner to determine what are appropriate components to be presented; thus each entity would be determining what is appropriate componentization and it is unlikely that similar institutions would make the same componentization determinations. This would very likely result in an increased lack of financial statement comparability between similar institutions.

As stated earlier, the implementation would be very difficult and very costly for LMU. It would require hiring outside experts to componentize and estimate the relative value of the components that have been built and renovated over the past 75 years. Once that was completed, LMU would need to equate that value to the depreciated costs. Additionally, since it has not been the practice of LMU to capitalize major repairs (e.g. a roof replacement) a search of the previous accounting records (some of which may no longer be available) would be required to determine the appropriate componentization cost. The ultimate question that LMU does not see being answered is what additional value is being brought to the users of the financial statements. Additionally, is the value added to the

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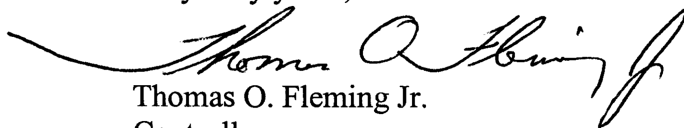
financial statements far outweighed by the cost of capturing and maintaining that information.

While LMU is not a large research institution, it still needs to comply with the rules promulgated by the federal Office of Management and Budget (OMB). Under Circular A-21, Cost Principles for Educational Institutions, paragraph J(12)(a)(2) requires LMU to utilize the same depreciation accounting in the reimbursement process as is used in our GAAP-based financial statements. This would impact our indirect overhead rate. In order to implement the changes required by the ED, LMU would be required to undertake an extensive disclosure and approval process. The cost/benefit of that exercise cannot be justified by the University's low level of research grants.

It is Loyola Marymount University's request that not-for-profit entities be excused from being subject to the ED.

LMU appreciates this opportunity to respond to the Proposed Statement of Position, Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment.

Very truly yours,



Thomas O. Fleming Jr.
Controller

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November 13, 2001

Mr. Marc Simon
Technical Manager, Accounting Standards
File 4210.CC
AICPA
1211 Avenue of Americas
New York, NY 10036-8775

RE: Proposed Statement of Position: *Accounting for Certain Costs and Activities Related to Property, Plant and Equipment*

Dear Mr. Simon:

This letter provides our comments on the June 29, 2001 Exposure Draft (ED) of the Proposed Statement of Position, *Accounting for Certain Costs and Activities Related to Property, Plant and Equipment.*

Overview

CarrAmerica Realty Corporation is a publicly traded real estate investment trust. We and our affiliates own, directly or through joint ventures, interests in a portfolio of 288 office operating properties in the United States.

We support the development of accounting and reporting standards that more appropriately capture economic events and for which the benefit exceeds the cost of implementing. This ED, however, if adopted as written, would have a fundamental impact on our financial reports and operations. It would unfairly impact our financial results compared to other developers of real estate that use third parties more extensively and would require unreasonable costs to implement. We will outline our general comments and then in Attachment A address each of the issues.

Investment Property

Investment property has distinguishing characteristics: a) properties are unique with regards to location, design and tenants; b) cash flow relates directly to the leasing of the property; c) future cash flows can be estimated with some assurance as they are supported by leases; d) the cost of property is supported by non-recourse debt; e) a large market exists for the purchase and sale of investment property; and f) investment property values generally appreciate over time if properly maintained.

We believe that investment property is unique and after 20 years SFAS No. 67 is providing proper guidance as to the treatment of costs related to developing or constructing investment property. The area of concern seems to relate to the accounting of costs for long-term maintenance programs and that concern is driving many unnecessary changes. As that is the concern, why change the accounting for development and construction of investment property? We do not believe that there are wide variations in accounting for those costs between us and our industry peers.

CarrAmerica is engaged in the business of developing, owning and operating investment properties. Our operations are significantly different from a company whose property, plant and equipment relates principally to providing goods and services. SFAS No. 67 and other accounting literature recognizes the uniqueness of investment property and its specialized accounting.

Componentization

Componentization goes against current international standards which view an investment property as an integrated entity. Componentization for investment property should not be required by the final SOP.

Another concern regarding componentization is the cost. Componentization would be expensive to implement and maintain. It would not enhance the measurement of the cost or depreciation of an investment property in proportion to the cost of maintaining the fixed assets accounting system. The cost for us to componentize a property would be extremely expensive as we have found out from cost segregation studies we have had performed in the past. After the componentization is done, there is the payroll and system costs to maintain the componentization which we would not be able to do with our current staffing levels or systems. The componentization of investment property would not give cost effective, value added information to the financial statement user.

Project Stage Framework

We are also greatly concerned regarding the apparent elimination of deferred cost accounting for property, plant and equipment. The SOP would eliminate the ability to defer and capitalize preliminary costs as defined in the SOP even though costs incurred during the preliminary stage relate directly to the cost of acquiring an investment property and placing it into service. This inability to defer those costs would be inconsistent with FASB Concept Statement No. 6

Capitalization of General and Administrative Costs

Being unable to capitalize indirect incremental costs and overhead costs associated with development, construction and installation would only lead to significant differences between companies regarding their investment properties. Some companies, such as ours, are integrated and perform their own development work. The SOP would not allow capitalization of indirect incremental and overhead costs of development because the

function is performed internally while at the same time, a company who employs a third party developer, would in essence be capitalizing those costs through the third party billings. This provision alone of the SOP could have a significant impact on the comparability of earnings between companies that have internal development efforts and those competitors that employ third parties. This is unfairly punitive and results in inappropriate capital markets distinctions. In addition this provision could lead to companies making significant changes to their development function. An accounting rule would drive a business decision.

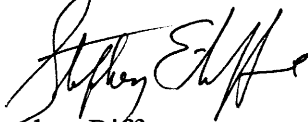
Summary

We would like to summarize our comments:

- We feel that investment property should be excluded from sections of the SOP that would modify the accounting for investment property as specified in SFAS No. 67. We feel that SFAS No. 67 needs no modification for the development and construction of investment property and any change would be inconsistent with international standards.
- Componentization:
  - Goes against international standards;
  - Would be expensive to implement and maintain without adding any real value;
  - Needs clearer definition.
- Deferred cost accounting would almost be eliminated at the cost of the matching principle.
- Capitalization of certain costs would be treated differently if performed by a third party or in house and this would result in inappropriate capital market distinctions due to non-comparable financial reporting.

Thank you for the opportunity to comment upon the ED. We would welcome any discussions you may wish to have with us regarding our comments.

Sincerely,



Stephen Riffee
Senior Vice President, Treasurer
and Controller
202-729-7520

Attachment

Attachment 1

Issue 1:

We feel that the accounting for reimbursable capital expenditures associated with investment property should be addressed separately and not included in this SOP.

Issue 2:

We generally agree with the "Project Stage Framework" except that the full cost of long-term capital programs should be capitalized and amortized over the future period when their benefits are received. We believe the practice should mirror EITF 00-2 Accounting for Web Site Development Costs.

Issue 3:

As we have stated in our comment letter, significant costs are incurred during the preliminary stage of developing investment property which would be inappropriate to expense if the project is eventually completed because they are economically invested to provide future benefits and income, not current income. We feel these costs should be deferred until a determination is made as to whether the project is successful and is developed. Impairment tests would ensure that the costs were recoverable.

Issue 4:

As we have stated, we believe that being required to expense all general and administrative and overhead costs would lead to arbitrary differences between companies who undertake development themselves and those that employ a third party. In addition, some executives and persons in overhead functions are intimately involved in development projects and by their titles, their salaries would be excluded from capitalization. Function should rule over form. To not allow these costs to be capitalized would distort the full cost of the asset.

In addition, to expense these costs would mismatch revenues and costs. As certain general and administrative and overhead costs are integral to the development of investment property, expensing them as incurred would yield negative results while an investment property was under development and higher than normal results due to lower depreciation expense when the investment property started to produce revenue.

Issue 5:

We feel that the guidance provided by SFAS No. 67 currently, should be the standard.

Issue 6:

We do not agree with this conclusion. This should be looked at closer and as a guide the SOP on software capitalization and the EITF on web site development should be used.

Issue 7:

This is impractical. Often removal costs are not separately identifiable and the data is not available. Further, the demolition of an asset is not an economic event that would occur apart from the construction of new assets. We believe demolition costs should be capitalized if it is done in connection with the development of a new or expanded investment property.

Issue 8:

We disagree with these conclusions (refer to our response to Issue 6). Long-term maintenance programs should be capitalized and amortized over the period of their future economic benefit.

Issue 9:

We disagree with this conclusion. Major activities that extend the lives of assets and the cost of replacements should be capitalized and amortized. Without these costs, the asset would no longer be serviceable.

Issue 10:

We believe the guidance is appropriate.

Issue 11:

We believe that the guidance provided by SFAS No. 67 should be followed and the cost accumulation model for real estate properties developed for rental or to be used by an enterprise should be consistent with the cost accumulation model for real estate property developed for sale.

Issue 12, 13, 14:

We have expressed our views on componentization in our comment letter. We believe the proposal for componentization should be reviewed and brought to a reasonable level.

Issue 15:

N/A

Issue 16:

We believe that alternatives to the transition accounting will result in practice differences and a lack of comparability between companies.

Issue 17:

We believe the conclusions under this issue are appropriate.

Issue 18:

We agree with this approach.

Issue 19:

We do not agree with conclusion that the accumulated depreciation difference described in this issue should be allocated back to the accumulated depreciation of each component. We suggest that the difference be accounted for as a cumulative effect of accounting change.

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November 14, 2001

Mr. Marc Simon, Technical Manager
Accounting Standards, File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Mr. Simon:

My response to the recently released draft of a proposed AICPA Statement of Position (SOP), Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment represents our Cooperative's view of the impact this proposal would have on utilities our size and the changes that would have to be implemented. Our Cooperative currently bills fifteen thousand accounts monthly and is located in Southern Nevada.

We endorse the fact that to look for and make beneficial changes is something we support and commend your efforts toward this goal as well. However, in my over twenty years experience with the Cooperative and Utility industry I have to question if this recommendation really would make a significant improvement in comparison to the present methods in place. The old adage "if it's not broke why fix it" - in other words, the system we are now using industry wide is adequate in giving the guidance that is required in this particular area. Please consider the following information in regard to a few specific issues that we feel confirms that the process presently in place is adequate and does not need to be changed.

Issue #3
It appears that the SOP is allowing the expensing of items or the capitalization of items determined solely when the decision is made to either go forward with a project or to abandon it. Why not defer the costs until a definite decision has been made to proceed with a project. This is the method currently being used and it more accurately accounts for the expenditures regardless of when the decision is made, namely, if the project proceeds, the costs are capitalized and if abandoned are expensed. How can you improve a system like that? That criterion is in place and if consistently and objectively applied, adequately accounts for either probability.

Issue #4
This item concerns the expensing of general and administrative costs as well as overhead. In order to accomplish the correct allocation of proper costs to a project the intent we should be looking at is that of getting the legitimate accurate costs that are related to a construction project rather than an accounting procedure. The change that is being suggested is that the costs associated with a construction project that are not directly charged should be expensed in the current period and not depreciated over the life of the asset. The result of this would be to cause the current consumer to pay for the benefits a future consumer will receive. The present system in place distributes those costs over the life of the asset and present and future consumers share the cost and the benefits as equally as possible.

Issue #6
The SOP states that any item added to an 'in-service' unit should be expensed unless it is an additional component (unit) or replaces an existing component (unit). However, if an expenditure is for something that technology developed after the component was in service, and it adds to the useful life, should it not be spread over the remaining life? Could that possibility be included in the SOP?

Issue #7
Cost of removal expensed in the period it occurs rather than expensing it over the useful life of the asset. Currently, that cost is recovered over the life of the asset by being incorporated into the depreciation rates being used by the utility. This again makes it possible to have these costs recovered from the consumers who benefited from the useful life of the asset. Several FASB statements seem to agree with this method of handling the "cost of removal" rather than the change suggested by this SOP. Possibly the utilities could have depreciation studies conducted on their systems at regular intervals to substantiate that the correct rates are being used which already include the cost of removal. This appears to be a more equitable method and its already functioning rather than the distinct possibility of impacting a certain period negatively. In most areas this cost is allowed as part of the rate structure that should cover the removal costs.

Issue #9
Similar to issue #6. Not a substantial item, yet if a major maintenance situation arises and it extends the life of the assets involved, why not adjust the depreciation being accessed and recover it over the period it is useful as we are presently doing with the procedure in place. By reviewing and adjusting depreciation as necessary, the utility can benefit from the latest "state of the art" maintenance enhancements as they become available for extending an assets usefulness and continue to meet accounting standards.

Issue #12
Component accounting for property, if instituted would create a very difficult situation for utilities like us, in regard to transitioning to, tracking, and add tremendous costs to each utility because of the systems needed to accomplish this. It seems to be an unworkable method for the utility industry. The question that needs to be considered is, will the benefits be worth the effort and costs associated with this change not only initially, but on a continuing basis? The group method presently being used works because of the large number of similar assets that can provide a reasonable basis for charging costs over the useful life of the asset. This is more reasonable than trying to implement and maintain a system of tracking large numbers of similar assets individually. Here again by the utilities paying particular attention to their depreciation rates and reserves with periodic studies should more than handle any differences before they become significant. Yes, component accounting would be more accurate, but what about the added operational and maintenance costs of the systems to accomplish it? Are there any studies to substantiate what this SOP is recommending? And is it possible some of these suggestions may be infringing on what management is hired to accomplish with their individual systems?

Issue #13
The issue here is the expensing of net book value when the asset is retired. Here again we would have to consider the cost of tracking net cost and what the added charges would be in comparison to what we already are using. Presently we have a track record using group depreciation. It has given each utility a systematic and reasonable method for allocating their asset costs, over the average service life through depreciation of any given asset. We know this is workable and are not aware of this group method producing significant errors where they are applied in a consistent manner by the utility.

Issue #16
The issue of transition. The only conclusion we could reach on this matter is that the accounting burden would be very large and time consuming, with accuracy in question, because assumptions would have to be made which may not fit a particular utility. Software revisions and/or new software to accommodate this change would be a large item as well as the time involved to do it. It would be very difficult to calculate and track net book value for each asset retired. Hopefully other alternatives would be considered and offered before this SOP would be implemented.

Another important item we feel needs to be considered is the effect this change will have on utility rates. We calculated at our utility, whether there would have to be a "rate adjustment" if this SOP were implemented. Using our historical records for the year of 2000, we would have had to increase our present rates by 6.2% to handle the costs associated with the recommended items to be expensed under this SOP. The costs of

transition and ongoing tracking needs with the required systems to accomplish this change were not considered. We therefore feel that rate adjustments or "rate shock" needs to be considered in light of some rather inconclusive benefits that this SOP is suggesting it will bring to the utility industry.

In conclusion, this SOP has the following important issues for utilities like us.

- Higher operating expenses resulting in a rate increase.
- New automated systems would be necessary, cost of these unknown at this time.
- Increased burden of administering the recommendations of this SOP from now until an unknown future time and date.
- Margins (profits) could fluctuate widely because of new method of handling gains and losses of assets.
- Shouldn't a recommended change of this magnitude be a FASB project?

Our sincere recommendation is that you please consider the items above and withdraw the SOP.

Respectfully yours,

Larry Ortman
Mgr., Finance/Administration

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AMERICAN ELECTRIC POWER

Mr. Marc Simon
Technical Manager, Accounting Standards
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1211 Avenue of the Americas
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November 14, 2001

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or Vice President & Controller
223 2821
614 223 1187
ɹonaiuto@aep.com

Subject: Comments on Statement of Position, Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment

Dear Mr. Simon:

The American Electric Power Company (AEP) appreciates the opportunity to respond to the Accounting Standards Executive Committee's (AcSEC) proposed Statement of Position (SOP), *Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment* (PPE). AEP is a multinational energy company based in Columbus, Ohio. AEP owns and operates more than 38,000 megawatts of generating capacity, making it one of America's largest generators of electricity. The company is also a leading wholesale electricity and gas trader. AEP provides retail electricity to more than 9 million customers worldwide and has more than $55 billion in assets, primarily in the U. S. with holdings in international markets. Wholly owned subsidiaries are involved in power engineering and construction services, energy management and telecommunications.

We commend the AcSEC for its efforts to establish standards of financial accounting and reporting. Although we support some of the AcSEC's proposals as detailed in the subject exposure draft, we have taken this opportunity to express our concerns regarding certain proposals contained in the SOP and to provide comments and suggestions. We are surprised that the AcSEC issued this SOP. SOP's issued by AcSEC are usually limited in scope and pertain to a specific industry. The proposed SOP, however, would establish new accounting policy by prohibiting the use of composite depreciation and requiring that all indirect costs of construction be expensed as incurred. We believe that a more appropriate venue for issuing new accounting policy would be through the issuance of an Exposure Draft (ED) by the Financial Accounting Standards Board (FASB). A FASB ED would provide for a more thorough study and review by the FASB's considerable staff of the accounting policy applicable to property, plant and equipment and provide notice of proposed new accounting standards through normal accounting policy making standards.

General Comments

We believe that the accounting model proposed by AcSEC in the SOP will result in inconsistent accounting practices. For example: A capital intensive organization that regularly performs its own construction in connection with ongoing operations would not be permitted to capitalize overhead costs under the proposed SOP. However if the organization outsourced the construction, overhead costs of the builder would be capitalized. Likewise, overhead costs that are incurred to produce inventory for sale to outside parties would be included in the cost of inventory. The same overhead costs would be required to be expensed if the organization produced the inventory for internal use.

Capital intensive operations such as AEP regularly incur major maintenance costs such as those associated with nuclear plant refueling. Utility regulators appropriately recognize that these kinds of costs benefit future operations and, consequently, issue regulatory rate orders prescribing a proper matching of the cost to the periods and ratepayers benefiting. This proposed SOP would require major maintenance costs to be expensed in the period the maintenance is performed and would not recognize that major maintenance does benefit future operating periods. Although SFAS No. 71 accounting would be employed by regulated entities to create regulatory assets in that situation, the resultant financial statements will not provide investors and other interested parties with meaningful information. We disagree that major maintenance that benefits future periods should be expensed for GAAP purposes.

The proposed SOP would also effectively require the use of component accounting and component depreciation. For decades recovery of investment in the public utility industry has been accomplished using group accounting and composite depreciation. The capital-intensive public utility industry's investment in PP&E includes large groups of homogenous assets. Over time, statistical techniques, similar to those used in the life insurance industry to project mortality patterns, have been developed to determine average service lives for large homogenous groups of assets. The composite depreciation rates that result from depreciation studies made using these statistical techniques and the resultant depreciation expense that is included in expenses are routinely examined and approved by regulators and have proven to be more accurate and reliable than what would have resulted through component depreciation. Also, composite depreciation is less costly to administer. If composite depreciation rates did not produce a reasonable, systematic and rational allocation of capital costs, the federal and state regulators would not have approved its use for regulated public utilities. The use of the component depreciation method for large homogenous groups of assets within the public utility industry will be very costly to implement and maintain because it requires a separate depreciable life to be established for each depreciable component.

We are concerned that the AcSEC may be attempting to correct perceived abuses related to the accounting for PP&E through the promulgation of accounting rules that will produce less meaningful financial statements and would cause capital intensive industries to incur considerable additional costs. It is our view that

accounting abuses with regard to PP&E should be addressed through SEC and auditor oversight and not the changing of generally accepted accounting principles to prohibit the use of acceptable depreciation methods or to prohibit the capitalization of indirect costs that support and benefit regular, ongoing construction activities.

AEP operates in both regulated and non-regulated environments. In the regulated environment, the Federal Energy Regulatory Commission (FERC) requires utilities to follow the FERC Uniform System of Accounts (USOA). Most state regulatory commissions have also adopted the FERC USOA. The FERC USOA requires general and administrative costs and engineering and supervision costs to be capitalized as indirect construction costs. In addition, the USOA provides that salvage and cost of removal be accounted for by crediting or debiting the accumulated provision for depreciation. There is no discussion in the proposed SOP regarding the use of SFAS No. 71 for regulated entities. If AcSEC decides to promulgate these changes, it should specifically acknowledge the use of SFAS No. 71, which provides for the creation of "regulatory assets" for financial reporting purposes to bridge the gap AcSEC is creating between the proper treatment of overheads, major maintenance, early plant retirements and removal costs in the setting of cost based regulated rates and the AcSEC proposals. Without the use of SFAS No. 71 accounting, the financial statements of regulated entities' will be inconsistent with the current FERC and state adopted USOA and the methods used to determine its cost based rates and revenues. Conforming to both the FERC requirements for regulatory reporting and to the guidance provided in the proposed SOP for reporting to the Securities and Exchange Commission (SEC) will require two sets of accounting books. This will add additional accounting complexity at a significant cost and will confuse and mislead users of regulated entities financial statements.

Responses to Issues Raised by the AICPA

Accounting for Costs Incurred

Issue 4

The proposed SOP states that PP&E-related costs incurred during the preacquisition, acquisition-or-construction, and in-service stages should be charged to expense unless the costs are directly identifiable with the specific PP&E. Directly identifiable costs include only (a) incremental direct costs incurred with independent third parties for the specific PP&E, (b) employee payroll and payroll benefit-related costs related to time spent on specified activities preformed by the entity during those stages, (c) depreciation of machinery and equipment used directly in the construction or installation of PP&E and incremental costs directly associated with the utilization of that machinery and equipment during the acquisition-or construction stage, and (d) inventory (including spare parts), used directly in the construction or installation of PP&E. All general and administrative and overhead costs incurred, including all costs of support functions, should be charged to expense. See paragraphs 24,

25, 29, and 30. Do you agree with these conclusions? If not, what alternatives would you propose and why.

AEP believes that the requirement to expense all indirect costs will result in inconsistent reporting practices across companies. If a company hires a contractor to perform the construction, the contractor would certainly include his overheads and indirect costs in the amounts billed to the company. This billed amount would be capitalized as the cost of the acquired asset. Under the guidelines contained in the proposed SOP, a company that self-constructs the same asset would be required to expense overheads. Consequently, the capitalized amount of an acquired asset would be greater than the cost of the same asset that was self-constructed.

This proposal would require that a regulated electric and/or gas utility maintain two sets of accounting books. For regulated utilities, like those owned by AEP, expensing of all indirect costs would be a violation of the provisions of the FERC USOA. Specifically, the Code of Federal Regulations 18 CFR, Part 101 of the Federal Power Act, Electric Plant Instruction No 4 states:

> All overhead construction costs, such as engineering supervision, general office salaries and expenses, construction engineering and supervision by others other than the accounting utility, law expenses, insurance, injuries and damages, relief and pensions, taxes and interest, shall be charged to particular jobs or units on the basis of the amounts of such overheads reasonably applicable thereto, to the end that each job or unit shall bear its equivalent proportion of such costs ant that the entire cost of the unit, both direct and overhead, shall be deducted from the plant accounts at the time the property is retired.

A cost based regulated utility will be required to record regulatory assets under SFAS No. 71 for the differences in depreciation and other operating expenses between the costs capitalized under the USOA and the costs capitalized pursuant to this proposed SOP. In general, regulatory assets do not earn a return in the ratemaking process while the investment in plant earns a return. Therefore the plant investment in the public financial statements will not represent the economic bases on which the company earns a profit.

The Code of Federal Regulation permits indirect costs to be capitalized because a regulated public utility regularly performs major construction that is supported by Company services, which produce overhead and administrative indirect costs. An appropriate portion of such costs should be capitalized reflecting the fact that they support regular recurring construction as well as operations activities. To deny this economic reality is to produce misleading financial statements and create unnecessary costs to maintain two depreciation and continuing property records.

Issue 6

Paragraph 37 of the proposed SOP states that the costs of normal, recurring or periodic repairs and maintenance activities should be charged to expense as incurred. It also states that all other costs related to PP&E that are incurred during the in-service stage should be charged to expense as incurred unless the costs are incurred for (a) the acquisition of additional PP&E or components or (b) the replacement of existing P&E or components of PP&E. Do you agree with those conclusions? If not, what alternatives would you propose and why?

In general AEP believes that this conclusion is appropriate. However, electric utilities place assets in-service when they are capable of performing their intended function. In some cases, additional work may be performed to complete the final construction which is not related to the primary function but which should be capitalized with the asset. An example would be the grading and paving of parking lots. AEP suggests that paragraph 37 be modified to include capitalization of costs that are necessary to complete the asset but were not required for the asset to be placed into service.

Issue 7

Paragraph 39 of the proposed SOP states that costs of removal, except for certain limited situation demolition costs, should be charged to expense as incurred. Do you agree with that conclusion? If not, what alternative would you propose and why?

After this proposed SOP was issued for comment, the FASB issued SFAS No. 143, Accounting for Asset Retirement Obligations. SFAS No. 143 requires that tangible assets with associated legal liabilities for removal should include the fair market value of the liability as part of the asset cost with an off-setting entry to a liability account. We believe the guidance provided under SFAS No. 143 should be incorporated into this proposed SOP.

Although SFAS No. 143, does not permit removal costs for non-legal liabilities to be recovered through depreciation rates, AEP does not agree with this SOP's proposal to expense the cost of removing assets, including costs necessary to disassemble a component to gain access to a subcomponent to be replaced. For regulated electric and gas utilities, this is in direct conflict with the accounting guidance provided in the Code of Federal Regulations (FERC USOA) in 18 CFR Part 101, Electric Plant Instruction No. 10 that requires the cost of removal be charged or credited as appropriate to the accumulated provision for depreciation. The proposed SOP would require the creation of a regulatory asset for regulated public utilities following the FERC USOA. This would imply that these costs do not earn a return when they actually do because under regulated accounting as cited above, they increase the net investment in plant upon which cost based regulated utilities earn their profit.

Issue 8

Paragraph 44 of the proposed SOP states that the total of costs incurred for planned major maintenance activities do not represent a separate PP&E asset or component. It states that certain of those costs should be capitalized if they represent acquisitions or replacements and that all other costs should be charged to expense as incurred. Paragraph 45 prohibits alternative accounting treatments including (a) the accrual of a liability for the estimated costs of a planned major maintenance activity prior to their being incurred, and (b) the deferral and amortization of the entire cost of the activity. Do you agree with those conclusions? If not, what alternatives would you propose and why?

AEP does not agree that the total costs of planned major maintenance should always be expensed as incurred. When the costs incurred in planned major maintenance activities represent costs that will benefit future operating periods, regulatory accounting and ratemaking practices recognize the fundamental economic differences between planned major maintenance activities and routine maintenance. Planned major maintenance activities are the expected and normal result of operating an asset and follow a normal and predictable schedule. In the case of a planned nuclear plant refueling outage, it is the normal course of business to perform scheduled maintenance activities during the length of the outage. Accordingly, most regulators provide ratemaking mechanisms to levelize the annual impact of planned major maintenance activities. In the unregulated arena, planned major maintenance is performed in connection with scheduled outages of generation and pipeline equipment as well. These costs should not be considered a current period cost. Unlike unplanned major maintenance activities which are the result of unforeseen operational problems and which may have a significant, unplanned effect on current operations, planned major maintenance costs are incurred specifically to benefit the current as well as future operating periods.

Issue 12

Paragraphs 49 through 56 of the proposed SOP discuss component accounting and state that if a component has an expected useful life that differs from the expected useful life of PP&E asset to which it relates, the component should be accounted for separately and depreciated or amortized over its separate expected useful life. Do you agree with this approach to accounting for PP&E? If not, what alternative would you proposed and why?

AEP does not believe that component accounting can be cost justified for the mass type assets owned and operated by public utilities. For example, electric utilities have millions of utility poles and millions of cross-arms and hundreds of thousands of feet of overhead wire and buried cable. These and similar types of homogeneous assets are currently accounted for using a vintage year group method. The sheer volume of additional accounting transactions that would be required to account for these items on a component basis would number in the millions. Composite depreciation should be allowed when a Company has a large

number of homogenous assets because it is a more efficient depreciation method that produces a more accurate depreciation life and rate for mass property.

Issue 13

Paragraphs 38 and 51 of the proposed SOP state that when existing PP&E is replaced or otherwise removed from service and the replacement is capitalized, the net book value of the replaced PP&E should be charged to depreciation expense in the period of replacement. Do you agree with this approach? If not, what alternative would you propose and why?

This provision is in direct conflict with the Code of Federal Regulations, FERC USOA in 18 CFR Part 101, Electric Plant Instruction No. 10 that requires the cost of property retired to be charged to the accumulated provision for depreciation. Electric utilities continue to be subject to cost-based regulation, which remains as a part of regulated utility service when generation has been deregulated. As an electric utility's largest asset category, PP&E is subject to extensive and well-developed regulatory accounting policies. The focus of this regulatory accounting framework is to provide the public utility with a fair and equitable recovery of its investment and a return on its investment in PP&E from ratepayers. Historically, electric utilities have applied this regulatory accounting for PP&E in their external financial statements. This accounting provides a matching of the cost of PP&E to the revenues derived from the PP&E. The SOP's proposal to expense the unrecovered cost of property as the property is retired would not appropriately match the period expense with revenues for a regulated utility that would continue to capitalize the net book value of retired assets. Consequently, we believe this concept is not appropriate for a regulated utility.

The SOP should consider permitting the use of mass asset or group accounting by providing guidelines where it would be an appropriate alternative to recognizing gain or loss on the retirement of each component.

The following guidance is included in SEC Staff Accounting Bulletin 5b:

> If such equipment is depreciated on the basis of group of composite accounts for fleets of like vehicles, gain (or losses) may be charged (or credited) to accumulated depreciation with the result that depreciation is adjusted over a period of years on an average basis. It should be noted that the latter treatment would not be appropriate for (1) an enterprise (such as an airline) which replaces its fleet on an episodic rather than a continuing basis or (2) an enterprise (such as a car-leasing company) where equipment is sold after limited use so that the equipment on hand is both fairly new and carried at amounts closely related to current acquisition cost.

Similar guidance could and should be developed for mass homogenous asset accounting.

Issue 14

The proposed SOP requires the use of component accounting to depreciate identified components over their respective expected useful lives. As noted in paragraph A48 of the proposed SOP, entities have developed and utilized various conventions to depreciate assets, including group depreciation or use of composite lives. Those conventions are acceptable only if they result in approximately the same gross PP&E, depreciation expense, accumulated depreciation, and gains or losses on disposals of PP&E as the component accounting method required by this propose SOP. Do you agree with this approach? If not, what alternative would you propose and why?

AEP does not agree with the SOP's proposal to effectively prohibit the use of a systematic and rational method of depreciating mass assets, i.e. composite depreciation. Public utilities have historically relied upon group accounting and composite depreciation methods to account for their numerous categories of PP&E. These methods were developed, perfected and employed in this capital intensive industry with regulatory oversight largely because of the large number of homogenous assets and the large cost of PP&E, which is the basis for providing for the utility's operating revenues and profits. Regulatory policies require a proper accounting framework for PP&E in order to provide for a fair, accurate and objective recovery of the utility's investment as well as a fair, accurate and objective recovery of a return on the investment in PP&E. The composite depreciation rates used by regulated entities are independently reviewed and examined by regulators, ratepayers and their consultants. If composite depreciation did not produce a systematic and rational allocation of capital costs, it would not be the accounting employed by one of the most capital-intensive industries, i.e. the Public Utility Industry.

AEP believes that group and composite accounting methods are more efficient and superior to the component method for large groups of assets for which statistical methods exist for determining the depreciable life of the group. One of the most important aspects in developing a depreciation rate is the selection of an estimated service life. Imagine installing miles of distribution or transmission poles and conductor along a busy city street. It is inevitable that automobiles or trucks will destroy some of the poles in the very early stages of their service life while some of the poles will never be damaged. Statistical techniques, similar to those used in the life insurance industry to project mortality patterns, are available to estimate the service life of a large homogenous group of assets. These statistical estimates are far more reliable than attempting to estimate the life of every individual pole and strand of conductor in the line. As such, the SOP should permit the use of composite depreciation.

The proposed effective date for this SOP is for fiscal years beginning after June 15, 2002. AEP does not believe that this would provide enough time to establish a second set of accounting records that would include setting up component assets and developing depreciation rates for each of our thousands of components. AEP recommends establishing an effective date that is at least 18 months from the date

the SOP is approved and issued in order to provide a reasonable amount of time to comply.

AEP appreciates the opportunity to respond to the proposed Statement of Position. We hope that our comments will be helpful in AcSEC's future deliberations to fashion a sound set of accounting policies for accounting for PP&E.

Sincerely,

J. M. Buonaiuto

cc: Edmund L. Jenkins - Financial Accounting Standards Board
Timothy M. Lucas - Financial Accounting Standards Board

P.O. Box 25 6257 Hwy. 115 W., Clarkesville, GA 30523-0025 Phone (706) 754-2114 or (800) 640-6812

November 14, 2001

Mr. Marc Simon
Technical Manager, Accounting Standards
File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

RE: Exposure Draft-Proposed Statement of Position "Accounting for Certain Costs and Activities Related to Property, Plant and Equipment"

Dear Mr. Simon:

Habersham Electric Membership Corporation (Habersham EMC) is a distribution electric cooperative providing electric services to approximately 30,000 members on a not-for-profit basis in Northeast Georgia.

Habersham EMC appreciates the opportunity to present comments to the American Institute of Certified Public Accountants regarding the Proposed Statement of Position referenced to above.

We understand that the National Rural Electric Cooperative Association (NRECA), the electric cooperative's trade association, has provided comments on the proposed system. Based upon our review of a copy of their response, we would like the record to show that we concur with the comments provided to you by NRECA.

In addition, we would like to submit the following comments of our own:

The proposed statement states "...In practice, the composite life may not be determined with a high degree of precision, and hence the composite life may not reflect the weighted average of the expected useful lives of the asset's principal components." Habersham EMC agrees with this statement when there are a small number of components. However, we believe that when there are a large number of small components as found in an electric distribution system, the composite life can be determined with a reasonable degree of precision and would be an appropriate method of accounting for assets.

The proposed statement also requires expense recognition of removal costs and over/under depreciation of assets at the time of disposal. Under Habersham EMC's current methods of depreciation and capitalization of removal costs, our rates are very predictable and vary slightly from year to year (unless there is a drastic change in wholesale power costs). If we implement the proposed statement, there would be a very

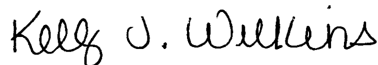
strong possibility that our cost of service could become quite volatile and could vary greatly from the costs we set out to recover when our rates are set at the beginning of the year. Even though adjustments can be made in rates at mid-year, this practice would result in the deterioration of hard earned goodwill and trust between Habersham EMC and our members.

The proposed statement would significantly change the way electric distribution cooperatives maintain plant asset records. In addition to the volatility in rates from over/under depreciation of assets at the time of disposal and expense recognition of removal costs, this proposed statement would most likely require at least one additional employee to keep up with the plant asset records. This cost would also be recovered by passing on the costs to our consumers.

This proposed statement appears to take a "one size fits all" position. It is requiring every industry and business to follow the same process without consideration of what process is the best method to provide a proper matching of revenues and expenses for each industry type. We believe that a more appropriate method should be utilized. The Federal Energy Regulatory Commission (FERC) has spent many years developing accounting procedures for electric utilities to assure proper matching of revenues and expenses. The Uniform System of Accounts developed by FERC is a good accounting system developed for all accounting areas, including property, plant and equipment, and should be considered for the capital-intensive electric utility business rather than the proposed statement of position. The Uniform System of Accounts has served the electric industry very well for several years and has allowed electric utilities throughout the United States to use similar methodology.

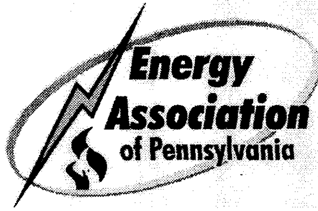
We appreciate the opportunity to provide our comments and hope that you will consider our views on the proposed statement on property, plant and equipment.

Sincerely,



Kelly J. Wilkins
Supervisor, Finance & Accounting

Enclosures



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November 15, 2001

Mr. Marc Simon
Technical Manager, Accounting Standards
File 4210.CC
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Via electronic mail to msimon@aicpa.org

RE: Comments Of The Energy Association of Pennsylvania on the Proposed Statement of Position, "Accounting For Certain Costs And Activities Related To Property, Plant, And Equipment."

Dear Mr. Simon:

The Energy Association of Pennsylvania (EAPA) appreciates the opportunity to comment on the proposed Statement of Position (SOP), "Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment" as prepared by the Accounting Standards Executive Committee (AcSEC). EAPA, the association of Pennsylvania's regulated electric and gas utility companies, makes these comments on behalf of its major member companies – Allegheny Power, Columbia Gas of PA/MA/VA, Dominion Peoples, Duquesne Light Company, Equitable Gas Company, GPU Energy, National Fuel Gas Distribution Corp., PECO Energy Company, Pennsylvania Power Company, PG Energy, a division of Southern Union Company, PPL Utilities, and, UGI Utilities, Inc.

The SOP contains several positive aspects that will contribute to a standardized reporting of costs and stages of projects eligible for capitalization as Property, Plant and Equipment (PP&E) assets. Comments in this letter focus on areas of concern by EAPA member companies.

Conflict with Current Accounting Requirements

Both Federal Energy Regulatory Commission (FERC) and Pennsylvania Public Utility Commission (PUC) require utilities to follow the FERC Uniform System of Accounts (USoA) structure that requires utilities to capitalize indirect construction overhead and general and

administrative costs, and gives the ability to track property using mass property accounting (18 CFR 1.101, Electric Plant Instructions 4.A, 3.A.12, and 10.B.2, respectively and 18 CFR Part 201, Gas Plant Instructions 4.A, 3.A.12, and 10.B.12 respectively). In addition, the FERC UsoA for electric and natural gas utilities requires that expenditures for preliminary surveys, plans, investigations, etc, made for the purpose of determining the feasibility of utility projects under contemplation be charged to Account 183.2, other preliminary survey and investigation charges. If construction results, this account is credited and the appropriate utility plant account is charged. Adoption of the SOP as defined would be in direct conflict to FERC guidance. Conforming to both FERC requirements for regulatory reporting and the SOP for reporting to the Securities and Exchange Commission (SEC) will require EAPA members to modify automated recordkeeping processes to categorize and capture information twice using different rules for reporting and ratemaking.

There have not been any compelling reasons given as to why the SOP position is superior to the current rule embedded in the FERC's USoA. Furthermore, there are compelling reasons to retain the status quo. For example, it is very likely that legal, tax and accounting personnel will be used in securing expenditures listed under the preliminary survey and investigation account. There is no compelling reason that such cost for securing early land not used in operations to be capitalized and similar costs for preliminary survey and investigation to be expensed.

Another area of concern is the SOP's proposed expensing of the total cost of removing utility assets in the period in which the asset is removed from service. This aspects of the SOP is a direct contradiction to a requirement part of Statement of Financial Accounting Standards (SFAS) No.143, "Accounting for Asset Retirement Obligations." SFAS 143 requires that tangible assets with associated liabilities for removal should include the fair market value of the liability as part of the asset cost with an off-setting entry to a liability account. The guidance under SFAS 143 has been finalized, therefore, the provisions in the SOP should be reconciled to the provisions of SFAS 143.

Such conflict with current accounting requirements is inconsistent with the Financial Accounting Standards Board's (FASB's) criteria for clearance of proposed documents that states "the proposal should not conflict with current or proposed accounting requirements, unless it is a limited circumstance, usually in specialized industry accounting, and the proposal adequately justifies the departure."

Negligible Improvements in Practice

FASB's criteria for clearance of proposed documents states that "the proposal will result in an improvement in practice." As currently drafted, the SOP does not meet that requirement.

The use of component accounting, or a component-based depreciation system, will not improve the accuracy of capital recovery, but could significantly put at risk an industry whose financial integrity rests upon recovery of large amounts of capital investment. Traditional recovery of electric and natural gas utility investment has been accomplished using group depreciation. This is because electric and natural gas utilities have significant numbers of items

of property and to track each item individually is not efficient or cost effective. Actuarial studies, university research, and continual revalidation of modeling techniques all support group depreciation methods currently utilized by regulated utilities.

Component-based depreciation requires a discrete estimate of life and salvage value for each component. This precludes the use of statistical and empirical analysis in an environment where the only reasonably accurate way of projecting retirements for the large volume of assets within electric and natural gas utilities is by applying statistical probabilities to groups of assets. Lacking empirical quantification, raw judgment would be applied under component-based depreciation to millions of individual assets to select useful lives and salvage value. Use of judgment of this magnitude is not an improvement in practice, but a step backwards in providing accurate capital recovery. Any change in depreciation policy that disallows the ability to use actuarial science to project future conditions and replaces it with a review mandating pure judgment cannot be seen as an improvement in practice.

Costs Outweigh Benefits

The application of this aspect of the SOP would be extremely expensive for electric and natural gas utilities. For example, electric utilities own millions of utility poles and hundreds of millions of feet of buried cable and overhead wire. Natural gas utilities own millions of feet of underground pipelines. These and similar types of homogeneous assets are currently accounted for using a vintage year group method. As such, a change to component accounting procedures would be neither economically feasible nor physically possible. Significant programming and operational changes would be needed to make the processes used for capturing, capitalizing, and tracking asset costs support component-based depreciation.

The proposed rule would also require the addition of a large number of regulatory assets or liabilities from the application of SFAS 71, "Accounting for the Effects of Certain Types of Regulation" on each company's books to synchronize regulatory reporting (for the purpose of recovering costs under a regulated framework) with reporting as mandated for generally accepted accounting principles (GAAP). Any benefits of this SOP that would be seen for industries not under rate regulation are negated in the electric and natural gas utility industries by the need for inclusion of significant levels of regulatory assets or liabilities and the inability to model retirements using actuarial methods.

Although AcSEC acknowledges in paragraph A48 Appendix A that current depreciation practices can be continued as long as "an entity can demonstrate that those [group depreciation] conventions can be used and produce the same results—related to gross Property, Plant & Equipment (PP&E), accumulated depreciation, depreciation expense, and gains or losses on replacements or disposals of PP&E—that are not materially different from those obtained under the component accounting prescribed in paragraphs 45 through 51," EAPA has concerns that demonstrating that the current practice works would cost as much as implementing component-based depreciation. If the proposed component accounting is adopted, EAPA suggests that AcSEC also provides a quantifiable process of limited scope (versus all asset classes) to

demonstrate that the results obtained using a group depreciation method are not materially different from those obtained under the component accounting prescribed by the SOP.

Therefore, EAPA concludes that for regulated utilities this proposed SOP does not meet the FASB clearance requirement in which "the costs of applying the SOP will outweigh the benefits of its application." Furthermore, the proposed SOP adds unnecessary burdens to an increasingly deregulated industry which is often artificially suppressed by rate caps.

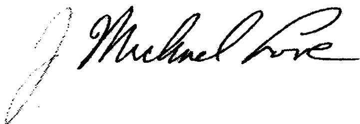
Exemption for Regulated Electric and Natural Gas Utility Industry

EAPA believes that regulated electric and gas utilities should be exempted from those provisions of the SOP that contradict regulatory accounting rules. Regulated electric and natural gas utilities are required to follow the accounting provisions of FERC's UsoA, one provision being the use of the composite rate method of depreciation. Furthermore, Pennsylvania's PUC has adopted regulation Title 52 Pa. Code §57.42 and 59.42 which follow FERC's accounting rules. Regulated utilities may not deviate from the FERC rules on computing depreciation. Requiring utilities to capitalize assets or compute depreciation using a methodology contradictory to existing FERC rulemaking would a) force utilities to maintain two separate sets of accounting books; b) decrease the accuracy of reporting; c) unnecessarily add to accounting and administrative costs incurred; and d) increase - not decrease - public confusion in regards to the financial statements of regulated utilities; and, e) cause a problem for taxing authorities. For utilities, this SOP will force additional accounting complexity at a significant cost without any appreciable improvement in either practice or accuracy.

For the reasons outlined above, EAPA believes that the proposed SOP's component accounting approach is not appropriate for regulated utilities, and that these entities should be exempted from these provisions. At a minimum, paragraph 52 of the proposed SOP should be supplemented to specifically exempt items of mass property from component accounting requirements, as the implementation of these requirements for mass property would be impracticable.

Again, EAPA members appreciate the opportunity to provide the AcSEC comment on this SOP.

Sincerely,



J. Michael Love
President & CEO
Energy Association of Pennsylvania

Glenn R. Richter
Senior Vice President - Finance

Sears, Roebuck and Co.
3333 Beverly Road, B5-128A
Hoffman Estates, IL 60179
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847-286-5776 (Fax)

November 15, 2001

Mr. Marc Simon, Technical Manager
Accounting Standards, File 4210.CC
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

RE: Proposed Statement of Position – *Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment*

Dear Mr. Simon:

Sears, Roebuck and Co. appreciates the opportunity to express its views on the proposed Statement of Position (SOP) – *Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment.*

We do not believe significant practice issues exist in the area of accounting for property, plant and equipment that warrant the issuance of the proposed SOP. In particular, we do not believe that the component approach to accounting for PP&E represents a new method of accounting that necessitates the development of new authoritative guidance. In our opinion, the component approach is only one, among a number of currently acceptable alternatives, that can be used to adequately account for PP&E assets. We see no reason for the component approach to be either required as the only acceptable method in accounting for PP&E assets or as the "recommended" approach to which results obtained from the application of any other alternative must be measured to ensure only minor differences exist.

The objective of PP&E accounting is to allocate the historical cost of capital assets over their respective service lives. This allocation is dependent upon management estimates; primarily an assessment of a particular asset's estimated useful life. The component approach set forth by the proposed SOP, despite being very detailed, does nothing to change the fact that PP&E accounting is still subject to management estimates. Thus, we do not see how a more-detailed approach will necessarily result in more accurate accounting when such accounting remains largely dependent upon management estimates.

Additionally, we believe costs relative to adhering to a component approach would be high relative to other approaches as a result of the need to process and maintain additional detail records under a component approach. We are cognizant of the provision within the proposed SOP that specifies entities should not account for components of PP&E that "fall below certain reasonable thresholds". However, we currently maintain in excess of 1.5 million individual PP&E records and believe that, even taking the aforementioned caveat into consideration, application of a strict component approach in accounting for all PP&E assets could drive that number significantly higher.

As an example, we currently employ approximately 13,000 fleet vehicles that are tracked within our accounting system by individual vehicle and depreciated over a composite estimated life. Strict adherence to the component approach would necessitate identification and tracking of individual vehicle components that exceed a "reasonable threshold" (e.g. body, engine, transmission, etc.). Thus, application of the components approach could potentially triple the number of required detailed tracking records for this single category of assets.

We do not believe this increased record keeping will generate more useful financial information than is currently generated from the appropriate application of other currently acceptable approaches that can be maintained with greater efficiency.

Additionally, while the project-stage timeline approach set forth in the proposed SOP may provide useful guidance to practitioners, we do not agree with the different treatment required for certain costs depending upon whether they are incurred internally or are the result of payments made to an external party. Specifically, the proposed SOP requires an entity to expense all internal administrative and overhead costs associated with PP&E procurement and construction as incurred. Conversely, if an external provider charges the entity for these same costs they are capitalizable.

We believe general and administrative expenditures should be eligible for capitalization when they are incurred as a result of an entity constructing capital assets and when such expenditures represent incremental costs that would not be incurred in the absence of such construction activity. The criteria for capitalization of such costs should not be contingent upon whether such costs are incurred internally or are paid to an outside party.

Specific comments on those issues where we believe we have a basis for comment are attached.

Sincerely,

Glenn R. Richter
Senior Vice President - Finance

Accounting for Certain Costs and Activities Related to
Property, Plant, and Equipment

Issue 1: Are there significant practice issues or concerns related to the accounting for contractually recoverable expenditures that should be addressed in the proposed SOP? Do you believe that there are other areas addressed in the proposed SOP that, with respect to their application to lessors and lessees of PP&E, could create conflicts with existing lease accounting standards?

We agree with AcSEC's exclusion of those issues pertaining to lessor or lessee accounting for reimbursements of contractually recoverable expenditures from the proposed SOP. We also agree with AcSEC's belief that a facts and circumstances approach to accounting for such arrangements is preferable to a single method being prescribed in the SOP.

Issue 2: The guidance in this proposed SOP is presented in terms of a project stage or timeline framework and on the basis of the kinds of activities performed during the stages defined...Do you agree with that approach? If not, what alternative would you propose and why?

We generally agree with the project stage approach.

Issue 3: Paragraph 16 of the proposed SOP states that the preliminary stage ends and the pre-acquisition stage begins when the acquisition of the specific PP&E is considered probable. Paragraph 22 of the proposed SOP states that, other than the costs of options to acquire PP&E, all costs incurred during the preliminary stage should be charged to expense as incurred. Do you agree with that conclusion? If not, how would you propose to modify the guidance and why?

We generally agree with the above conclusion.

Issue 4: The proposed SOP states that all PP&E-related costs incurred during the pre-acquisition, acquisition-or-construction, and in-service stages should be charged to expense unless the costs are directly identifiable with the specific PP&E. All general and administrative and overhead costs incurred, including all costs of support functions, should be charged to expense. Do you agree with those conclusions? If not, what alternatives would you propose and why?

As noted in our cover letter, we are concerned with the proposed SOP's inconsistent treatment of administrative overhead. Paragraph 29 of the proposed SOP would require an entity to expense all of its internal administrative and overhead costs as incurred. However, if an entity elects to engage a third party in performing potentially the same activities, paragraph 31 allows

the entity to capitalize any administrative overhead billed as an incremental direct cost. We fail to see the rationale for this differing treatment. We believe general and administrative costs should be capitalized when they are incurred as a result of an entity constructing capital assets and when such expenditures represent incremental costs that would not be incurred in the absence of such construction activity. The criteria for capitalization of such costs should not be contingent upon whether such costs are incurred internally or are paid to an outside party.

Issue 5: Paragraph 32 of the proposed SOP states that for real estate that is not being used in operations, costs of property taxes, insurance, and ground rentals should be capitalized, to the extent of the portion of the property that is under development, during the time that activities that are necessary to get the asset ready for its intended use are in progress. Do you agree with that conclusion? If not, what alternative would you propose and why?

We generally agree that conclusion.

Issue 6: Paragraph 37 of the proposed SOP states that the costs of normal, recurring, or periodic repairs and maintenance activities should be charged to expense as incurred. It also states that all other costs related to PP&E that are incurred during the in-service stage should be charged to expense as incurred unless the costs are incurred for (a) the acquisition of additional PP&E or components or (b) the replacement of existing PP&E or components of PP&E. Do you agree with those conclusions? If not, what alternatives would you propose and why?

We generally agree with those conclusions.

Issue 7: Paragraph 39 of the proposed SOP states that costs of removal, except for certain limited situation demolition costs, should be charged to expense as incurred. Do you agree with that conclusion? If not, what alternative would you propose and why?

While we generally agree with that conclusion, we believe that there are practical constraints that can limit an entity's ability to segregate removal costs from an overall project.

Issue 8: Paragraph 44 of the proposed SOP states that the total of costs incurred for planned major maintenance activities does not represent a separate PP&E asset or component. It states that certain of those costs should be capitalized if they represent acquisitions or replacements and that all other costs should be charged to expense as incurred. Paragraph 45 prohibits alternative accounting treatments.... Do you agree with those conclusions? If not, what alternatives would you propose and why?

We generally agree with those conclusions.

Issue 9: Should the costs of restoring PP&E's service potential, in addition to the cost of replacements that would be capitalizable under this proposed SOP, be eligible for capitalization? Do you believe that prohibiting the built-in overhaul method is appropriate, or should it be allowed as an alternative method? If you believe that the built-in overhaul method should continue to be allowed, what industries or entities should be allowed to use it, and why?

We believe the initial determination of an asset's useful life should consider the repair and maintenance activities, including major maintenance and overhauls, necessary to sustain the service potential of the asset. Thus, the costs of restoring PP&E's service potential should not be eligible for capitalization.

Issue 12: Paragraphs 49 through 56 of the proposed SOP discuss component accounting and state that if a component has an expected useful life that differs from the expected useful life of the PP&E asset to which it relates, the component should be accounted for separately and depreciated or amortized over its separate expected useful life. Do you agree with this approach to accounting for PP&E? If not, what alternative would you propose and why?

As stated in our cover letter, we do not agree with AcSEC mandating a component accounting approach for PP&E. We believe the component accounting approach is only one among a number of acceptable alternatives. AcSEC notes its concern that a composite approach may "not be determined with a high degree of precision". We would propose that a component approach is also subject to potential imprecision given the fair value allocations among individual components required when a multi-component PP&E item is acquired for a lump-sum amount.

Additionally, a strict component approach would almost certainly necessitate a significant increase in PP&E record keeping. We do not believe such increased record keeping will generate information that provides incremental benefit to financial-statement users over other appropriately applied approaches. Accordingly, we do not believe the incremental costs associated with maintaining more detailed PP&E records under the component approach is merited.

Issue 13: Paragraphs 38 and 51 of the proposed SOP state that when existing PP&E is replaced or otherwise removed from service and the replacement is capitalized, the net book value of the replaced PP&E should be charged to depreciation expense in the period of replacement. Do you agree with this approach? If not, what alternative would you propose and why?

We agree with this approach.

Issue 14: The proposed SOP requires the use of component accounting to depreciate identified components over their respective expected useful lives. As noted in paragraph A48 of the proposed SOP, entities have developed and utilized various conventions to depreciate assets, including group depreciation or use of composite lives. Those conventions are acceptable only if they result in approximately the same gross PP&E, depreciation expense, accumulated depreciation, and gains or losses on disposals of PP&E as the component accounting method required by this proposed SOP. Do you agree with this approach? If not, what alternative would you propose and why?

See response to Issue 12. Additionally, we do not see the necessity in an entity having to revisit all of their capital assets in an exercise to prove that the accounting results generated from such a convention mirror those that would have been derived had a component approach been used. We believe the component approach is, and should remain, only one acceptable alternative among a number of acceptable alternatives in accounting for PP&E assets.

Issue 16: Paragraph 71 of the proposed SOP states that the prescribed component accounting guidance should be initially adopted for existing PP&E using one of two alternatives, the election and disclosure of which should be made when the SOP is adopted. Do you agree with that approach and, if so, do you agree with the choice of the two alternatives from which the election is to be made? If you do not agree with that approach for existing PP&E, what approach would you propose and why?

See response to Issue 12.

Issue 17: Under paragraph 71(a) of the proposed SOP, the allocation of existing net book value to components at transition should be based on (a) allocation of original accounting records, if available, (b) relative fair values of components at date of transition, if original accounting records are not available, or (c) another reasonable method, if relative fair value is not practicable. Do you believe that the ordering of allocation methods is appropriate? If you believe that a different order would be appropriate, what order would you propose and why? Should the proposed SOP provide additional examples to illustrate what constitutes "another reasonable method"?

See response to Issue 12.

Issue 18: Paragraph 72 of the proposed SOP states that the SOP should be applied prospectively for all costs incurred after the adoption of the SOP. It also states that costs incurred prior to the adoption of the proposed SOP should not be re-characterized (as capital or expense items) to conform to the guidance in the SOP, with the exception of certain costs of planned major maintenance activities. Do you agree with that approach? If you do not agree with that approach, what approach would you propose and why?

We generally agree with this approach.

Issue 19: Under paragraph 71(a) of the proposed SOP, and as illustrated in Example 3 in appendix C, an entity applying component accounting retroactively at date of adoption may calculate a difference between the pre-adoption balance of accumulated depreciation and the balance recalculated based on the estimated useful lives of components that previously were not accounted for as separate components. Under that paragraph, the difference is allocated back to the accumulated depreciation of each component based on the net book values of the components. Two alternatives considered were recording the difference as a cumulative effect type adjustment at adoption and recording the difference as additional depreciation expense at adoption. Do you agree with the proposed approach or either of the alternatives, and why?

See response to Issue 12.

Butler Rural Electric Cooperative Assn., Inc.

216 – 218 S Vine
PO Box 1242
El Dorado, KS 67042
(316) 321-9600

November 15, 2001

Mr. Marc Simon
Technical Manager, Accounting Standards
File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Exposure Draft - Proposed Statement of Position, "Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment"

Dear Mr. Simon:

Butler Rural Electric Cooperative Association, Inc. appreciates the opportunity to submit written comments regarding the above-referenced Proposed Statement of Position (PP&E Accounting Proposal) to the Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants (AICPA).

Butler is an electric cooperative in the state of Kansas, providing electricity to approximately 6,300consumers-owners in seven counties. Since we operate within the capital-intensive electric utility industry, the PP&E Accounting Proposal would significantly and negatively impact Butler's accounting policies and administrative costs. Over the past three years, additions to our total utility plant have averaged $1,127,633 annually. During this same period, yearly reported patronage capital (margins) has averaged $882,665. We conservatively estimate that, if adopted, this PP&E proposal could decrease these margins by at least sixty percent or more. Resultant electric rates to our consumers would have to be increased substantially to cover the incremental costs associated with this proposal and to protect our financial integrity and credit rating.

Butler is required to follow accounting requirements promulgated by the Rural Utilities Service (RUS). The PP&E Accounting Proposal raises significant ratemaking, operational, and accounting concerns for ***Butler***. The most significant of these concerns arise due to accounting inconsistencies between this proposal and the RUS Uniform System of Accounts and attendant RUS regulations and interpretations (collectively, Electric Cooperative Accounting Requirements). The PP&E Accounting Proposal and the attendant detrimental impacts to ***Butler*** include the following:

- Electric Cooperative Accounting Requirements specify capitalization of overheads in support of construction projects and permit capitalization of an appropriate portion of administrative and general (A&G) costs. In addition, Electric Cooperative Accounting Requirements specify capitalization of preliminary investigation and survey (PI&S) charges. The PP&E Accounting Proposal would prohibit capitalization of overheads, PI&S charges, and A&G costs.

  Implementation of these provisions would dramatically increase earnings volatility, as these overhead, PI&S charges, and A&G costs would be expensed, rather than capitalized as they are today. We estimate that the annual financial impact of these items would decrease our margins by at least $156,485 annually or more, depending upon the extent of the capital restrictions ultimately imposed. Furthermore, from the standpoint of rate-making fairness, failure to capitalize these costs would inequitably shift the burden of collection of these costs from customers using the plant asset over its useful life to existing customers at the time the plant asset is constructed.

- Electric Cooperative Accounting Requirements prescribe the use of the group method of depreciation for plant assets. The PP&E Accounting Proposal would require use of depreciation accounting by component, defined as "a tangible part or portion of [plant] that can be separately identified as an asset and depreciated or amortized over its own separate expected useful life". The PP&E Accounting Proposal generally prohibits the use of a group method of depreciation, unless it can be shown by the entity that the asset balances and operating results under the group method is not materially different from that obtained under the component method. Implementation of this provision would require administrative reorganization to comply with the data collection requirements, as well as expensive new automated accounting systems -- or at a minimum, significant upgrades to existing software. In addition, determination of material differences between the component and group accounting methods would require record keeping for both methods, adding significantly to plant record-keeping costs, as well as audit costs. The estimated costs to upgrade automated systems and provide additional administrative record-keeping and data input is projected to add at least $50,000 in one-time costs and will conservatively exceed $531,042 on an annual basis thereafter. If adopted, our staffing costs are projected to increase by at least $173,597 annually, or more than 25%, to support the extra administrative and reporting burdens of this requirement.

- Electric Cooperative Accounting Requirements, consistent with group depreciation accounting convention, generally prescribe that gains and losses on normal dispositions of mass assets be closed to the accumulated depreciation account, under the theory that over time gains and losses will net out. The PP&E Accounting Proposal would require that gains and losses be reflected in the results of operations in the current accounting period. Implementation of this provision would result in increased earnings volatility, as gains and losses on plant disposition are reflected in the current results of operations. Annual gains / (losses) closed to the accumulated depreciation account over the past three years have averaged $117,367. Electricity rates would likely require significant upward adjustment to provide for this increased uncertainty of earnings.

- Electric Cooperative Accounting Requirements generally recognize the cost of removal of a plant asset over the useful life of that asset, as a component of the depreciation rate. The PP&E Accounting Proposal would require that cost of removal be reflected in the results of operations in the accounting period in which such cost was incurred. Removal costs we've incurred over the past three years have averaged $83,592 annually. Implementation of this provision would result in increased earnings volatility, as cost of removal would be reflected in a single accounting period. Furthermore, from the standpoint of ratemaking fairness, failure to recognize cost of removal over the asset's life would inequitably shift the burden of collection of these costs from customers using the plant asset to customers during the retirement of the plant asset.

Each of the above accounting inconsistencies pose operational problems and create significant administrative burdens for ***Butler*** that will dramatically raise the cost of electricity our rural member owners. The detrimental impacts of each item should be carefully considered and weighed against any identifiable benefits before the AICPA AcSEC implements the attendant provision of the PP&E Accounting Proposal for electric utilities. Further, we recommend that any and all decisions and changes impacting PP&E be closely coordinated in advance with RUS and all other federal and state governmental authorities regulating electric cooperatives and the electric industry.

Butler Rural Electric appreciates the opportunity to provide comments on the PP&E Accounting Proposal and respectfully urges the AICPA AcSEC to consider its views. If questions arise concerning these comments, please feel free to contact Gary Abel or Dale Short (General Manager) at (316) 321-9600.

Sincerely Yours,

Gary M. Abel

Gary Abel
Accounting Manager

November 15, 2001

Mr. Marc Simon
Technical Manager, Accounting Standards
File 4210.CC
AICPA
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Mr. Simon:

I am writing to you in response to the AcSEC proposed Statement of Position; *Accounting for Certain Costs and Activities Related to Property, Plant.* The proposed guidance, if enacted as currently stated, would have material and detrimental effects on JDN Realty Corporation. In the following paragraphs I would like to present a few of the areas in which this SOP would most effect our business.

First, the proposed componentization of Property, Plant and Equipment would require JDN to change from the composite method of depreciation. This change will be both costly and time consuming to effect. In addition, the ongoing impact would be an increase to the company's operating and maintenance expenses, and a decrease to the company's earnings and funds from operations ("FFO"). Examples of how this proposed componentization would affect the company are as follows:

- JDN's fixed assets are currently maintained on software that allows the Company to maintain 5,000 assets at a time. Componentization would increase the number of individual assets on the company's fixed asset system to approximately 25,000. This would require a new and more powerful software package capable of accommodating a large number of assets, and increase the company's investment in software by approximately $30,000.
- Given the large number of assets that the Company would be administering, the Company would be forced to hire at least one full-time employee dedicated to maintaining the fixed asset system. The estimated annual cost to the Company of another full-time employee to maintain the Company's assets is $55,000.
- In an effort to minimize time spent administering assets with a small basis, the company would likely increase its capitalization threshold, which would result in an increase to operating and maintenance expenses. The company would attempt to pass these increased expenses along to its tenants through the common area clause of the tenant's leases. This attempted pass through would result in an increase in the number of tenant audits, a reduction in the company's recovery rate on its operating expenses, and significant time administering the increase, among other things.
- Proposed guidelines would require any remaining book value of a componentized asset to be written off when a significant repair or replacement occurs on that asset. This would result in an increase to operating expenses, increased operating expenses passed through to the tenants, and a decrease in Net Income and FFO.

In addition to the impact that componentization would have on the company, the Proposal would require expensing certain indirect and overhead costs currently permitted to be capitalized. Because JDN develops almost all of the properties that it owns and operates, this change would eliminate approximately one-fifth of its net income and significantly affect how it operates in the future. JDN develops approximately 10 to 12 projects per year with a project basis of approximately $20 million per project. Of this estimated $200 to $240 million in project costs, approximately $8 million is internal costs imbedded in the cost of the projects. Under the proposed guidelines, a significant portion of these capitalized costs would be expensed in operations. JDN would be forced to eliminate positions and begin contracting for services with independent contractors.

The areas discussed above are just two of the areas that will be most significantly impacted by the proposed SOP. We ask that if the proposed SOP on Property, Plant and Equipment is passed as it is currently stated that Real Estate entities be excluded from its scope. We believe Financial Accounting Statement No. 67

provides more than adequate guidance for consistent and proper capitalization of costs related to real estate developments. Additionally, we believe that the cumbersome administration of asset componentization as prescribed in the proposed SOP on PP&E componentization far outweighs any benefit to the Company or its financial statement users.

Sincerely,

Michael Quinlan
Controller
JDN Realty Corporation

CC: John D, Harris
Mary Caneer
Melanie Ward

Shenandoah Valley Electric Cooperative

"Consumer Owned"

Corporate Office
147 Dinkel Avenue
P.O. Box 236
Mt. Crawford, VA 22841-0236
(540) 434-2200

BY E-MAIL AND FEDERAL EXPRESS

November 15, 2001

Mr. Marc Simon
Technical Manager/Accounting Standards
File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

RE: COMMENTS ON PROPOSED RULE —EXPOSURE DRAFT— PROPOSED RULE, "ACCOUNTING FOR CERTAIN COSTS AND ACTIVITIES RELATING TO PROPERTY, PLANT, AND EQUIPMENT"

Dear Mr. Simon:

The Shenandoah Valley Electric Cooperative appreciates the opportunity to submit these written comments regarding the above referenced proposed rule of the Accounting Standards Executive Committee of the American Institute of Certified Public Accounts "AICPA'.

SVEC is a distribution electric utility serving approximately 34,000 consumers in the States of Virginia and West Virginia. These consumers are the ratepayers/ member-consumers of the Cooperative. SVEC has over $112 million invested in electric distribution plant to serve these members. This plant investment is recorded at actual installed costs at the time of installation and has been installed over a period of 65 years. Since the Cooperative is multi-jurisdictional, that is, it operates under the regulation of both the Virginia State Corporation Commission and the West Virginia Public Service Commission, the rates, terms and conditions for the service, territory, and accounting methodology are regulated by these two Commissions. Additionally, the Cooperative is a borrower from the Rural Utilities Service (RUS).

The proposed rule if implemented would have a significant impact upon the Cooperative and its ratepayers. After studying the proposed rule in detail, it appears that this impact would add considerable costs, record keeping

requirements, with continued additional costs, and would create inherent conflicts while producing no tangible benefits to the Cooperative, its members, or to the general public.

The proposed accounting rule would, among other things:

1. Strictly limit types of costs that can be capitalized as Capital PP & E;
2. Impose a detailed system of property accounting and associated depreciation by asset component;
3. Require current period expense recognition of gain or loss on the replacement or retirement of an asset component; and
4. Require current period expense recognition of asset removal costs.

All of the above are contrary to current utility accounting and ratemaking methodology.

While the proposed rule may have certain merits for certain types of industries with public stockholders, the Cooperative can see no benefit to the rule in a capital intensive industry such as the electric utility industry. The underlying principal in this industry, with the Cooperative, and with regulators is that those receiving the benefit of electric service should be the ratepayers paying the costs. Of course, with long lived assets such as those in the electric distribution industry with some lives as long as 30 years, it is important that all costs of the asset by spread over the life of the asset.

Following this principle, the Cooperative is required to follow the Uniform System of Accounts (USoA) as prescribed by FERC as amended by RUS and the two states regulatory agencies. It is mandated that to receive funding from RUS the Cooperative must comply with the USoA. These accounting requirements specify capitalization of overhead and other costs incurred with the installation of the equipment. The total capitalized costs serve as the basis for receiving long term funding and for ratemaking. The various state regulatory commissions have accepted the composite depreciation method as a reasonable alternative to component depreciation.

If the proposed rule were implemented, it would immediately place the Cooperative in conflict with RUS, the state regulatory Commissions, and its auditors. The only way to avoid this conflict would be setting up and

keeping two sets of accounting records--additional costs and confusion with no apparent benefit.

The Cooperative estimates that it would cost in excess of $2 million to perform a field audit in order to reclassify its electric plant on a component/vintage basis with additional expenses for conversion of software both in the accounting and work order systems including procedure and policy changes to implement the proposed rule. Since the Cooperative is a not-for-profit entity these costs would essentially be paid for by the member/ratepayers. However, due to restructuring of the electric utility industry within the State of Virginia to allow for "Choice" in the generation component, legislation has capped the rate level for utilities thus incurring these costs could result in the Cooperative defaulting on its mortgage requirements, since there is no recovery mechanism.

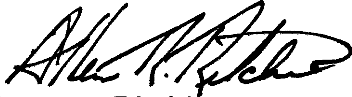
One thing that has been learned in the California Choice debacle has been that electric utility ratepayers want and demand price stability. This is another reason why the ratemaking is based upon the current USoA and regulators are requiring cost of service studies and functionally unbundled rates for the deregulated environment, said rates being based on embedded plant dollars. The proposal to require current period expense recognition of removal costs and loss or gain on the replacement of an asset adds significant volatility, not stability, to earnings and thus rates.

While some concerns that the AICPA might have with respect to earnings manipulation or misstatement of earnings in some enterprises might be just, they are relevant in the Cooperative business structure. The desire for uniformity of accounting across all industry segments must account for the realization that some distinction and differences are necessary. Any final plant accounting rule should not overturn existing, tested, and required electric utility accounting policies, procedures, and results including ratemaking practices without significant investigation, consultation, and imput from utility regulators and no final plant accounting rule should overturn any existing accounting practices of the industry without significant evidence that the benefits gained will out weigh the costs.

For the reasons stated above and the reasons stated in the comments filed by our national association, NRECA, and the state association, VMDAEC, the Cooperative opposes the implementation of the proposed accounting rule for the electric utility industry and suggests that should a rule be implemented at least

electric cooperatives should be exempted from compliance with this proposed rule.

Sincerely,



Allen R. Ritchie
Vice President-Finance & Administration

ARR/nas

Marc Simon

11/15/2001 04:41 PM

To: agadkins@uss.com, bdrake@kpmg.com, cdaugherty@dttus.com, james_ross@csx.com, jbrant@deloitte.com, leonard.gatti@us.pwcglobal.com, lmayshak@dttus.com, msimon@aicpa.org, richard.h.moseley@aexp.com, rrendino@pgrt.com
cc: Sharon Macey/NY/AICPA@AICPA
Subject: PP&E Comment letter #246

PP&E Comment letter #246
----- Forwarded by Marc Simon/NY/AICPA on 11/15/01 04:46 PM -----

Thomas_Sayers@hendersonna.com

11/15/01 04:45 PM

To: msimon@aicpa.org
cc: Douglas_Denyer@hendersonna.com, James_Martha@hendersonna.com, Denise_Ouellet@hendersonna.com, Helen_Vaverchak@hendersonna.com
Subject: Comments on Proposed SOP re: Cost Componentization

The following are questions and comments regarding the Proposed SOP on
Accounting for Certain Costs and Activities Related to Property, Plant and
Equipment as this exposure draft relates to its' relevance and
applicability to Fair Value reporting within the institutional real estate
investment universe:

The first item is a general question about whether or not this will
provide additional benefit to the primary users of the financial
statements. The total performance of an asset in any measurement period
is really just a reflection of the cash flows of that investment and the
Fair Valuation change from period to period of that particular
investment property and is not effected by this proposed
componentization of hard costs. This does not mean that there is not
any distinction between the components of the total income of a
particular period, namely income and appreciation

(discussed below).
The segmentation of costs is purely a geographic distinction which is
most relevant, meaningful and applicable to historical cost accounting.
Fair Value reporting standards for real estate which are widely used, in
acceptance, and at least impliedly endorsed by the AICPA, have been
developed by the National Council of Real Estate Investment Fiduciaries
("NCREIF"). These standards have been developed with the ultimate goal
of providing Fair Value reporting to investors. Historical cost and
segmentation have nothing to do with this particular goal other than to
provide an initial basis for an investment. For institutional real
estate investors, Fair Value reporting is a much more relevant method of
reporting on an investment than historical cost reporting. The
applicability of historical cost methods to this type of reporting are
not relevant in much the same manner as depreciating these components
over a projected useful life does not relate to Fair Value. The bottom
line for investors is that the costs to incur this would vastly exceed
any percieved benefit.

As mentioned in the previous item, admittedly, the reporting and
designation of items that are currently considered part of the cost of
an investment could be improved. There is a certain lack of clarity in
the distinction between income and appreciation for these types of
investments. Many items that are normal recurring items are currently
capitalized. There is probably a better distinction that could be made
between long-term investments in the future value of a property and
designation of expenses that recur as part of a normal operating cycle.
However, once this distinction has been made, it is reasonable to
consider all items that are capitalized as investments that are made to
correspond with attaining the Fair Value of that

property. To place
items in the cost basis of an asset and then pull them out in future
periods creates a disconnect between an investment basis and the value
that corresponds with that basis (this is important!). Investors in
this asset class are very concerned with the cumulative investment
amount which relates to the Fair Value of that investment and all
capital fundings need to relate to achieving the ultimate investment
goal of maximizing the asset's value. For instance, a roof replacement
may only be required once every fifteen years, however, the replacement
of that roof has not reduced the investor's capital requirements for
that investment. The investment capital (cost) and the cash invested
relates to attaining a Fair Value for that asset. The matching of
historical cost accounting/componentization with Fair Value reporting is
really a mismatch.

As mentioned in the first bullet, implementation of this would be very
costly, resource exhaustive and would not really provide more meangful
information to investors and other potential users of this financial
information. This enormous economic impact must be measured in
assessing whether or not this provides a perceived benefit that is worth
the cost. It is the impression of many that this is really an attempt
to reconcile two completely different types of reporting (Fair Value and
Historical Cost), a simpler task than trying to move all reporting in
the direction of Fair Value reporting. Cost componentization is really
a hybridization of these two methods. Most of the recent standards and
guidance that I have seen promulgated by the FASB and AICPA have been
very cognizant of the cost/benefit relationship associated with
reporting modifications and that the delicate competetive balance in the
marketplace can be altered by items which can

create an economic drag
such as this. The nature of the accountant's role in every industry has
changed as the speed of society has increased and, in general, the
industry has adjusted to the need to maximize benefit at a reasonable
cost. We believe this SOP goes well beyond this balance point and feel
it is necessary to point this out to AcSEC for their consideration.

If, after weighing all of the feedback and responses, the AICPA feels
that this SOP needs to be issued essentially in its present form, we
would like to ask for a couple of considerations. 1). That NCREIF be
given tacit authorization to play an active role in the deliberation or
design of the format or template for implemenatation of this SOP and
that this could be implemented in a manner that would minimize the
economic impact to investors in real estate and 2). Since this is a
very new concept to this industry and will require a significant amount
of preparation and interaction to accomplish, that it be implemented for
fiscal years beginning subsequent to December 31, 2003.

Sincerely,

Thomas P. Sayers

Affiliated member of the
Connecticut Society of CPA's

Henderson Global Investors,
NA (Advisor)

Hartford, CT

WABASH VALLEY POWER

A Touchstone Energy® Cooperative

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November 15, 2001

Mr. Marc Simon
Technical Manager, Accounting Standards
File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Exposure Draft – Proposed Statement of Position, "Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment"

Dear Mr. Simon:

Wabash Valley Power Association, Inc. (WVPA) is a not-for-profit corporation that generates and transmits electricity to 24 rural electric membership cooperatives in Indiana and Michigan. WVPA owns over 250 miles of high-voltage transmission lines, over 40 substations, and a stake in a coal-fired generating facility. The company's total plant in service is in excess of $211 million. WVPA also is a member of the National Rural Electric Cooperative Association (NRECA), the national trade association representing the interests of cooperative electric utilities and the customers they serve.

You most likely have already received correspondence for the NRECA in regards to the AICPA's Exposure Draft and Proposed Statement of Position, "Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment" (PP&E Accounting Proposal). WVPA had the opportunity to discuss the PP&E Accounting Proposal and its impacts on the cooperative electric utility industry with representatives from the NRECA and has also reviewed the NRECA's response to the AICPA. Based on our discussions and thorough review, WVPA fully supports the NRECA's response.

In addition to the concerns raised by the NRECA, WVPA foresees that if it were forced to comply with the provisions of the PP&E Accounting Proposal as written, the company would be saddled with additional administrative costs that would ultimately be passed along to our member distribution systems and the more than half million people that they serve. Furthermore, WVPA perceives no real benefit associated with these additional costs, nor does it anticipate any material change in the financial results of the company's

operations (excluding those stemming from increased administrative costs) over the long term. These additional costs can be categorized as follows:

1. **WVPA's Asset Management (AM) system would be rendered inadequate and need to be replaced.**

WVPA's AM system performs adequately under the company's current operating environment and also interfaces effectively with the company's other accounting systems. However, asking this system to conform to a new set of detailed standards brought about by the implementation of the PP&E Accounting Proposal would present WVPA with the real possibility of replacing its current AM software which has been in use for less than two years. In particular, the company has a concern over the ability of its present system to handle component depreciation. The cost of a new plant accounting system varies depending on the software selected, but one could conservatively estimate a cost of over $100,000 to purchase and implement a new system as well as a $15,000 write-off associated with the retirement of our present AM system.

2. **The company's depreciation rates would need to be revamped, forcing the need for a depreciation study to be performed.**

WVPA's depreciation rates are determined by depreciation studies performed by professional consultants and the assistance of company personnel. WVPA is regulated by the Indiana Utility Regulatory Commission (IURC), and any new depreciation study must be submitted to the IURC for their approval. Given that the company's current depreciation rates are founded on the premise of composite (group) depreciation and that gains and losses on the disposal of assets are factored into the depreciation rate structure, the PP&E Accounting proposal and its provision for the use of component depreciation would render WVPA's current depreciation rates useless. The company would incur significant costs in hiring a consultant to perform a depreciation study as well as the costs of WVPA staff to support the consultant's work. Past depreciation studies have cost WVPA about $25,000, and with the new rate structure the cost would likely be greater.

3. **WVPA's Plant Accounting group would experience a greater administrative workload.**

The PP&E Accounting Proposal does provide an exception which allows companies to continue to use their current method of composite depreciation if they can "demonstrate that those conventions can be used and produce results related to PP&E, accumulated depreciation, depreciation expense, and gains and losses on replacements or disposals of PP&E that are not materially different from those obtained under the component accounting prescribed". To accomplish this, WVPA's plant accounting personnel (currently one full-time position) would be required to maintain two separate sets of plant accounting and depreciation records, creating a significant administrative burden for the department.

4. **The company would need to build into its member rates a provision for increased margin volatility from gains and losses on asset disposals.**

WVPA charges its members a standard rate for electricity based on cost of service rate studies. These studies, or rate cases, take into account not only what the company must spend on generation/wholesale power purchases and transmission but also on other expenses. Depreciation expense is one component of WVPA's total cost of doing business. The fact that gains and losses of asset disposals and removal costs of assets are charged back to the depreciation reserve means that these costs are built into the company's depreciation rates. Also, the gains and losses on asset disposals will "offset" each other over time by design, creating a leveling effect and lending added stability to that component of the company's costs. The provisions of the PP&E Accounting Proposal dealing with current period expense recognition of gains and losses of asset disposals and of asset removal costs would erode the rate stability achieved by including those costs in depreciation rates. Therefore, WVPA would be compelled to factor in that variability when determining member rates. Increased earnings volatility would likely create the need for a rate study costing the company well over $100,000 to perform.

WVPA is grateful for the opportunity to convey its opinions to the AICPA on the PP&E Accounting Proposal and urges the AICPA to consider WVPA's and the NRECA's comments on the proposal before finalizing any policy. If you should have any questions or need clarification on WVPA's response, please feel free to contact us at (317)481-2800.

Sincerely,

WABASH VALLEY POWER ASSOCIATION, INC.

Marvin D. Gwin, Jr.
Plant Accountant

cc: Jeff Conrad, WVPA
Steve Piecara, NRECA
Robyn Poole, WVPA

November 15, 2001

Mr. Marc Simon
Technical Manager, Accounting Standards
File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

Re: Proposed Statement of Position: Accounting for Certain Costs and Activities Related to Property, Plant and Equipment

Dear Mr. Simon,

Weingarten Realty Investors ("WRI"), an equity-based real estate investment trust headquartered in Houston, Texas, would like to respond to the AICPA's request for comments on the Exposure Draft for the proposed Statement of Position on Accounting for Certain Costs and Activities related to Property, Plant and Equipment ("ED"). As an owner and operator of 281 income-producing retail and industrial properties in 17 states, WRI consistently expands its holdings through both the acquisition and development of operating properties and, accordingly, many of the issues addressed by this ED have significant implications to us.

Before commenting on the specific issues raised by the Task Force, we would like to make two general comments with respect to our more global concerns with the ED. First, it is our understanding that the AICPA has always been an advocate of the cost versus benefit standard in determining whether a project should go forward. While we cannot comment specifically on the impact the adoption of this standard would have on other companies, we can, with great certainty, assure you that the cost of the implementation and ongoing maintenance of an accounting system for WRI which would be capable of handling the componentization method proposed in the ED would be significant. Clearly, componentization would improve the quality of information regarding assets and depreciation under the premise that more information is always better. However, we believe the usefulness of this additional information in allowing financial statement users to make better decisions as compared to that produced under the current group or composite methods used today does not come close to justifying the incremental cost. Additionally, the transition alternatives proposed in the ED, which will produce differing financial statement results based on the alternative chosen, will inevitably lead to non-comparable results between companies.

Second, we fail to understand the need to revise the guidance provided under SFAS No. 67, "Accounting for Costs and Initial Rental Operations of Real Estate Projects", as it relates to the development of income-producing real estate assets. We believe that SFAS 67 provides specific, objective guidance for accounting for development projects that results in a comprehensive accumulation of expenditures that accurately reflects the

economic cost of completing a project. Every legitimate developer of real estate assets must clearly understand the relationship between the underwritten cost of a project and the returns generated. Under the proposed methodology of expensing all costs until an acquisition of property is "probable", we would be required to maintain a "second set of books" which would track the true cost of the development in order to accurately determine the economic success of the project. Furthermore, only to the extent that all expenditures related to the completion of the project are captured and depreciated over the appropriate period will the proper matching of expenses with the related revenues be accomplished. The ED requirement to expense all costs of a project until the acquisition is "probable" would result in an improper matching of revenue and expense in amounts which could, in many cases, be very significant. Similarly, the proposed ED requirement to capitalize taxes and insurance only until the first tenant occupies a space could also result in an inaccurate reflection of the total cost of a project and improper matching of revenue and expense. Again, we believe the guidance provided by SFAS 67 already provides a very useable and objective framework for accounting for development projects.

Issue #1
We are not aware of significant practice issues or concerns related to reimbursable expenses, nor did we identify any conflicts with existing lease accounting.

Issue #2
We have no issue with this approach.

Issue #3
As addressed in our opening comments, we do not agree with the proposal that the treatment of costs in the preliminary stage be different than in the preacquisition stage. Current practice of deferral of these costs until a decision has been made regarding the future of a project results in a more accurate accumulation of costs of the project. Expensing of these deferred costs in the event a project does not proceed occurs in the period in which the decision is made. Moreover, we believe the determination of when an acquisition is "probable" will be a very subjective decision that will result in a much greater diversity in practice than exists today. We believe the guidance provided in SFAS 67 remains relevant.

Issue #4
We agree that all general and administrative costs should be expensed as incurred but we also believe that there are other costs inherent in the operation of a construction/development department, which vary, with the level of activity within the department. While these costs may not be directly identifiable with a specific project, they clearly relate only to the Company's development activity in general, and thus represent an incremental cost of each project.

Issue #5
We agree that property taxes, insurance and ground rental should be capitalized as a cost of the asset during the development period. We do not agree with the proposal that all

capitalization shall cease upon the commencement of any operations in the project. Especially as it relates to commercial real estate projects, rental operations often commence in phases, with construction of additional phases proceeding concurrently. Total cessation of capitalization would result in the latter phases of the development being undervalued from a historical cost perspective and would, again, result in an improper matching of revenue and expense. SFAS No. 34, "Capitalization of Interest Costs", provides very clear guidance on how this should be handled.

Issue #6
We generally concur with the proposal except as it relates to planned major maintenance activities. In the operation of commercial real estate, these types of activities result in large amounts being expended in a given year, with a similarly large amount not expended for several more years. To expense these costs in their entirety in the year they are incurred results in a poor matching of revenue and expense, as these activities enable the owner to obtain higher rental rates in subsequent periods. Allowing the deferral and amortization of these costs over subsequent periods would be an appropriate alternative.

Issue #7
We disagree with this proposal. We believe that the cost of removing an asset in order to install a new asset is clearly an incremental cost and should be capitalized and depreciated over the life of the new asset. Contractors which perform removal and installation of assets do not currently segregate their billings to WRI between the two components and would likely not do so absent additional cost to us. We do not see a benefit from this proposed change to justify the additional cost.

Issues #8 & 9
See issue #6 above.

Issue #10
We agree with the proposal.

Issue #11
We believe that SFAS 67 provides guidance for cost accumulation on all real estate development projects, regardless of their intended use and that such guidance should remain operative.

Issues #12, 13 & 14
As discussed earlier, we believe the componentization methodology proposed in the ED is not a practical approach to accounting for PP&E. The cost of implementing and maintaining this accounting system would far outweigh the benefits of the additional information derived. We would support a system which would potentially expand the number of categories of assets beyond what commonly exists today, however the use of methodology similar to what is used for the group or composite method for retirement of assets would be much more cost effective. With respect to allowing companies to use the group or composite method as long as the result is similar to that produced by

componentization, it would not seem possible to make this statement without also implementing the component accounting model and therefore accounting for it twice.

Issue #15
We have no comment with respect to this issue.

Issues #16, 17, 18 &19
We agree with the need to offer alternatives for transition. Nonetheless, as discussed earlier, we believe that any requirement to move to componentization would be very costly and incredibly time-consuming without providing a significant improvement in the quality of the financial statements. We are certain that many companies would be unable to complete the full componentization of all existing assets in time to meet the current adoption deadline. Therefore, the fallback alternative of estimating the cost of components upon retirement would need to be used, in which case the company would show increased expenses upon retirement of most assets, which would seem to be an unfair penalty.

We appreciate the opportunity to comment on this Exposure Draft and would be happy to answer any questions you might have. I can be reached at (713) 866-6054.

Sincerely,

Stephen C. Richter
Senior Vice President and Chief Financial Officer

Marc Simon

11/15/2001 04:48 PM

To: agadkins@uss.com, bdrake@kpmg.com, cdaugherty@dttus.com, james_ross@csx.com, jbrant@deloitte.com, leonard.gatti@us.pwcglobal.com, lmayshak@dttus.com, msimon@aicpa.org, richard.h.moseley@aexp.com, rrendino@pgrt.com
cc: Sharon Macey/NY/AICPA@AICPA
Subject: PP&E Comment Letter #249

PP&E Comment Letter #249
----- Forwarded by Marc Simon/NY/AICPA on 11/15/01 04:53 PM -----

Serge.Pharand@cn.ca
Sent by: DIANE.LAFLECHE@cn.ca

11/15/01 04:39 PM

To: msimon@aicpa.org
cc:
Subject: Proposed Statement of Position (SOP)

November 15, 2001

Mr. Marc Simon
Technical Manager, Accounting Standards
File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Mr. Simon,

We thank you for the opportunity to address the Proposed Statement of
Position (SOP) ? "Accounting for Certain Costs and Activities Related to
Property, Plant, and Equipment". While we have presented our specific
comments in the attached Appendix, following the same order as the SOP for
your convenience, this covering letter summarizes the substance of our
disagreement with the SOP.

Canadian National (CN) operates 18,000 route miles of track from as far
west as Vancouver, British Columbia to as far east as Halifax, Nova Scotia
and as far south as New Orleans in the Gulf of Mexico. CN is the only
railroad to span three coasts of North America. We have approximately
2,100 locomotives and 100,000 freight cars. Our

track infrastructure is
composed of 56 million cross ties and 115 million tons of ballast. The
April 16, 2001 edition of Fortune Magazine rates the railroad industry as
the most capital-intensive industry in the United States with an asset to
revenue ratio of 2.64. The U.S. Bureau of the Census rated Class I
Railroads as the highest investors in capital as a percentage of revenues
(19.8%) versus all other manufacturing industries (3.7%).

CN is regulated by the Canadian Transportation Agency in Canada and the
Surface Transportation Board (STB) in the United States. Both of these
agencies prescribe accounting practices for fixed assets. In the US, the
STB requires that our accounting practices follow the Uniform System of
Accounts (USOA) for Railroad Companies (specifically Title 49
?Transportation Code of Federal Regulations, Subchapter C, Part 1201,
Subpart A, Paragraphs 4-1 through 4-2).

We trust that the AcSEC members will review and understand the implications
of this SOP on the railroad industry. CN believes that the application of
this proposed SOP would adversely impact capital-intensive industries such
as the railroads and cause significant confusion in the investment
community for several years. This implication would have a serious
detrimental impact on the evolution of the transportation of freight
creating export and domestic consequences.

The existing accounting rules for our vast network of track infrastructure
and the capital-intensiveness of our industry are designed to ensure
comparability within the rail industry. We believe these accounting rules
satisfy the readers of our financial statements. We also estimate that
the accounting treatments proposed in this SOP would significantly increase
the costs of maintaining a fixed asset accounting system for our company
while being detrimental to the readers of our

financial statements since
the accounting rules would be more complex and not comparable with other
railroads in our industry.

The major disagreements from a high level perspective include:

1. Not permitting the capitalization of general and administration and
overhead costs which are from a business perspective, incremental and
associated with capital projects;

2. Requiring the immediate expense of all removal costs; and

3. Requiring the componentization of all Property, Plant, and Equipment to
levels that will become un-manageable.

We have elaborated on these topics and our concerns in the attached
Appendix. These concerns are also shared by my colleagues in the railroad
industry. As an industry, we have collectively responded to the SOP
through the Association of American Railroads thereby indicating the level
of concern with this SOP.

If you would like further clarification, please do not hesitate to call me
directly at (514) 399-4784 or Costa Bucci, Assistant Comptroller -
Financial Reporting at (514) 399-4056.

Sincerely yours,

Serge Pharand, CA
Vice-President & Corporate Comptroller
Canadian National Railway Company

Appendix

Response to Proposed SOP ? Accounting for Certain Costs and Activities
Related to Property, Plant & Equipment

Issue 1

We have no comment on this topic.

Issue 2

The proposed project framework would force companies to identify costs in various stages of a project. While this framework might be useful as a guide, we believe that there will always be a need to review the substance of the costs incurred to determine if they will produce future benefits. While one may argue that companies will be placed on a common footing in terms of capitalization policies, some companies incur a significant amount of costs in the preliminary phase due to the nature of the business.

Issue 3

We disagree with the concept that all costs of the preliminary phase should be shown as an expense. If management can clearly demonstrate that costs incurred in the preliminary phase ultimately end up in the successful completion or acquisition of a pertinent item, then the incremental costs should be capitalized. Simply expensing removes the potential benefits to be derived from this initial phase. For example, FAS 19 ? "Financial Accounting and Reporting by Oil and Gas Producing Companies" allows the capitalization of drilling exploratory wells and costs of drilling exploratory-type test wells pending determination of whether the well has found proven reserves. Routine processes that have a past history of yielding beneficial outcomes should be eligible for capitalization.

Issue 4

We disagree that incremental support functions should be entirely expensed. If part of an individual's salary and benefits is to oversee these acquisitions and ensure that they meet the company's overall objectives (i.e. ROI), then the portion of time spent on the proposed acquisition is directly incremental to the project. If that individual was not accountable for ensuring that the acquisition was congruent with the firm's overall objectives, the position would not be

necessary and hence would be
incremental.

We also disagree that all overhead costs should be charged to expense, as
we believe that some internal overhead costs are incremental to specific
projects that we undertake. The railroad industry is extremely
capital-intensive and this is primarily due to the fact that it is more
efficient for us to use internal work-forces rather than external
third-parties (i.e. most of our self-constructed assets are fairly specific
to the railroad industry). As well, our union contracts with our employees
restrict the amount of contracts given externally to third-parties.
Although some of our overhead costs are not directly assignable to specific
units of property, we find that these costs are incremental. Capitalization
of overhead costs are permitted by the STB and are subject to audit by our
external auditors on an annual basis. CN believes that many overhead costs
meet the definition of incremental costs and thus should be subject to
capitalization.

In addition, it is mentioned in paragraph 26 that transactions with third
parties include a portion of the third party's administrative overhead.
The conclusion that this third-party overhead is incremental and
capitalizable is contradictory to paragraph 25.

Issue 5

We concur with this issue. Cost of property taxes, insurance and ground
rentals should be capitalized for properties under development.

Issue 6

We concur with this issue. If costs incurred improve the functionality of
the underlying asset, measured in terms of extended life years, increased
output, and improved quality of the finished product, they should be
capitalized. Costs of a normal, recurring nature should be expensed.

Issue 7

We disagree with this issue. As with other railroads, CN adjusts its accumulated depreciation for costs of removal related to our track infrastructure. As depreciation is allocated to the income statement, the costs of removal are matched with the revenue generated from the utilization of our track infrastructure. It is ultimately the utilization of the track infrastructure through the revenue generation process that results in the wear and tear of the assets, which in turn necessitates the removal process. Again, this is a practice that is required by the STB.

The proposed SOP wishes to recognize removal costs at the end of the life cycle of an asset. The result of this is an understated depreciation expense during the life of an asset and an overstatement of expenses at the end of an asset's life cycle.

In addition, this proposed analogy would penalize entities that have a different level of capital budgeting from year to year, causing blips in the reported results, as opposed to matching costs with revenues. For example, knowing that removal costs are to be expensed for track replacement, a company might be motivated to adhere to financial decisions rather than engineering decisions to remove track.

The proposal to expense all removal costs will only increase the volatility of financial statements in the railroad industries. Railroads that have high capital expenditure programs at a given time will be unfairly penalized for simply improving and maintaining their track infrastructure.
Removal costs represent a reduction in the estimated salvage value; hence net salvage (salvage less removal costs) is utilized in the railroad industry in terms of a railroad's depreciable base.

Issue 8

We have no comment on this topic.

Issue 9

We have no comment on this topic.

Issue 10

We have no comment on this topic.

Issue 11

We have no comment on this topic.

Issue 12

We agree that separate pools of assets should be shown and accounted for separately. We believe that our current method of segregating homogeneous pools of assets for the purposes of group depreciation meet the requirements of this proposed SOP for componentization. We currently have approximately 100 categories of like assets in our fixed asset records, which are prescribed by the STB for all railroads. When a depreciation study is conducted periodically (every three years), the life attributable to a homogeneous pool of assets should be a weighted average for all the pertinent components implicit in the pool. Any additional level of componentization will result in extensive administrative duties and record keeping, while not reaping any benefits of improved accuracy in both the Income Statement and the Statement of Financial Position figures. A comprehensive depreciation study is expected to identify all the components' individual attributes under the umbrella of a homogeneous pool of assets.

Issue 13

We disagree with the statement. This change would mean the end of the Group Method of Accounting, which stipulates that gains and losses from the replacement of depreciable assets be applied to accumulated depreciation, rather than flow through the Income Statement. By applying the gain or loss to accumulated depreciation, depreciation

expense will be impacted
accordingly.

The Group Method of Accounting has been a
recognized and valid form of
depreciating homogenous groups of assets and meets
the requirements of the
STB. In a letter dated in 1980 to the General
Accounting Office (GAO), the
SEC Chairman "?agreed that depreciation accounting
systematically allocates
the cost of capital assets over their estimated
lives". As well, ARB 43
defines depreciation as, "a system of accounting
that aims to distribute
the cost or other basic value of tangible capital
assets, less salvage (if
any), over the estimated useful life of the unit
(which may be a group of
assets) in a systematic and rational manner." Group
depreciation has been
a recognized and valid methodology under GAAP for
years and we formally
propose to the AcSEC members that this form of
depreciation accounting
continue to be applied for the railroad industry and
others who operate a
vast network of homogeneous capital assets and
equipment.

A depreciation study considers historical retirement
patterns, observation
of the property, interviews with engineering
staff and discussion with
knowledgeable individuals about future trends
and industry changes
regarding the assets. The study also estimates the
amount of accumulated
depreciation for each component category using the
new estimated life and
expected salvage value. The difference between
the actual accumulated
depreciation in our books and the calculated
accumulated depreciation
derived from our new estimates is recorded
prospectively to depreciation
expense since it is a result of a change in
estimate. Based on past
depreciation studies, significant deficiencies in
accumulated depreciation
have not arisen.

Further componentization would not yield better
financial results for the
users of the financial statements due to the

increased subjectivity of
determining what a component of track is. Should
this proposed SOP become
final, further componentization of all PP&E
assets will be at the
discretion of the individual railroads. This of
course will negatively
impact comparability between railroads.

We do not believe that the proposed component
accounting will increase
accuracy over what is already an accurate, defined
and supported method
approved by GAAP and by the STB. The fact that our
depreciation studies
monitor significant assumptions in the group method
every three years lend
credibility to this long-standing method of
accounting.

Issue 14

We concur with this approach. We would however
like to see some more
guidance as to how to go about proving that our group
method of accounting
closely approximates the proposed component
accounting. Will it require an
annual or interim comparison between other
conventions and component
accounting or is it suitable to apply this
comparison at initial adoption
of the standard only? Are there any additional
disclosure requirements if
another convention other than component accounting
is used to account for
PPE?

Issue 15

We have no comment on this topic.

Issues 16-19

We believe that we have presented strong
arguments and concerns that
warrant reflection as to the impact of the
provisions of the Statement on
the railway industry. The transitional provisions,
both prospective and
retroactive application, will have their drawbacks.

Prospective treatment is counter to the
fundamental concept of having
comparative accounting policies between reporting
periods since:

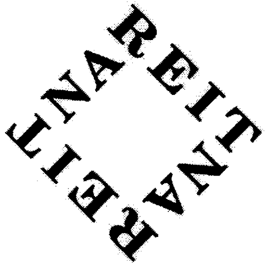
- indirect overheads are required by the Statement SOP to be prospectively
  expensed as incurred, and
- indirect overheads that have been capitalized prior to the adoption of
  the Statement are allowed to remain in capital.

In addition to having inconsistent accounting policies, prospective
treatment unfairly burdens future results of operations due to depreciation
expense being incurred on indirect overheads that continue to form part of
the capital base since they occurred prior to the adoption of the
Statement.

While a retroactive application is a better alternative than the
prospective application, it also has many drawbacks. The retroactive
application with a cumulative effect will result in tremendous time and
effort to change accounting policies, revise current practices and
implement the arduous changes to our fixed asset information system.
Footnotes with pro forma figures should be allowed in the notes to the
financial statements. This enormous undertaking may still yield a risk that
the current information systems we have in place may not accommodate these
changes without massive modifications to the basic functionality of the
operating software, which were not designed at the time of implementation
to meet these needs. The cost and complexity of these changes to
management reporting systems is a major barrier in adopting the provisions
of the Statement for the railway industry due to the magnitude and
uniqueness of our asset profile. A minimum of two years would be required
to implement such changes.

FAS 109 - "Income Taxes" paragraph 68, states that "the Board follows the
precept to promulgate standards only when the expected benefits of the
resulting information exceed the perceived costs. The proposed standard
will fill a significant need and that the costs imposed to meet that

standard, as compared with other alternatives, are justified in relation to
the overall benefits of the resulting information."
We trust that AcSEC
will take the above statement into consideration, based on the issues
raised by our letter to you.



NATIONAL
ASSOCIATION
OF
REAL ESTATE
INVESTMENT
TRUSTS®

November 14, 2001

Mr. Marc Simon
Technical Manager, Accounting Standards
File 4210.CC
AICPA
1211 Avenue of the Americas
New York, New York 10036-8775

Re: Proposed Statement of Position: *Accounting for Certain Costs and Activities Related to Property, Plant and Equipment*

Dear Mr. Simon:

As you know, the National Association of Real Estate Investment Trusts (NAREIT) has followed and directly supported the Accounting Standards Executive Committee's (AcSEC) process and deliberations with respect to its proposed Statement of Position (SOP), *Accounting for Certain Costs and Activities Related to Property, Plant and Equipment*. NAREIT representatives have attended public AcSEC meetings at which this project has been discussed and provided AcSEC's Project Task Force with NAREIT's views and concerns based on the materials discussed at these meetings. This letter provides our comments on the June 29, 2001 Exposure Draft (ED).

NAREIT is the national trade association for real estate investment trusts (REITs) and other publicly traded real estate companies. NAREIT members include over 200 REITs and other companies that develop, own, operate, and finance investment property,[1] as well as those firms and individuals who advise, study, and service these businesses. Providing useful and relevant financial information related to investment property is of vital importance to the capital formation and investor relations activities of companies involved in these businesses.

NAREIT has, and will continue to, actively support the development of transparent accounting and reporting standards. Our goal is to responsibly advocate those standards that reflect the economic reality of acquiring, developing, owning and operating investment property. In this context, the accounting standards for capitalizing the costs of these assets are fundamental to producing useful financial reports for real estate companies that acquire, develop, own and operate investment property. These standards may have a more

[1] Investment property is also referred to as income-producing real estate, both of which are defined as real estate held for rental and/or capital appreciation.

1875 Eye Street, NW, Suite 600, Washington, DC 20006-5413
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significant impact on the financial statements of these companies than on the financial statements of companies that simply use property, plant and equipment in the production of products or delivery of services, in view of the fact that property assets account for the great majority of member company assets and maintenance of these properties represents a significant annual cost.

This comment letter is organized as follows:

Cover letter:

I.	Summary of Significant Concerns
II.	Scope of the Proposed SOP
III.	Investment Property – a Unique Asset Recognized in Accounting Standards
IV.	Basis for Selection of Cost Accumulation Model
V.	Request to Limit Scope of Proposed SOP Related to Investment Property

Exhibit A	General Comments
Exhibit B	Comments on Areas Requiring Particular Attention
Exhibit C	Participants in writing this comment letter
Exhibit D	References to the composite or group method of depreciation

I. *Summary of Significant Concerns*

As discussed in Exhibit A attached to this letter, our most significant concerns with the proposed SOP as drafted are as follows:

- Component accounting at the detailed level prescribed by the SOP is not cost justified – it would not enhance the measurement of the cost or depreciation expense of PP&E to a degree commensurate with the cost of applying the SOP.
- The proposed SOP would effectively eliminate the group and composite methods of depreciation.
- The SOP virtually would eliminate the concept of "deferred cost/prepaid expense" accounting with respect to PP&E. This is contrary to the definition of an asset as set forth in the FASB's Concepts Statement No. 6, *Elements of Financial Statements.* We believe that this result would not allow for appropriate matching of revenues and costs and, therefore, would not produce financial reporting that would provide a faithful representation of the periodic profitability of owning and operating investment property.
- Finally, the proposed SOP would not result in more uniform accounting for capital maintenance expenditures – one of the explicit purposes of the proposal.

Based on our comments in this letter and its attached Exhibits, we respectfully request that investment property be exempted from the scope of those sections of the proposed SOP that modify the accounting prescribed in SFAS 67, as well as those sections that require detailed componentization.

II. *Scope of the Proposed SOP*

We understand and appreciate that there may be a need to provide clearer guidance with respect to:

- accounting for the costs of repairs and maintenance and long-term capital maintenance programs,
- disclosure of accounting policies governing the accounting for the cost of repairs and maintenance,
- depreciation methodology and measurement parameters, and
- providing more useful disclosures with respect to appropriate categories of PP&E and depreciation.

At the same time, and in addition to other concerns, we believe the scope of the proposed SOP extends far beyond the "Accounting Issues" identified in the project prospectus. Each of the issues identified in paragraphs 5 through 8 of the prospectus focus specifically on accounting for expenditures made subsequent to the initial installation, development or construction of PP&E. Beyond the scope indicated in the prospectus, the proposed SOP would create new accounting for:

- the initial costs of installing, developing and constructing PP&E;
- carrying costs during the initial lease-up phase of a real estate project; and
- overhead costs relating to the initial development and construction of PP&E.

Standards with respect to each of these areas for investment property are set forth in Statement of Financial Accounting Standard No. 67 (SFAS 67), *Accounting for Costs and Initial Rental Operations of Real Estate Projects*.

In addition, paragraph 4 of the prospectus specifically states that the project will not cover depreciation. As discussed further in this letter, the proposed SOP would dramatically affect universal depreciation practice – it would eliminate the group and composite methods of depreciation and would require, instead, a depreciation system that would require extensive and costly changes to current practices.

While we may not fully understand the AcSEC's/FASB's policy with respect to adherence to a project's prospectus, we believe the scope of the proposed SOP should be consistent with the project prospectus. Therefore, we believe the proposed SOP should be revised to conform to the prospectus and the revised documents re-exposed.

III. *Investment Property – a Unique Asset Recognized in Accounting Standards*

First, we understand and appreciate that certain practices with respect to accounting for costs of PP&E may not be uniform in all respects and that these areas of accounting diversity may need to be addressed. But, from our research, the specific areas of concern are accounting for costs of repairs and maintenance and long-term capital maintenance programs as opposed to the costs of developing or constructing PP&E. We have not seen evidence that accounting practices with respect to costs of developing or constructing investment property are significantly diverse. It, therefore, is difficult for us to conclude that principles contained in SFAS 67 have provided incorrect or misleading guidance for almost 20 years. Contributing to the longevity and continued relevance of SFAS 67 was the FASB's 1982 review of these principles that were originally contained in AICPA Statements of Position. We do not understand why the AICPA/FASB would want to continue to expend scarce resources on a standard that has provided clear guidance for over 20 years (since SOP 78-3 was issued) and was reviewed and re-issued by the FASB in 1982 as SFAS 67.

Second, we note that SFAS No.19 (SFAS 19), *Financial Accounting and Reporting by Oil and Gas Producing Companies*, would not be affected by the issuance of the proposed SOP. Many of the cost accumulation principles found in SFAS 19 are consistent with the principles included in SFAS 67. Many characteristics of producing oil and gas, especially the exploration and development of wells and supporting facilities, are similar to the development and construction of investment property. This is even true of accounting for costs of "dry holes/abandoned projects" and the relevance of fair value information. Therefore, we do not understand why the scope of the proposed SOP leaves SFAS 19 intact (as it should) but obsoletes SFAS 67.

And third, the economics of owning and operating investment property are far different than the economics related to PP&E used to provide goods and services. SFAS 67 and other authoritative accounting literature recognize the unique economic characteristics of "investment property." Characteristics that distinguish investment property from most property, plant and equipment include the following:

- Each property is unique in terms of location, design and tenant mix.
- Cash flows are directly associated with renting or leasing the property to unaffiliated parties.
- Future long-term cash flows generated by the property are reasonably estimable – they are supported by contracts (leases).
- In many cases, the cost of the property is funded by specifically related non-recourse mortgage debt that has been underwritten by third-party lenders on the basis of the quality of projected cash flows.
- There is an active market for the exchange of investment property.
- The value of well-maintained investment property generally increases over time.

Generally Accepted Accounting Principles (GAAP) in the U.S. have recognized the uniqueness of investment property in SFAS No. 41, *Financial Reporting and Changing Prices: Specialized Assets – Income-Producing Real Estate,* and in SFAS 67. In the international arena, International Accounting Standard No. 40 (IAS 40), *Investment Properties*, also recognizes these distinctions. Conclusions reached in this March 2000 standard are based on contemporary views of fundamental financial reporting concepts.

IAS 40, a part of the core international accounting standards that are recognized by the new International Accounting Standards Board, requires disclosure of the fair value of investment property either in the financial statements or in accompanying notes. To achieve this measurement and disclosure, it views an investment property as an integrated operating entity, a package of service potential – not as an amalgamation of hundreds of components. IAS 40 also addresses the accounting for "subsequent expenditure."

In testimony at a July 31, 2001, House Energy and Commerce Subcommittee meeting, Edward Jenkins, Chair of the FASB, stated:

> We [FASB] are committed to having a close, active and constructive relationship with the IASB [International Accounting Standards Board] and other standards setters in achieving convergence of high quality financial reporting standards around the world.

Further, as reported in the October 16, 2001 issue of *Status Report*, the FASB has reached a tentative agreement to change its agenda decision criteria "to include consideration of the prospects for cooperation and convergence with each topic added to the Board's agenda..."

To require owners/operators of investment property to dramatically move in a direction counter to the more far-reaching direction of international accounting standards seems inappropriate, unnecessary and inconsistent with the FASB's commitment to achieve international convergence of high quality accounting standards. **We believe that changing U.S. GAAP to require extensive, detailed componentization of the costs of investment property while core international standards view them as integrated operating entities, will result in the real estate industry's financial reporting and accounting systems being whipsawed as the U.S. moves toward convergence with international standards.**

IV. *Basis for Selection of Cost Accumulation Model*

In its justification of a cost accumulation model that would exclude the capitalization of certain indirect and overhead costs related to the installation, development or construction of PP&E, AcSEC analogized to SOP 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*. This is an inappropriate justification based on AcSEC's own conclusions as set forth in paragraph 80 of SOP 98-1, which states:

> AcSEC recognizes that the costs of some activities, such as allocated overhead, may be part of the overall cost of assets, but it excluded such costs because it believes that, as a practical matter, costs of accumulating and assigning overhead to software projects would generally exceed the benefits that would be derived from a "full costing" accounting approach. AcSEC considered that costing systems for inventory and **plant construction** (emphasis added) activities, while sometimes complex, were necessary costs given the routine activities that such systems support.

Similar to plant construction, the development, construction, or improvement of investment property entails certain indirect and overhead costs that represent routine activities. Clearly, these costs are part of the overall cost of the asset. Moreover, the benefits derived from a full costing approach for investment property far exceed the expense of required costing systems. Real estate companies track and account for the costs of these activities through the use of mature systems that have been developed to comply with SFAS 67. The financial results produced by these systems have been included in audited financial statements for more than 20 years.

V. *Request to Limit Scope Related to Investment Property*

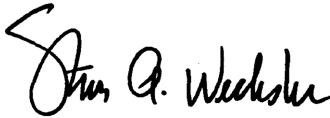
We respectfully request that investment property be exempted from the scope of those sections of the proposed SOP that modify the accounting prescribed in SFAS 67, as well as those sections that require detailed componentization, for the following reasons:

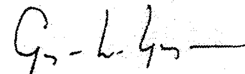
- There is no evidence that SFAS No. 67 needs modification to ensure a reasonable degree of uniform accounting for the development and construction of investment property—in fact, AcSEC's July 2000 draft of the SOP (Appendix A, paragraph 46) stated that "diversity in practice is minimal" with respect to SFAS 67;
- SFAS 67 provides an appropriate long-standing cost accumulation model – reflecting the model used in SFAS 19;
- The application of SFAS 67 reflects the economics of developing and operating investment property in terms of costs recognized and returns measured by investors,
- The project prospectus did not identify accounting for these costs as an issue; and
- The proposed SOP's componentization accounting model for investment property is inconsistent with IAS 40 and is inferior in its conceptual and practical approach to accounting for this property.

Concurrently with this comment letter, we are responding to the Financial Accounting Standards Board's Exposure Draft that would amend SFAS 67. Our position is that SFAS 67 should not be amended.

NAREIT appreciates the opportunity to continue to participate in AcSEC's considerations with respect to accounting for PP&E. The positions taken in this comment letter represent consensus views of a Task Force of NAREIT members. In addition, this comment letter has been reviewed and approved by NAREIT's Best Financial Practices Council. A list of companies represented by these participants is included in Exhibit C. In addition, representatives of the major accounting firms provided advice and comments in connection with this letter. If you have any questions regarding this comment letter, please contact George Yungmann at (202) 739-9432 or David Taube at (202) 739-9442.

Respectfully submitted,





Steven A. Wechsler
President and CEO

George L. Yungmann
Vice President, Financial Standards

Exhibit A

General Comments

Accounting for All Distinguishable Components of PP&E as Separate Assets

The detail to which the proposed accounting carries componentization of PP&E is impracticable and difficult for us to even imagine justifiable on a cost/benefit basis.

As indicated elsewhere in this letter, the proposed level of componentization would dramatically increase the costs of accounting for PP&E. NAREIT has not developed specific estimates of all of these costs, but will be urging our member companies to do so. We are certain that the expansion of cost segregation studies and the more detailed approach to these studies required by the proposed SOP alone could cost a real estate company $50,000 to $100,000 per property – just to initially allocate costs to detailed components. Moreover, there would be an exorbitant total cost that would have to be incurred to achieve even reasonable accuracy in allocating trillions of dollars of net book value of investment properties at adoption of the proposed SOP. NAREIT members alone have interests in more than 27,000 individual property investments. Assuming a per-property cost at the low end of the range of $50,000, the cost to initially allocate the net book value would approximate $1.35 billion. We cannot even begin to estimate what the cost would be to complete these allocations for the more than four trillion dollars of investment-grade real estate in the United States. It is clearly not practicable nor cost-justified to allocate this cost to the level of components required by the proposed SOP. This would be a massive and expensive undertaking with minimal enhancement to reported results. AcSEC should seriously consider field-testing this proposed guidance as part of its post-comment-letter review of the proposed SOP.

Further, we do not believe that the Board or AcSEC have adequately considered the effort and cost that would be required to apply the detailed level of PP&E componentization to large, complex PP&E – such as investment property. Paragraphs 58 and 59 of the ED discuss disclosures and suggest that "buildings and building improvements," represents a major category of PP&E and that this category be sub-categorized into tenant improvements, integral equipment and the building shell. We are very concerned that the discussion in these paragraphs suggests that AcSEC believes that a real estate project consists of far fewer components (at the level defined by the proposed SOP) than actually exists in the case of investment property. The level of components implied by these paragraphs may be acceptable to the real estate industry – but it is far less detailed than the level actually required by the ED. There are hundreds of replaceable PP&E components in a single investment property. While it is possible to account for the cost of each one of these components, we do not believe that the result would provide significantly more useful information than the composite or group methods of accounting for major categories of components.

In addition, with respect to component asset accounting, we do not believe that the cost of multi-million and even billion-dollar acquisitions can be reasonably assigned to replaceable components (e.g., a $ 25,000 motor in major mechanical equipment, the interior façade of a bank of elevators, the treads on an escalator, the hundreds of appliances in a large apartment project,

etc.). In July 2001, Equity Office Properties Trust acquired Spieker Properties, Inc., the assets of which consisted primarily of a portfolio of office buildings. This acquisition was valued at more than $7 billion. We cannot imagine how this value could be allocated to tens of thousands of detailed property components as required by the proposed SOP.

Some have suggested that real estate companies have information already available from cost segregation studies to enable them to implement the proposed SOP. This is not the case. First, cost segregation studies undertaken today are not completed for even a majority of real estate properties. Second, in the great majority of cost segregation studies, investment property is simply grouped into three broad categories – personal property, buildings and land improvements. The personal property, which generally only accounts for about 5% of the property's total value, is further detailed by small components. The remaining 95% of a property's cost is not broken down into components or even individual systems (i.e., mechanical, electrical, integral equipment, etc.). While very detailed cost segregation is possible, we estimate that it would double or triple the current cost of these studies that range from $30,000 to $50,000 per property, depending on the complexity and size of the property.

And finally, with respect to the detailed level of componentization called for by the proposed SOP, we would assume that physical identification of components would be required to be completed and reconciled to accounting records for audit purposes. This would, of course, increase the cost of audits.

We note that in the Forward to the ED, one of the four criteria required for FASB clearance of AcSEC proposed projects and documents is that "the benefits of the proposal are expected to exceed the costs of applying it." We also note that the project prospectus states:

> AcSEC believes that the benefits arising from consistent application of accounting principles and the improved comparability of financial statements will exceed the costs of implementation.

We would appreciate the AcSEC sharing with us their analysis or rationale that would justify the cost of the detailed accounting called for in the proposed SOP.

This proposed detailed componentization accounting would effectively eliminate the use of the composite and group methods of depreciation – currently acceptable accounting methods universally used in practice. Under the composite method of depreciation, assets or components of assets with different service lives are depreciated over the weighted useful lives of the individual assets or components of the group. If an individual asset or component is retired before or after its useful life, any implicit gain or loss is charged/credited to accumulated depreciation. This practice is justified because individual components are retired both before and after the end of their useful lives.

The group method of depreciation does not utilize weighted average useful lives. It groups assets or components of assets having similar useful lives and measures depreciation expense for the groups. Both the composite and group methods of depreciation result in appropriate financial reporting at reasonable cost.

The composite or group method of depreciation is referred to and considered acceptable in current accounting literature, including:

- SFAS No. 19, Appendix B;
- AICPA Industry Audit Guide; Audits of Airlines (Chapter 3 – Depreciation, paragraphs 3.101 and 3.102); and
- AICPA Industry Audit Guide; Audits of Agricultural Producers and Agricultural Cooperatives (paragraph 6.55).

The composite method of depreciation also is described in many accounting texts. See Exhibit D for specific references.

We are very concerned that the proposed SOP would eliminate accounting methods that have solid bases in both accounting literature and practice.

Paragraph A48 of the ED indicates that the group or composite method of depreciation would not be precluded if an entity can demonstrate that they "produce results related to gross PP&E, accumulated depreciation, depreciation expense, and gains or losses on replacements or disposals of PP&E that are not materially different from those obtained under the accounting prescribed in paragraphs 49 through 56 of this SOP. . . ." Alternative approaches of componentization may provide the basis for reconciling results of the alternative approach with the results of the detailed component methodology called for in the proposed SOP, except for measuring gains or losses on replaced components. This specific reconciliation cannot be accomplished without also implementing component depreciation to the level described in the ED. Therefore, the notion that financial statement preparers can avoid the detailed level of componentization required by the proposed SOP through comparisons and reconciliations with alternative methods is illogical. We urge the AcSEC to consider more reasonable and cost justifiable alternative approaches for PP&E cost componentization.

Componentization – alternative approaches

We believe that there are approaches to component cost accounting that would be more appropriate and cost effective. While we have not had the opportunity to fully develop such an approach, one possibility is for the cost of a PP&E asset to be broken down into categories by the useful lives of components at a reasonable level of detail. These categories might number a dozen or more for investment property. This degree of break down would depend on the number of major components and the degree to which their useful lives were similar. Components within these "useful-life buckets" would be accounted for using the group method of depreciation. No "losses" (remaining net book values) would be recognized in earnings at the time of replacement. These "losses" could be minimized through more precise determination of useful lives of major components and regular comparisons of the parameters used with actual experience.

Deferred Cost Accounting

The proposed SOP would virtually eliminate the concept of "deferred cost accounting" with respect to PP&E. It concludes that only costs of PP&E and PP&E components and the direct costs of acquiring, developing and/or installing them may be capitalized. This would apply to any project stage. It would not allow for the deferral and amortization of long-term capital maintenance, development and other costs that may not be considered PP&E or PP&E components—even where evidence indicates that such costs would unquestionably provide future economic benefits. Examples of these costs are:

- Preliminary costs as defined in the ED
- Indirect costs of development, construction and installation
- Incremental overhead costs related to employees directly related to the development or construction of PP&E
- Costs that may not meet the definition of PP&E in the proposed SOP but that extend the life or add value to a PP&E asset

Moreover, the proposed SOP provides guidance that is inconsistent with the matching of costs with related probable future revenue streams. These conclusions are contrary to the fundamental definition of an asset set forth in FASB Concepts Statement No. 6 (Statement 6), *Elements of Financial Statements*, and inconsistent with precedent established by broad financial standards such as SFAS No. 34 (SFAS 34), *Capitalization of Interest Cost*, and SFAS 19. SFAS 34 provides an excellent example of appropriate principles for cost accumulation and the matching of costs and revenues. SFAS 19 provides for a cost accumulation model similar to that provided for in SFAS 67 – a model that has and continues to produce, the most appropriate financial reporting for large, long-term physical assets. We strongly object to the imposition of a cost accumulation model that differs significantly from the model reflected in SFAS 19. Paragraph A7 of the ED indicates that AcSEC chose not to address the issues required to conform the proposed SOP to SFAS 19, but no basis for this conclusion is given. We request that a basis for this significant conclusion be provided so that we might understand the rationale for this inconsistent application of the proposed SOP.

With respect to "in service stage" costs, we believe that AcSEC's conclusions as discussed in paragraphs A30 and A31 of the ED ignore concepts set forth in Statement 6. The concept of deferred costs is well established in Statement 6. Paragraph 145 of Statement 6 states:

> Accrual accounting uses accrual, deferral, and allocation procedures whose goal is to relate revenues, expenses, gains, and losses to periods to reflect an entity's performance during a period instead of merely listing its cash receipts and outlays. Thus, recognition of revenues, expenses, gains and losses and the related increments and decrements in assets and liabilities – including **matching of costs and revenues, allocation, and amortization – is the essence of using accrual accounting to measure the performance of entities** (emphasis added).

Further, paragraphs 246 through 250 of Statement 6 clearly establish the basis for deferring costs that "do not by themselves qualify as assets" but may provide future economic benefit.

Paragraphs A30 and A31 of the ED conclude that costs related to PP&E may only be capitalized as fixed assets or charged to expense. There is no provision for the deferral of costs that provide probable future economic benefit. These paragraphs also imply that the practice of capitalizing these costs may be based on the presumption that (i) they extend the life of the asset or (ii) "simply because it [an expenditure] is a large monetary amount or it does not occur on a recurring basis." These factors are not necessarily relevant to the capitalization decision. Certain costs should be capitalized simply based on a conclusion that they meet the definition of an asset provided by Statement 6.

As further discussed below, the costs of long-term capital programs, as well as all costs that support initial development, related to investment property provide economic benefits beyond the period in which they are incurred and should, therefore, be capitalized and amortized over the periods benefited. Long-term capital maintenance programs have been referred to as refurbishments, renovations, rehabilitations and similar terms. The ED suggests that these programs/costs relate to past operations. This is not so for investment property.

Investment property (office buildings, shopping malls, apartments, industrial buildings, hotels, health care facilities, etc.) requires long-term capital expenditures in order to perpetuate and/or enhance their market position and class level. These properties are generally classified as class A, B or C properties. A property's class level has a direct impact on the level of future rental income. Properties are developed to achieve a certain class level that provides the basis for achieving rents consistent with such class level. The great majority of leases supporting these rents call for long-term rental income streams. The properties are regularly maintained, but may require capital expenditures to maintain their class level and, therefore, their ability to command commensurate rents upon releasing. Another example of programs, the full cost of which should be capitalized, would be post-acquisition costs contemplated in the acquisition pricing. All costs of these programs should be capitalizable based on Statement 6.

In summary, while there may be some lack of uniformity in the area of deferred cost capitalization, to eliminate the ability to match costs against highly probable, if not certain, future economic benefits results in inappropriate reporting of operating results. The final SOP's guidance for accounting for long-term capital costs should allow for the capitalization of costs which provide future economic benefit even if they do not represent physical PP&E – consistent with Statement 6. Otherwise, these costs will be accounted for on a cash basis – clearly in opposition to the foundation upon which GAAP has been developed.

Accounting for Property Taxes, Insurance and Ground Rents

The Exposure Draft's discussion of these carrying costs primarily relates to real estate assets. Current accounting for these costs generally follows the accounting for interest costs. In fact, paragraph 6 of SFAS 67, which provides the accounting for property taxes and insurance, refers to SFAS 34, *Capitalization of Interest Costs*. Clearly, ground rent is a cost of financing – similar to interest costs. As indicated previously, SFAS 34 provides excellent guidance with respect to criteria required in order to capitalize these carrying costs.

Paragraph 32 of the ED provides two conclusions that may conflict with accounting under SFAS 34. Both of these conflicts relate to the concept of accounting for what might be considered a single project as multiple projects – as illustrated in Example 9 of the ED.

The first conclusion suggests that, "if a property under construction remains in operation while the construction takes place, costs incurred for property taxes, insurance and ground rentals should be capitalized only if they are incremental and directly attributable to the construction activities." We assume that, if a separate portion of a property is closed down for construction (not in operation), all carrying costs related to the portion under construction would be capitalized. This would be consistent with the conclusions with respect to "property under construction" included in Paragraph 32.

The second conflict is clearer. Paragraph 32 concludes that the capitalization of property taxes, insurance and ground rentals should cease "no later than the date initial operations commence in any portion of the building or structure." For large real estate projects, this accounting would cause a significant mismatch between costs and revenues. For example, under the proposed SOP, if a 400,000 square foot office building were being developed and the first tenant occupied 25,000 square feet, costs of property taxes, insurance and ground rentals applicable to the entire 400,000 square foot building would be charged to the rental income stream from the 25,000 square feet of space leased. The earnings (or probably loss) resulting from this accounting would not provide appropriate information with respect to the future profitability of the property.

In this example, the appropriate accounting would be to allocate the property taxes, insurance and ground rents proportionally between space generating revenue (the 25,000 square feet) and the non-revenue generating space (the 375,000 square feet) as the building leases up. Limits to the capitalization should be required in terms of the maximum length of time subject to this allocation. In addition, the property would be subject to impairment testing.

We strongly urge AcSEC to use Paragraphs 17 and 18 of SFAS 34 as a model for accounting for property taxes, insurance and ground rentals – as illustrated to some extent in Example 9 of the ED. At the same time, we disagree with the last paragraph of Example 9. All land directly associated with a project under development should be subject to the capitalization of property taxes, insurance and ground rents.

A Few Final Comments

We do not believe the proposed SOP will achieve uniformity in practice.

From our reading of correspondence from the SEC to AcSEC, as well as the project prospectus, one of the primary purposes of the proposed SOP is to substantially narrow the diversity in accounting for PP&E repair and maintenance costs and capital improvement expenditures. We do not believe the proposed SOP achieves this goal for the following reasons:

- Neither components nor the level of componentization are clearly defined.

- Some companies would avoid detailed componentization through the use of relatively high capitalization thresholds. Other companies would continue capitalizing costs based on lower thresholds.
- Some companies may outsource development/construction/installation costs and others would use internal staff. The proposed SOP's limitation on the capitalization of indirect and overhead costs related to the use of internal employees would result in cost differentials as compared to costs of the same activities that are outsourced.
- Estimates of the remaining net book value of replaced components would be used – as opposed to actual net book values.
- Allowing two methods of adoption would result in long-term diversity.

This diversity would especially disadvantage smaller companies that would generally use lower thresholds to avoid earnings volatility and may need to utilize external resources to determine the net book value of components at date of adoption.

The costs associated with implementing the proposal are not justified.

A number of our comments discuss the extensive costs of allocating the current net book value of PP&E at the date of adoption. We could not begin to estimate the cost to complete this allocation for trillions of dollars of real estate costs. We also noted the required expansion of the use of cost segregation studies and the doubling or tripling of costs of far more detailed studies in order to segregate components to the detailed level called for in the proposed SOP. In addition to these costs, accounting for the detailed level of individual components rather than grouping and depreciating them at a more reasonable level would result in increased ongoing administrative costs.

The cost of implementing the proposed SOP may be reduced to an acceptable level if:

- the level of componentization is raised to group all PP&E and PP&E components into useful-life categories,
- the group/composite depreciation methods are not eliminated but are used to depreciate all assets in a single useful-life category, and
- the requirement to measure the remaining net book value of components replaced is eliminated from the proposal.

Unless the detailed accounting requirements of the proposal are reduced, the effective date of the SOP is too aggressive.

The adoption of the SOP, as currently proposed, would require substantial planning, systems enhancements and organizational changes. We believe that adoption should be deferred until no sooner than eighteen months after the final SOP is issued.

Exhibit B

Comments on Areas Requiring Particular Attention

This section of our comment letter addresses the issues raised in AcSEC's cover letter to the ED.

Issue 1
There is diversity in accounting for both costs and revenues related to reimbursable capital expenditures associated with investment property. This issue should be addressed separately from the proposed SOP. We are prepared to assist in addressing this issue. We have not identified other areas of the SOP that would conflict with existing lease accounting standards.

Issue 2
We generally agree with the *Project Stage Framework* except that we strongly believe that the full cost of long-term capital programs should be capitalized and amortized against future economic benefits. Our view is more fully discussed under "Deferred Cost Accounting" in our general comments. If it would facilitate the identification of costs to be appropriately capitalized, we urge the AcSEC to define the commonly used terms contained in paragraph 1 of the ED.

Alternatively, criteria could be established that would provide for the capitalization of the costs of certain capital programs. In fact, the minutes of AcSEC's January 2000 meeting indicate a tentative conclusion that "subsequent" real estate costs would be charged to expense unless one of a number of criteria were met. One of these criteria was "the costs are incurred to alter the functionality, extend the life, or improve the safety or efficiency of the real estate, whereby the condition of the real estate after the costs are incurred would have to be improved as compared with its initial condition." This view was carried to a subsequent draft. We believe that these or similar criteria would be operational.

Developing capitalization criteria for PP&E would mirror the practice of setting criteria for the capitalization of web site development costs incurred in the operating stage as discussed in paragraph 8 of EITF 00-2, *Accounting for Web Site Development Costs.*

Issue 3
Significant costs may be incurred during the preliminary stage of developing investment property. We believe it is inappropriate to expense these costs if the project is eventually completed. We recommend that these costs be capitalized/deferred until a determination is made as to whether it is probable that they will result in a successful development. This accounting would mirror the accounting for "exploration costs" as required by paragraph 19 of SFAS 19. The application of impairment tests would ensure that these costs are recoverable or, if not, the property's costs would be written down.

Issue 4
This is a very broad question that may have wider implications than accounting for general and administrative and overhead costs. While we agree that certain general and administrative costs should be expensed as incurred, we believe that there may be costs that are neither "directly

identifiable costs" as defined in the SOP nor general and administrative and overhead costs that should be expensed. Such costs should be capitalized as a part of the cost of major capital programs. These costs would include the costs of material and labor that directly support major capital programs and development/construction/installation activities. For example, a company would capitalize costs incurred for support personnel employed in a construction function who may be supporting multiple projects. This cost accumulation model would result in PP&E costs similar to the cost of outsourcing development/construction/installation activities.

A second example would be costs of executive management effort. In some cases, executive level staff is integrally involved in the development of investment property. The criteria for capitalizing or expensing costs of executive effort should be based on the same principles provided in the proposed SOP for other costs. Paragraph 28 of the ED states that "costs related to PP&E that are incurred during this [acquisition or construction] stage should be capitalized if they are directly identifiable with the specific PP&E or the costs meet the requirements in paragraphs 32 through 35." Our general view with respect to deferring non-PP&E direct costs is more fully discussed under "Deferred Cost Accounting" in our general comments.

Issue 5
We agree with AcSEC's conclusion and would recommend that SFAS No. 34, *Capitalization of Interest Costs*, be used as a guide for applying it. See further discussion of this issue under "Accounting for Property Taxes, Insurance and Ground Rents" in our general comments.

Issue 6
We do not agree with this conclusion and refer to our related comments in "Deferred Cost Accounting" in our general comments and in Issue 4 above.

Issue 7
This conclusion is, in the great majority of cases, impracticable and, therefore, not operational. Contractors generally do not provide data that segregates removal costs from installation costs. Therefore, we believe that removal costs should not be distinguished from costs of installing replacement PP&E or PP&E components.

With respect to demolition costs, we believe that the costs of demolishing any structure that was not being used in an entity's core business activities (e.g. a structure used for incidental operations) should be capitalized if the demolition is completed in connection with the development of a new or expanded property.

Issue 8
We strongly disagree with these conclusions. See our discussion under "Deferred Cost Accounting" in our general comments and in Issue 4 above. All costs of long-term capital maintenance programs should be capitalized and amortized against the probable, if not certain, future economic benefits.

Issue 9
Again, we disagree with this conclusion. We strongly believe that costs of restoring the service potential of PP&E should be capitalized – in addition to the cost of replacements that would be

capitalizable under this SOP. At the same time, we do not support the "built-in-overhaul" method of accounting for these costs. These costs should be capitalized/deferred as incurred and amortized over an appropriate period.

Issue 10
We believe that AcSEC's guidance is appropriate. Also, we would not attempt to define what kinds of changes in intended use would constitute "a pattern" because we do not believe that such definition could cover all facts and circumstances. This should be left to the judgment of management and auditors.

Issue 11
As stated earlier in this comment letter, we believe that the cost accumulation model for real estate properties developed for rental or to be used by an enterprise should be consistent with the cost accumulation model for real estate property developed for sale. This model is contained in SFAS 67 and should not be modified.

Issues 12, 13 and 14
These issues relate to component accounting and, therefore, are covered by our views as expressed under "Accounting for All Distinguishable Components of PP&E as Separate Assets" in the general comments section of this letter. To reiterate, we support the use of componentization to a reasonable level – but the detailed level required by the proposed SOP is unreasonable.

Issue 15
We have no comment on this issue.

Issue 16
We believe that providing alternatives to the transition accounting will result in diversity in practice and lack of comparability between companies. At the same time, in the event AcSEC decides to proceed with transition alternatives, we believe that paragraph 71.a. needs to be clarified and we strongly disagree with "the penalty," as it has been called in AcSEC discussions, with respect to applying paragraph 71.b. pursuant to methodology described in paragraph 53.

The second paragraph of Paragraph 71.a. describes the method to be used in determining the accumulated depreciation for each component. We assume that these calculations do not apply if the total net book value of PP&E is allocated based on the relative fair market value of each component. The AcSEC should clarify whether paragraph 71.a. is calling for the allocation of the net book value or gross book value when using relative fair value for the allocation.
The method of determining the net book value of PP&E subsequent to adoption of the SOP as described in paragraph 53 is simply not logical. Members of AcSEC were accurate in labeling this methodology "the penalty." If a composite weighted average depreciable life of a PP&E asset is 40 years and a component having a 15 year life (reflected in the weighted average life used) is replaced at the end of 10 years, the applicable accumulated depreciation is 10/15 times the original cost – not 15/40 times the original cost.

In this example, while the weighted average life of the PP&E asset is 40 years, the short-lived component has been depreciated over its 15-year useful life. To measure the accumulated depreciation related to a replaced, short-lived component using the full weighted average life rather than the life of the short-lived component used to develop the weighted average does not result in an accurate measurement of the net book value of the component. Why should this adverse result ("the penalty") be applied to an entity that simply decides to defer allocation of the net book value of its PP&E until after its adoption of the SOP?

Issue17
We believe the conclusions covered by this issue are appropriate.

Issue 18
We agree with the approach described in this issue.

Issue 19
We disagree with the conclusion that the accumulated depreciation difference described in this issue should be allocated back to the accumulated depreciation of each component. The transition allocation called for in Paragraph 71.a. will consume enormous effort and cost. We would not want to have the results of this effort arbitrarily changed. Therefore, we recommend that the difference be accounted for as a "cumulative effect of accounting change."

Exhibit C

NAREIT Task Force and Best Financial Practices Council – Comment Letter Contributors

AMB Property Corporation	Keystone Property Trust
AMLI Residential Properties Trust	Kilroy Realty Corp.
Associated Estates Realty Corp.	Kimco Realty Corp.
BNP Residential Properties Inc.	Koger Equity Inc.
BRE Properties Inc.	LaSalle Investment Management Securities
CAPREIT Inc.	Mack-Cali Realty Corp.
Chatham Financial Corporation	Manufactured Home Communities Inc.
Christopher Weil & Co.	MeriStar Hospitality Corp.
CNL Fund Advisors	Mills Corp.
Corporate Office Properties Trust	Pennsylvania REIT
Cousins Properties Inc.	Reckson Associates Realty Corp.
Crown American Realty Trust	Security Capital Group Inc.
Equity One Inc.	Simon Property Group
Equity Residential Properties Trust	SL Green Realty Inc.
Forest City Enterprises	Summit Properties Inc.
General Growth Properties Inc.	Taubman Centers Inc.
Green Street Advisors	The Rouse Company
Host Marriott Corp.	Vornado Realty Trust
HVP Capital Management Inc.	Washington REIT
Intellectual Capital Markets	Watson Land Company

Exhibit D

References To The Composite Method Of Depreciation

The proposed SOP implicitly eliminates the composite or group method of depreciation as it is defined in a number of references (listed below) and as it is widely applied in practice. The specific issue is the accounting for replacements. Many companies use the composite/group method of depreciation for major portions of an investment property and do not recognize gains and losses on retirement of components within the major categories.

Under the proposed SOP (paragraph 51), the original cost and accumulated depreciation of a replaced component would be estimated and any remaining net book value would be recorded as an expense. Requiring such recognition would result in a significant change in practice and represent a clear inconsistency with the widely accepted definition of the composite/group method of depreciation.

One of the earliest cites of "group depreciation" can be found in ARB No. 43, *Restatement and Revision of Accounting Research Bulletins*, chapter 9, Depreciation.

In addition, we have reviewed the discussion of the composite/group method of depreciation in the following texts:

- *Accounting Principles*; Fess & Warren; Seventeenth Edition, 1993, page 389.
- *Intermediate Accounting*; Keiso and Weygandt; Seventh Edition, 1992, pages 550 – 552.
- *Intermediate Accounting;* Welsch and Zlatkovch; Eighth Edition, 1989, pages 490 – 493.
- *Intermediate Accounting*; Smith & Skousen; Eighth Edition, 1984, pages 396 – 398.
- *Intermediate Accounting*; Meigs, Johnson and Keller; McGraw Hill, 1963, pages 556 – 557.

Specifically, all of these references indicate that no recognition of gain or loss is required under the composite/group method of depreciation upon retirement/replacement of a component.

November 15, 2001

Mr. Marc Simon, Technical Manager – Accounting Standards
American Institute of Certified Public Accountants
File 4210.CC
1211 Avenue of the Americas
New York, NY 10036-8775

Re: AcSEC Exposure Draft, Proposed Statement of Position, Accounting for Certain Costs and Activities Related to Property, Plant and Equipment (dated June 29, 2001)

Dear Mr. Simon:

One of the objectives that the Council of the American Institute of CPAs established for the PCPS Executive Committee is to act as an advocate for all local and regional firms and represent those firms' interests on professional issues, primarily through the Technical Issues Committee ("TIC"). This communication is in accordance with that objective.

TIC has reviewed the above referenced exposure draft and is providing the following comments and suggestions for your consideration.

GENERAL COMMENTS

TIC members believe the ED provides needed guidance in certain areas of PP&E where no authoritative guidance previously existed. Specifically, TIC supports the following areas: (1) the project stage framework for PP&E projects; (2) the treatment of demolition costs; and (3) the treatment of liquidated damages.

While TIC members conditionally support the ED's planned major maintenance activities approach, TIC is concerned that the final SOP would conflict with *International Accounting Standards Board (IASB) Interpretation SIC-23 (Property, Plant and Equipment – Major Inspection or Overhaul Costs)*, as discussed in paragraph A38 of the ED. While TIC understands that IASB Standards and Interpretations are not *currently* US GAAP, TIC sees no reason to create additional differences between US and international standards in light of the convergence goal set by IASB and FASB.

Additionally, TIC believes AcSEC may wish to clarify the differences between the removal costs charged to expense under paragraph 39 of this ED and those costs accounted for as a retirement under footnote 2 of FASB Statement No. 143, *Accounting for Asset Retirement Obligations.*

Component Depreciation

TIC members believe, however, that component depreciation would create challenges for many local and regional CPA firms and their clients. TIC members believe that allocating the cost of an asset over its useful life represents an *estimate*, based on numerous factors, which are evaluated and adjusted over the

asset's useful life. This approach appears consistent with both current Financial Accounting Standards Board (FASB) and IASB standards. TIC has not received any indication from its constituencies of significant problems in allocating this estimate in financial statements. TIC questions whether requiring the use of component depreciation for essentially all assets would produce more meaningful financial reporting.

Further, adoption of component depreciation may require auditors to engage specialists (under Statement on Auditing Standards No. 73, *Using the Work of a Specialist*) to evaluate PP&E component allocations, which may (or may not) have been developed internally by clients. If a specialist is not engaged, new audit guidance may be necessary for auditors to make these determinations without external assistance. TIC is also concerned about any independence issues these evaluations may raise. TIC believes component depreciation will significantly increase costs to nonpublic entities, and questions whether this additional cost is justified.

Ordinary Repairs and Betterments

The ED also does not appear to address what TIC believes is a fundamental issue: the definitions of an *ordinary repair* (expensed) and a *betterment* (a capitalized asset). Based on TIC's research, this issue was a major concern to the Securities and Exchange Commission in the ED's genesis. TIC does not believe the ED addresses this fundamental GAAP issue. TIC recommends the ED should define ordinary repairs and betterments.

Scope Issues

TIC believes that the scope of any new standard should be applicable to all circumstances, including the leasing transactions that are currently excluded from the scope of the ED. A standard that applies only under certain circumstances for economically similar transactions may result in further inconsistencies in practice, even within a financial statement for the same entity. TIC believes this may further confuse financial statement users and add to standards overload for practitioners and preparers.

Overhead

While TIC understands AcSEC's reasoning to exclude overhead costs from PP&E capitalization, TIC is concerned whether a *conceptual* basis exists to include overhead costs in certain areas (e.g. manufacturing inventory) while *excluding* overhead in other areas (e.g. software and PP&E). TIC believes AcSEC should conceptually discuss why overhead allocation is appropriate with certain assets and not others in its Basis for Conclusions.

Disclosures

TIC recommends that AcSEC consider eliminating the extensive disclosure requirements for nonpublic entities. TIC believes its constituents would not obtain any additional benefit from a further breakdown of asset categories or amounts expended for repairs and maintenance.

Format

TIC was pleased with the format and style used previously in the *Accounting for Investors Interests in Unconsolidated Real Estate Investments* ED. This provided numerous examples for implementation guidance. TIC believes that this ED would benefit from the inclusion of more examples of projects moving through various stages. For example:

- Construction of equipment by outside vendors under company employee supervision
- Planned development that is delayed due to regulatory approval (hospital requiring a certificate of need and an entity awaiting environmental approvals)
- Delays caused by either internal or external economic factors
- A betterment which does not involve removal or replacement of a specific PP&E component
- An ordinary repair and maintenance item

SPECIFIC COMMENTS

TIC has provided specific comments below on selected issues.

Issue 4 (excerpt): All ... overhead costs incurred, including all support functions, should be charged to expense. See paragraph 30. Do you agree with those conclusions? If not, what alternatives would you propose and why?

Issue 10 (excerpt): Paragraphs 47, 48, and A41 of the proposed SOP...state that the entity should evaluate for impairment amounts included in PP&E that were previously capitalized as inventory but should not redetermine their carrying amount as PP&E using the guidance in the proposed SOP, unless the entity has a pattern of changing the intended use of assets from inventory to PP&E. Do you believe that guidance is appropriate, ..., and why?

TIC believes parts of issues 4 and 10 relate to overhead allocation.

The ED uses *AICPA Statement of Position 98-1, Accounting for Costs of Computer Software for Internal Use*, as a basis for conclusions. Paragraph 80 of SOP 98-1 states: "AcSEC recognizes that the costs of some activities, such as allocated overhead, may be a part of the overall cost of assets, but it excluded such costs because, as a practical matter, costs of accumulating and assigning overhead to software projects would generally exceed the benefits that would be derived from a 'full costing' accounting approach. AcSEC considered that costing systems for *inventory* and *plant construction activities* (emphasis added), while sometimes complex, were necessary costs given the routine activities that such systems support." AcSEC seems to suggest, in SOP 98-1, that intangible assets should not adopt a "full costing" approach, while tangible assets should be "fully costed," while this ED appears to take a different approach to overhead for a tangible asset.

The ED also appears to contradict IASB Standard No. 16, *Property Plant and Equipment*. Paragraph 18 of the standard states: "The cost of a self-constructed asset is determined using the same principles as for an acquired asset. If an enterprise makes similar assets for sale in the normal

course of business, the cost of the asset is usually the same as the cost of producing the asset for sale." Paragraph 47 of this ED would appear to contradict that approach.

TIC believes overhead allocation may be a larger GAAP issue that is beyond the scope of this project. However, TIC believes the appendix should clarify *conceptually* the justification for excluding overhead from PP&E.

Issue 6: Paragraph 37 of the proposed SOP states that the costs of normal, recurring, or periodic repairs and maintenance activities should be charged to expense as incurred. It also states that all other costs related to PP&E that are incurred during the in-service stage should be charged to expense as incurred unless the costs are incurred for (a) the acquisition of additional PP&E or components or (b) the replacement of existing PP&E or components of PP&E. Do you agree with those conclusions? If not, what alternatives would you propose and why?

The ED does not address the concept of "ordinary repairs and maintenance" and "betterments". Many entities struggle with the classification of costs incurred that add value to an asset or extend its useful life. Neither the glossary nor the text of the ED adequately addresses this distinction, which has been a practice problem for many years. At a minimum, TIC believes the ED should define ordinary repairs and maintenance (an expense) and a betterment (a capitalizable asset).

In developing these definitions, TIC recommends AcSEC review IAS No.16, *Property Plant and Equipment*, especially the discussion under "*Subsequent Expenditures*" which begins with paragraph 23. TIC believes the discussion under *Emerging Issues Task Force Issue No. 90-8, Capitalization of Costs to Treat Environmental Contamination,* may be useful in defining a betterment.

Issue 7: Paragraph 39 of the proposed ED states that costs of removal, except for certain limited situation demolition costs, should be charged to expense as incurred. Do you agree with that conclusion? If not, what alternative would you propose and why?

FASB Statement No. 143, *Accounting for Asset Retirement Obligations*, paragraph 11, requires that an entity capitalize, as part of the asset cost, an asset retirement obligation. Footnote 2 of FASB Statement No. 143 defines retirement as the "other-than-temporary *removal* (emphasis added) associated with the retirement of a tangible long-lived asset from service." AcSEC may wish to clarify situations where demolition costs are expensed under this ED versus capitalized under the FASB standard.

Issue 11: The proposed SOP requires assets that are produced by an entity to be leased to a lessee under an operating lease to be accounted for under the provisions of this SOP. As discussed in paragraph A43 of the proposed SOP, AcSEC recognizes that some entities routinely construct or manufacture products, some of which are sold directly and some of which are leased to lessees under sales-type leases whereas others are leased to lessees under operating leases. In some situations, the entity does not know the form the transaction will take until it occurs, and the customer decides whether its acquisition of product will be accomplished through purchase or lease. The proposed SOP requires an entity to accumulate

costs differently for similar assets depending on whether the asset is sold outright or leased to a lessee under a sales-type lease (In either case, inventory cost accumulation rules would apply). Do you agree with that conclusion and, if so, do you believe the proposed SOP should provide additional guidance on such cost accumulation? Or would it be preferable for a single cost accumulation model to apply during the production process and that there should be a presumption that the assets should be accounted for all as inventory or all as PP&E? If so, which presumption should be applied and why?

As stated previously, TIC believes that the ED should propose a standard that would apply consistently to all capital assets. AcSEC notes in paragraph A1 that "... different accounting for assets for sale versus internal use {under FASB Statement No. 67} is *acceptable*." [Emphasis added] AcSEC also elected to exclude certain lease arrangements under FASB Statement No. 13, although AcSEC acknowledges that diversity in practice would narrow if capitalization practices were uniform. TIC believes this dichotomy is not theoretically justifiable. TIC believes cost capitalization should be uniform for all PP&E, regardless of whether the asset is sold, leased, or used internally. TIC understands that implementing this recommendation would involve the FASB, instead of AcSEC.

Issue 12: Paragraphs 49 through 56 of the proposed SOP discuss component accounting and state that if a component has an expected useful life that differs from the expected useful life of the PP&E asset to which it relates, the component should be accounted for separately and depreciated or amortized over its separate expected useful life. Do you agree with this approach to accounting for PP&E? If not, what alternative would you propose and why?

Issue 13: Paragraphs 38 and 51 of the proposed SOP state that when existing PP&E is replaced or otherwise removed from service and the replacement is capitalized, the net book value of the replaced PP&E should be charged to depreciation expense in the period of replacement. Do you agree with this approach? If not, what alternative would you propose and why?

Issue 14: The proposed SOP requires the use of component accounting to depreciate identified components over their respective expected useful lives. As noted in paragraph A48 of the proposed SOP, entities have developed and utilized various conventions to depreciate assets, including group depreciation or use of composite lives. Those conventions are acceptable only if they result in approximately the same gross PP&E, depreciation expense, accumulated depreciation, and gains or losses on disposals of PP&E as the component accounting method required by this proposed SOP. Do you agree with this approach? If not, what alternative would you propose and why?

TIC understands AcSEC's concern of capitalizing a replacement asset while a portion of the original asset may still be capitalized. TIC believes the use of composite depreciation, applied properly by management, accounts for the various different lives of an asset's components, and can be a reasonable alternative to component depreciation. TIC believes a sufficient study of nonpublic companies has not been made to conclude that component depreciation produces a materially different result from composite depreciation. TIC also requests that AcSEC perform a cost benefit analysis before finalizing the ED.

We appreciate the opportunity to present these comments on behalf of PCPS member firms. We would be pleased to discuss our comments with you at your convenience.

Sincerely,

Candace Wright, Chair
PCPS Technical Issues Committee

cc: PCPS Executive and Technical Issues Committees

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November 19, 2001

Mr. Marc Simon
Technical Manager, Accounting Standards
File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Comments on the Proposed Statement of Position, *Accounting for Certain Costs and Activities Related to Property, Plant and Equipment* (File 4210.CC)

Dear Mr. Simon:

PricewaterhouseCoopers LLP appreciates the opportunity to comment on the exposure draft of the proposed statement of position (the "proposed SOP") *Accounting for Certain Costs and Activities Related to Property, Plant and Equipment* that has been prepared by the Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants (AICPA). Although our responses to the specific questions in the proposed SOP are contained in the appendix to this letter, our principal concern is described herein. That concern is that the cost of implementing the proposed SOP and the ongoing compliance costs may exceed the benefits to be derived from the new accounting. Accordingly, we do not support the proposed SOP as it is currently drafted. This letter describes the principal measures that we recommend be taken to address our concern about costs and benefits. If our recommendations are accepted, and our other concerns (described in the appendix) are appropriately considered, we would support issuance of a final SOP.

Cost/Benefit

We believe that the proposed SOP has the potential to significantly improve the practice of accounting for property, plant and equipment (PP&E). By establishing a more uniform framework for evaluating costs associated with PP&E, we believe the proposed SOP will reduce the current diversity in practice and bring about enhanced comparability and consistency in the accounting for PP&E.

We are concerned, however, that the benefits of the proposed SOP will not exceed the costs of applying it. As noted in the foreword of the proposed SOP, one of the criteria that the

Financial Accounting Standards Board (FASB) considers when reviewing proposed AcSEC documents is whether the benefits of the proposal can be expected to exceed the costs of applying it. Based on feedback we received concerning the potential implementation and compliance costs that entities believe they will face in applying the new rules, we believe that the proposed SOP, as currently drafted, will not meet this criterion. We cannot overemphasize this concern.

Based on the feedback that we have received from preparers, we believe that the requirement to apply component accounting at the level prescribed by the proposed SOP, the apparent implicit elimination of the group method of depreciation, and the proposed additional disclosures contribute to an imbalance in the cost/benefit equation. We understand that the costs of applying component accounting, particularly at the level of detail prescribed by the proposed SOP, would be very significant for many entities, especially those in capital-intensive industries such as the real estate, utilities, telecommunications, and transportation industries. Many of those costs would be incurred during the process of initially identifying and quantifying the various components of complex PP&E assets. Further, many of those entities are concerned that their existing fixed asset systems are inadequate to accommodate the volume of individual components that will need to be identified and tracked on an ongoing basis under the proposed SOP. As a result, we understand that many entities will need to incur significant costs to make systems enhancements and to devote personnel to the task of complying with the proposed SOP.

Costs of ongoing compliance will be incurred even by entities that elect not to retroactively apply component accounting, since the requirements of paragraph 71b of the proposed SOP call for every entity in that situation to estimate the remaining net book value of assets replaced and to do so in a manner prescribed by paragraph 53. Further, every entity will be required to make the proposed disclosures, which are additional to those required currently and may also require systems enhancements to facilitate the accumulation of required information.

Our support of the proposed SOP depends largely on whether AcSEC adequately addresses this cost/benefit issue. Although we expect that AcSEC will pay particular attention to the input it receives from respondents on this issue, the following is what we believe AcSEC should focus on to achieve a balance between costs and benefits.

Component Accounting

The proposed SOP can be interpreted as requiring the application of component accounting at a very detailed level. Specifically, paragraph 49 states:

> A component is a tangible part or portion of PP&E that (a) can be separately identified as an asset and depreciated or amortized over its own separate useful life and (b) is

expected to provide economic benefit for more than one year. If a component has an expected useful life that differs from the expected useful life of the PP&E asset to which it relates, the cost should be accounted for separately and depreciated or amortized over its separate expected useful life.

We believe that as a result of this provision, more individual components of an asset would be accounted for via component accounting than would be beneficial from a financial-reporting standpoint and feasible from a cost standpoint. For example, a complex asset such as a building might have to be broken down into hundreds (or even thousands) of components based on a literal reading of this paragraph.

We acknowledge that the guidance in paragraph 52 may limit the cases in which components of PP&E must be accounted for separately and depreciated over their separate expected useful lives. However, that guidance, which refers to "certain reasonable thresholds" and "periodic replacements of minor items," is not specific solely to the provisions in paragraph 49, and many readers are overlooking it or simply not making the connection given the clarity of paragraph 49. Moreover, it is difficult to apply the guidance in paragraphs 49 and 52 because both paragraphs appear to require component accounting at low levels of detail. For example, an entity that has 5000 individual stores replaces the roof on 200 stores each year and considers such replacements to be a normal, recurring, and periodic replacement. We would look to paragraph 52 and conclude that the replacements constitute minor items for this entity and thus would not require capitalization under the proposed SOP. However, because some will assess the significance of a roof in relation to the building, and believe it is difficult to characterize the roof of a building as a "minor" item with respect to the building, they would look to paragraph 49 and conclude that because each roof can be separately identified and will provide an economic benefit for more than one year, component accounting should be applied to each roof. Further, even among those who would view the replacements as minor in this situation, some will could conclude that paragraph 49 should control based on the separately identifiable and economic benefit criteria. In our opinion, this is unnecessary and not a cost beneficial result and demonstrates that as written, the proposed SOP lacks the clarity required to allow preparers to exercise reasonable flexibility in applying it.

To limit the extent to which component accounting must be applied where it is not cost beneficial, we recommend eliminating in paragraph 52 the test of whether a replacement is minor. That would enable entities such as those in the example above that make normal, recurring, and periodic replacements to apply component accounting only if they choose to do so in their circumstances. On the other hand, it would result in an entity applying component accounting to a roof that it replaces on one of three buildings that it owns, which we think is appropriate. Accordingly, we recommend that the word "minor" be deleted from the first sentence in paragraph 52. In our opinion, this would have the desired effect of limiting the extent to which component accounting must be applied. We also recommend that paragraph 49 be modified to refer readers to the reasonableness tests in paragraph 52, as revised. Further,

we would suggest that AcSEC expand the basis for conclusions to (1) explain why AcSEC removed "minor" from paragraph 52, (2) clarify the interaction between paragraphs 49 and 52, and (3) perhaps include our examples above to provide readers with a way to think about applying the standard in a cost beneficial manner.

Additionally, paragraph 54 of the proposed SOP is unclear about whether an entity that elects not to retroactively apply component accounting to its assets at the time that it adopts the SOP (as permitted by paragraph 71b) would have to subsequently apply that accounting to those and similar assets. We believe that paragraph 54 should apply only to assets that are placed in service after the adoption of the SOP and are accounted for using component accounting. When an entity elects not to retroactively apply component accounting to assets that exist on the date of adoption, it should not be forced to apply component accounting to those and similar assets later merely because it subsequently replaces a component of one of those assets. Instead, the entity should be allowed to identify and charge off the remaining net book value of the replaced component and capitalize the new component without any requirement to apply component accounting to the remaining asset or similar assets. We recommend that paragraph 54 be revised accordingly.

Group Depreciation

We support the continued use of group depreciation and are concerned that the proposed SOP may implicitly eliminate this method. We believe that the application of group depreciation to an asset base comprising a large group of homogeneous assets with similar expected useful lives results in an appropriate allocation of the cost of assets to the periods benefited by their use. However, since gains and losses on replacements and disposals under the group method typically are not reflected as gains and losses in the income statement, that method would not meet the condition in paragraph A48, which provides that in order for an entity to continue using group depreciation it must demonstrate that the method produces results related to gross PP&E, accumulated depreciation, depreciation expense, and gains and losses that are not materially different from the results obtained under the method of component accounting prescribed in the proposed SOP. Thus, the test in paragraph A48 could force some entities to abandon the use of group depreciation when replacements or disposals occur. We believe this would be a needless result and an inappropriate one given that level A generally accepted accounting principles[1] permit the use of the group method. Moreover, although the gain or loss component of net income would be different under the group method versus component

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1. Paragraph 5 in chapter 10 of AICPA Accounting Research Bulletin 43 describes depreciation accounting as "a system of accounting which aims to distribute the cost . . . of tangible capital assets . . . over the estimated useful life of the unit (which may be a group of assets) in a systematic and rational manner."

accounting, the net impact on the income statement of each method would generally be consistent, assuming the group method is applied correctly.

Accordingly, we recommend eliminating the test that paragraph A48 prescribes for entities to continue using the group-depreciation method and recommend that the SOP explicitly permit the use of group depreciation. We further recommend that AcSEC provide guidance on when the group-depreciation method is appropriate and how it should be applied, since this would ensure a level of consistency in the application of that method. For example, we believe that the method is only appropriate when the assets being grouped are homogeneous and have similar useful lives. An example in Appendix C may be helpful.

Disclosures

We find the presentation and disclosure requirements in paragraphs 58 and 59 of the proposed SOP to be excessive and without a commensurate benefit to financial reporting. Implementing these disclosures would require entities to perform the time consuming task of coding various PP&E assets into the prescribed categories. In our opinion, these additional disclosures would not provide users of financial statements with meaningful information. Accordingly, we encourage AcSEC to eliminate those requirements. Instead, a more useful disclosure would be the expected depreciation expense for the next five years for PP&E owned at the balance sheet date. Such a disclosure would provide investors with useful information in assessing future income statement charges that do not have cash flow implications and would be consistent with other required disclosures of forward-looking cash flow information such as future lease payments and future debt repayments. We believe that most entities' fixed asset systems could be modified to calculate depreciation for this additional time period relatively easily, and we encourage AcSEC to prescribe such disclosures in lieu of the proposals in paragraphs 58 and 59.

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We appreciate the opportunity to express our views in this letter and its appendix. If you have any questions regarding our comments, please feel free to contact James F. Harrington at (973) 236-7203, Kenneth E. Dakdduk at (973) 236-7239, or Jeff Johnson at (973) 236-4505.

Sincerely,

PricewaterhouseCoopers LLP

Appendix

Scope

Issue 1

Paragraph 10 of the proposed SOP states that the SOP does not provide specific guidance on lessor or lessee accounting for reimbursements of costs incurred by a lessor that are directly recoverable from lessees under the terms of one or more leases, and that the lessor and lessee should refer to FASB Statement No. 13, Accounting for Leases, *and related lease accounting literature for guidance on accounting for such reimbursements. In many instances, depending on the terms of the lease, those reimbursements may constitute minimum lease payments or contingent rentals under FASB Statement No. 13. As discussed in paragraph A2 of the proposed SOP, AcSEC elected not to address the accounting for such transactions in this SOP because AcSEC did not want to create conflicts with existing lease accounting guidance and AcSEC did not believe it was appropriate to address the accounting under all of the various reimbursement scenarios and arrangement structures within the scope of this SOP. Are there significant practice issues or concerns related to the accounting for contractually recoverable expenditures that should be addressed in the proposed SOP? Do you believe that there are other areas addressed in the proposed SOP that, with respect to their application to lessors and lessees of PP&E, could create conflicts with existing lease accounting standards?*

We believe that any reimbursements pursuant to a lease should be evaluated under applicable lease-accounting literature. Accordingly, we agree with AcSEC's decision not to provide specific guidance on lessor or lessee accounting for reimbursements of costs incurred by a lessor that are directly recoverable from a lessee. We have not identified other areas of the proposed SOP that might conflict with existing lease-accounting standards.

Project-Stage Framework

Issue 2

The guidance in this proposed SOP is presented in terms of a project stage or time line framework and on the basis of the kinds of activities performed during the stages defined in the proposed SOP rather than on whether an expenditure fits into certain classification categories such as ordinary repairs and maintenance, "extraordinary" repairs and maintenance, replacements, betterments, additions, redevelopments, renovations, rehabilitations, retrofits, rearrangements, refurbishments, and reinstallations. Do you agree with that approach? If not, what alternative would you propose and why?

We agree with the "project-stage framework" approach. Basing capitalization criteria on the types of activities performed and the kinds of costs incurred is, in our opinion, more

operational than basing those criteria on whether an expenditure fits into one or more categories of activities.

Issue 3

Paragraph 16 of the proposed SOP states that the preliminary stage ends and the preacquisition stage begins when the acquisition of specific property, plant, and equipment (PP&E) is considered probable. Paragraph 22 of the proposed SOP states that, other than the costs of options to acquire PP&E, all costs incurred during the preliminary stage should be charged to expense as incurred. Do you agree with that conclusion? If not, how would you propose to modify the guidance and why?

Under the FASB's current conceptual framework, preliminary-stage costs, other than the cost of an option to acquire PP&E, would not, in our opinion, meet the definition of an asset. Accordingly, we agree with AcSEC that such costs should be expensed as incurred. We also believe that it is appropriate for the preliminary stage to end and the preacquisition stage to begin when the acquisition of specific PP&E is considered probable. However, AcSEC may wish to assess whether there is a need to assist entities in determining whether an acquisition or construction is probable by clarifying the intended meaning of "committed to funding," "financial resources are available," and "the ability exists to meet requisite local and other governmental regulations." For instance, we believe that the SOP would not require an entity to obtain a commitment from a third-party lender to demonstrate that the entity's management is committed to funding the acquisition or construction of the asset. We also believe that it would be reasonable for an entity to assume that zoning or other regulatory obstacles will be favorably resolved where there is evidence to support that assumption. If AcSEC believes that our interpretations are inconsistent with the intent of the guidance, then we suggest that appropriate clarifications of these phrases be made in the SOP.

Accounting for Costs Incurred

Issue 4

The proposed SOP states that PP&E-related costs incurred during the preacquisition, acquisition-or-construction, and in-service stages should be charged to expense unless the costs are directly identifiable with the specific PP&E. Directly identifiable costs include only (a) incremental direct costs incurred with independent third parties for the specific PP&E, (b) employee payroll and payroll benefit-related costs related to time spent on specified activities performed by the entity during those stages, (c) depreciation of machinery and equipment used directly in the construction or installation of PP&E and incremental costs directly associated with the utilization of that machinery and equipment during the acquisition-or-construction stage, and (d) inventory (including spare parts) used directly in the construction or installation of PP&E. All general and administrative and overhead costs incurred, including

all costs of support functions, should be charged to expense. See paragraphs 24, 25, 29, and 30. Do you agree with those conclusions? If not, what alternatives would you propose and why?

In general, we agree with the conclusions reached by AcSEC. However, we encourage AcSEC to address the following areas in this regard:

The proposed SOP does not define the term "nominal passive investment," which denotes the criterion that an entity would have to fulfill in order to have an ownership interest in a third party and still view that party as independent. We suggest that AcSEC specify "significant influence" as the criterion instead. The term "significant influence" is used in the independence rules of the AICPA and the U.S. Securities and Exchange Commission, and those rules refer to Accounting Principles Board Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock,* for the meaning of "significant influence." Thus the term "significant influence" has been used by accountants for many years and would be easier to apply in a determination of whether a third party's independence of the reporting entity would be affected by an investment that the reporting entity has in it.

Additionally, many companies maintain a supply of spare parts for PP&E assets, and some of those companies report that supply as PP&E. In some cases, that PP&E is depreciated and in others it is not. There are many different scenarios regarding the use of spare parts, and many different policies for accounting for those parts before their deployment. We believe that AcSEC should consider whether there is a need for guidance on the accounting for spare parts, and whether the proposed SOP might be the appropriate venue to disseminate that guidance.

<u>*Issue 5*</u>

Paragraph 32 of the proposed SOP states that for real estate that is not being used in operations, costs of property taxes, insurance, and ground rentals should be capitalized, to the extent of the portion of the property that is under development, during the time that activities that are necessary to get the asset ready for its intended use are in progress. Do you agree with that conclusion? If not, what alternative would you propose and why?

Paragraph 32 specifies that capitalization of ground rent, insurance, and property taxes (carrying costs) related to a PP&E asset under construction should cease no later than the date that initial operations commence in any portion of the building or structure. However, in some projects (such as the construction of a multi-unit strip mall) a portion of the project might be complete and generating revenue while other portions are still under active construction. We believe that it is reasonable to permit continued capitalization of the carrying costs that are allocable to the portions of the project that are undergoing active construction with respect to

the basic structure. This is consistent with the guidance in FASB Statement No. 34, *Capitalization of Interest Cost,*[2] and FASB Statement No. 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects.*[3] We suggest that AcSEC conform the SOP to this concept.

In addition, we suggest replacing the word "contemplated" in paragraph 33 with the word "probable." Using the criterion "probable" instead of the criterion "contemplated" for determining when a demolition will occur seems more appropriate; also, the criterion "probable" is more consistent with other determinations under the accounting literature than the criterion "contemplated," which seems to suggest too early a point in the continuum spanning "remote" to "occurrence" vis-à-vis the demolition.

Issue 6

Paragraph 37 of the proposed SOP states that the costs of normal, recurring, or periodic repairs and maintenance activities should be charged to expense as incurred. It also states that all other costs related to PP&E that are incurred during the in-service stage should be charged to expense as incurred unless the costs are incurred for (a) the acquisition of additional PP&E or components or (b) the replacement of existing PP&E or components of PP&E. Do you agree with those conclusions? If not, what alternatives would you propose and why?

We agree.

Issue 7

Paragraph 39 of the proposed SOP states that costs of removal, except for certain limited situation demolition costs, should be charged to expense as incurred. Do you agree with that conclusion? If not, what alternative would you propose and why?

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2. Paragraph 18 of FASB Statement No. 34 states, "Some assets are completed in parts, and each part is capable of being used independently while work is continuing on other parts. An example is a condominium. For such assets, interest capitalization shall stop on each part when it is substantially complete and ready for use."

3. Paragraph 23 of FASB Statement No. 67 states, "If portions of a rental project are substantially completed and occupied by tenants or held available for occupancy and other portions have not yet reached that stage, the substantially completed portions shall be accounted for as a separate project. Costs incurred shall be allocated between the portions under construction and the portions substantially completed and held available for occupancy."

We support capitalizing the costs of disassembling a component to gain access to a subcomponent, subject to impairment testing. The purpose of the disassembly is to replace the subcomponent. If a deficient or worn-out subcomponent does not need to be replaced because, for example, the asset continues to function adequately, presumably an entity would not be willing to incur the cost of removing it. Thus it can be argued that disassembly costs are a necessary part of installing a new subcomponent and therefore are not costs related to the removal of a replaced subcomponent. Further, there are many instances where the costs to disassemble a component to gain access to a subcomponent are inseparable from the costs of the replacement component. For example, a third party hired to furnish and install a subcomponent may not separately identify the cost to disassemble the related component. Any amount charged to expense in this situation would represent an arbitrary allocation of the third party's costs.

Issue 8

Paragraph 44 of the proposed SOP states that the total of costs incurred for planned major maintenance activities does not represent a separate PP&E asset or component. It states that certain of those costs should be capitalized if they represent acquisitions or replacements and that all other costs should be charged to expense as incurred. Paragraph 45 prohibits alternative accounting treatments including – (a) the accrual of a liability for the estimated costs of a planned major maintenance activity prior to their being incurred, and (b) the deferral and amortization of the entire cost of the activity. Do you agree with those conclusions? If not, what alternatives would you propose and why?

We agree.

Issue 9

Paragraph 45 of the proposed SOP further prohibits, as an alternative accounting treatment, the "built-in overhaul" method for costs incurred for planned major maintenance activities. Under that method, additional depreciation expense is recognized currently to give effect to the decline in service potential that is subsequently restored once the major maintenance activity occurs. When the major maintenance activity occurs, its cost is considered capitalizable. In lieu of the built-in overhaul method, AcSEC concluded that better cost allocation would result from the use of component accounting and limiting the major maintenance activities that would be capitalizable to costs that represent replacements of components of PP&E. Should the costs of restoring PP&E's service potential, in addition to the cost of replacements that would be capitalizable under this proposed SOP, be eligible for capitalization? Do you believe that prohibiting the built-in overhaul method is appropriate, or should it be allowed as an alternative method? If you believe that the built-in overhaul method should continue to be allowed, what industries or entities should be allowed to use it, and why?

We believe prohibiting the built-in-overhaul method is appropriate.

Use of Inventory in Production of Internal-Use PP&E

Issue 10

Paragraphs 47, 48, and A41 of the proposed SOP discuss the situation in which an entity owns an asset that it intended to sell as inventory but subsequently decided to retain for use in its own internal operations. Those paragraphs state that the entity should evaluate for impairment amounts included in PP&E that were previously capitalized as inventory but should not redetermine their carrying amount as PP&E using the guidance in the proposed SOP, unless the entity has a pattern of changing the intended use of assets from inventory to PP&E. Do you believe that guidance is appropriate, or should an entity be required to redetermine the carrying amount of PP&E assets previously capitalized as inventory, and why? Should AcSEC provide additional guidance on what kinds of changes in intended use constitute a "pattern," and why?

The second sentence above suggests that if an entity has a pattern of changing the intended use of assets from inventory uses to PP&E uses, its previously capitalized inventory would be subject to the provisions of the SOP. We interpret paragraph 47 as requiring that the SOP be applied to "any such assets subsequently produced" when it is determined that such a pattern exists. We suspect that the second sentence above is simply misworded and that the guidance in paragraph 47 is controlling. We agree with the guidance in paragraph 47. Further, we believe that AcSEC should not provide additional guidance on the kinds of changes in intended use that would constitute a pattern. A decision about what types of changes might represent a pattern would need to be based on the specific facts and circumstances of each case.

PP&E-Type Assets Produced for Sale or Operating Lease

Issue 11

The proposed SOP requires assets that are produced by an entity to be leased to a lessee under an operating lease to be accounted for under the provisions of this SOP. As discussed in paragraph A43 of the proposed SOP, AcSEC recognizes that some entities routinely construct or manufacture products, some of which are sold directly and some of which are leased to lessees under sales-type leases whereas others are leased to lessees under operating leases. In some situations, the entity does not know the form the transaction will take until it occurs, and the customer decides whether its acquisition of product will be accomplished through purchase or lease. The proposed SOP requires an entity to accumulate costs differently for similar assets depending on whether the asset is sold outright or leased to a lessee under a sales-type lease (in either case, inventory cost accumulation rules would apply)

or leased to a lessee under an operating lease (in which case, the cost accumulation provisions of the proposed SOP would apply). Do you agree with that conclusion and, if so, do you believe the proposed SOP should provide additional guidance on such cost accumulation? Or would it be preferable for a single cost accumulation model to apply during the production process and that there should be a presumption that the assets should be accounted for all as inventory or all as PP&E? If so, which presumption should be applied and why?

We agree that different cost-accumulation models should apply to the two different fact patterns. In our opinion, it would be inappropriate to require the use of a single model. Instead, the selection of the appropriate cost-accumulation model should be based on the facts and circumstances of a particular situation. An entity should record the asset that is in the process of being constructed or manufactured as either inventory or PP&E based on the entity's assessment of the most likely use of that asset. In that regard, it would be helpful if the SOP were to contain guidance on how an entity should account for costs accumulated to date when that entity determines that the most likely use of the asset has changed.

Component Accounting

Issue 12

Paragraphs 49 through 56 of the proposed SOP discuss component accounting and state that if a component has an expected useful life that differs from the expected useful life of the PP&E asset to which it relates, the component should be accounted for separately and depreciated or amortized over its separate expected useful life. Do you agree with this approach to accounting for PP&E? If not, what alternative would you propose and why?

Refer to our cover letter for our comments on this subject.

Issue 13

Paragraphs 38 and 51 of the proposed SOP state that when existing PP&E is replaced or otherwise removed from service and the replacement is capitalized, the net book value of the replaced PP&E should be charged to depreciation expense in the period of replacement. Do you agree with this approach? If not, what alternative would you propose and why?

We agree.

Issue 14

The proposed SOP requires the use of component accounting to depreciate identified components over their respective expected useful lives. As noted in paragraph A48 of the proposed SOP, entities have developed and utilized various conventions to depreciate assets, including group depreciation or use of composite lives. Those conventions are acceptable only if they result in approximately the same gross PP&E, depreciation expense, accumulated depreciation, and gains or losses on disposals of PP&E as the component accounting method required by this proposed SOP. Do you agree with this approach? If not, what alternative would you propose and why?

Refer to our cover letter for our comments on this subject.

Amendments to Other Guidance

Issue 15

Paragraphs 61 and 63 of the proposed SOP list amendments to SOP 85-3, Accounting by Agricultural Producers and Agricultural Cooperatives, *and the AICPA Audit and Accounting Guide,* Audits of Agricultural Producers and Agricultural Cooperatives, *respectively. Do you agree with the proposed amendments? Do you believe that there are unique aspects of agricultural accounting, such as the accounting for breeding and production animals and the accounting for plants and vines, that should not be amended by the proposed SOP, and why?*

We agree with the proposed amendments.

Transition

Issue 16

Paragraph 71 of the proposed SOP states that the prescribed component accounting guidance should be initially adopted for existing PP&E using one of two alternatives, the election and disclosure of which should be made when the SOP is adopted. Do you agree with that approach and, if so, do you agree with the choice of the two alternatives from which the election is to be made? If you do not agree with that approach for existing PP&E, what approach would you propose and why?

We agree with the proposed approach and the two alternatives for initial adoption. However, consistent with the comments in our cover letter, we believe that group depreciation methods continue to be appropriate. Accordingly, AcSEC should ensure that the transition provisions of the SOP do not operate to preclude the use of such methods.

Issue 17

Under paragraph 71(a) of the proposed SOP, the allocation of existing net book value to components at transition should be based on (a) allocation of original accounting records, if available, (b) relative fair values of components at date of transition, if original accounting records are not available, or (c) another reasonable method, if relative fair value is not practicable. Do you agree that that ordering of allocation methods is appropriate? If you believe that a different order would be appropriate, what order would you propose and why? Should the proposed SOP provide additional examples to illustrate what constitutes "another reasonable method"?

We believe that the ordering of allocation methods is wrong and should be as follows: (1) allocation based on original accounting records, if such records are available, (2) allocation based on a reasonable estimate of historical cost, if original accounting records are not available, and (3) allocation based on the relative fair values of components on the date of transition, if historical cost is not reasonably estimable. Allocations that are based on historical costs are most appropriate, and a reasonable effort should be made to ascertain or estimate historical costs. We believe relative fair values should be used only as a last resort (i.e., when historical costs cannot be determined or reasonably estimated) because we are concerned that such an approach may produce results that are not reflective of the economics of the original acquisition. We would welcome the opportunity to explain our specific concerns should AcSEC desire us to do so.

Issue 18

Paragraph 72 of the proposed SOP states that the SOP should be applied prospectively for all costs incurred after the adoption of the SOP. It also states that costs incurred prior to the adoption of the proposed SOP should not be re-characterized (as capital or expense items) to conform to the guidance in the SOP, with the exception of certain costs of planned major maintenance activities. Do you agree with that approach? If you do not agree with that approach, what approach would you propose and why?

We believe that if the final SOP will preclude the capitalization of certain costs (e.g., general, administrative, and overhead costs), it would be appropriate to allow entities to identify such costs that were previously capitalized and expense those amounts as a cumulative-effect adjustment upon adopting the final SOP. Allowing entities to do this would not only bring entities' balance sheets into compliance with the SOP more quickly, but would effectively eliminate the impact of recognizing previously capitalized costs in future income statements at the same time that current period costs are recognized. Thus, this would prevent entities' future operating income from being penalized for such costs that were capitalized in the past but would be prohibited from being capitalized under the proposed SOP. We believe that in most cases entities will be able to identify the remaining portions of previously capitalized

costs or make a reasonable estimate of those amounts. However, arbitrary allocations of such amounts for this purpose should not be permitted.

Issue 19

Under paragraph 71(a) of the proposed SOP, and as illustrated in Example 3 in appendix C, an entity applying component accounting retroactively at date of adoption may calculate a difference between the pre-adoption balance of accumulated depreciation and the balance recalculated based on the estimated useful lives of components that previously were not accounted for as separate components. Under that paragraph, the difference is allocated back to the accumulated depreciation of each component based on the net book values of the components. Two alternatives considered were recording the difference as a cumulative effect type adjustment at adoption and recording the difference as additional depreciation expense at adoption. Do you agree with the proposed approach or either of the alternatives, and why?

If AcSEC accepts our recommendations regarding the group method of depreciation, we agree with the proposed approach. We acknowledge that adoption of the proposed SOP would represent a change in accounting principle for some entities. However, we believe that for most entities the adoption of the SOP would bring about changes in the estimated useful lives of many components that were not previously accounted for as separate components. Distinguishing between the amount that is attributable to a change in principle and the amount that is attributable to a change in estimate will be impracticable for many entities. As a result, we believe that a prospective approach consistent with the guidance in paragraph 11 of Accounting Principles Board Opinion No. 20, *Accounting Changes*, is the most appropriate approach.

November 15, 2001

Mr. Marc Simon
Technical Manager
Accounting Standards, File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775
Email address: msimon@aicpa.org.

Re: AcSec Exposure Draft, Proposed Statement of Position, "Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment," dated June 29, 2001

Dear Mr. Simon,

We would like to submit the following comments with regard to the referenced Proposed Statement of Position concerning planned major maintenance activities and liquidated damages.

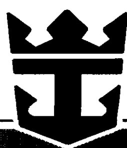
Company Background

Royal Caribbean Cruises Ltd. is a global cruise company operating 23 cruise ships under the Royal Caribbean International and Celebrity Cruises brand names.

Planned Major Maintenance Activities

The Proposed Statement of Position, "Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment," states that the accrue-in-advance method of accounting for planned major maintenance activities was not supported by the AcSEC because estimated future repair and maintenance costs do not represent a liability as defined in FASB Concepts Statement No. 6. The AcSEC contends that prior to the performance of the planned major maintenance activity, an entity does not have a present unavoidable duty or responsibility to sacrifice assets in the future. AcSEC does not believe that there has been an obligating event prior to the maintenance activities being performed.

Concepts Statement No. 6 defines liabilities as "probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events". Paragraph 36 of Concepts Statement No. 6 further explains, "a liability has three essential characteristics: (a) it embodies a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event or on demand, (b) the duty or responsibility obligates a particular entity, leaving it little or



no discretion to avoid the future sacrifice, and (c) the transaction or other event obligating the entity has already happened.

Paragraph 40 of Concepts Statement No. 6 further expands the definition to include "an equitable obligation which stems from ethical or moral constraints rather than from rules of common or statute law, that is, from a duty to another entity to do that which an ordinary conscience and sense of justice would deem fair, just, and right—to do what one ought to do rather than what one is legally required to do. . . . . A constructive obligation is created, inferred, or construed from the facts in a particular situation rather than contracted by agreement with another entity or imposed by government."

We believe planned major maintenance activities in our industry, hereby referred to as "dry docks", qualify as liabilities for the following reasons:

1) We are required to conduct periodic dry docks by rules imposed under the Det Norske Veritas (DNV). DNV is a classification society that administers regulations regarding the certification of cruise ships. DNV Rules for Ships (Pt.7, Ch. 2, Sec. 1) requires "at least two surveys are to be carried out in dry dock within each five year period of the Classification Certificate, provided there shall not be more than 36 months between two surveys in dry dock". We are required to comply with this rule to maintain operating certificates to operate our cruise ships.

2) DNV rules require dry docks upon the passage of a specified period of time. The passage of time and the event of cruising are the past, present and continuing occurrences that obligate the unavoidable event of a dry dock.

3) We have an ethical and moral obligation which results in a constructive obligation to the prepaid passengers to provide safe and reliable vessels for enjoyable cruise vacations. This constructive obligation is created, inferred or construed from the facts in this particular situation rather than contracted by agreement with another entity. We are obligated to sacrifice future economic benefits to provide our passengers with well maintained vessels.

We believe the definition provided by Concept Statement No. 6 clearly supports the recognition of planned major maintenance activities in our industry as liabilities. These maintenance activities have a high degree of predictibility with regard to the amount and timeframe, and as such, we believe the accrue-in-advance method is a reasonable method to record the dry dock liabilities.

Liquidated Damages

The Statement of Position proposes that a "purchaser of PP&E should account for the receipt of contractually specified liquidated damages recoverable from the seller as a reduction of the PP&E cost. . . . . Any damages in excess of the total PP&E cost should be recognized by the purchaser as income."

We believe liquidated damages specific to late delivery should not be recorded as a reduction of the PP&E cost because they do not reduce the value of the underlying asset. In the cruise industry liquidated damages represent mitigation of consequential economic costs incurred as a result of the late delivery of a new vessel. As such, we believe liquidated damages should be amortized to income over the period they relate to (a few weeks), not over the asset's depreciable life (thirty years) as proposed. We believe the same accounting treatment should apply to incentive payments made for the early delivery of new vessels. These incentive payments should be amortized over the benefit period, or the period between the early delivery date and the contracted delivery date.

The Statement of Position contends that "liquidated damages are negotiated in advance and do not purport to reimburse actual costs." We submit that liquidated damages do purport to reimburse actual economic costs. The shipyards will not accept a contract based on damages that are not quantified in advance. They will only agree to an amount based on expected economic costs. The amount is quantified based on historical economic costs of missed voyages due to a late ship delivery.

The AcSec contends that "no part of the buyer's payments are treated as insurance premiums". While it is true that the payments made to the shipyard do not constitute insurance payments, it is also true that the intent of liquidated damages clauses, included within the shipyard contracts, is to replace any claims that would have otherwise been made on delayed delivery insurance in force. Therefore, we believe the facts are conclusive that liquidated damages are comparable to insurance coverage and should be recorded as income.

Sincerely,

Blair H. Gould

Blair H. Gould
Vice President and
Corporate Controller
Royal Caribbean Cruises Ltd.

BHG:cw

Heartland Rural Electric Cooperative
P.O. Box 40
110 N. Enterprise Drive
Girard, KS 66743

November 15, 2001

Mr. Marc Simon
Technical Manager, Accounting Standards
File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Exposure Draft - Proposed Statement of Position, "Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment"

Dear Mr. Simon:

Heartland Rural Electric Cooperative appreciates the opportunity to submit written comments regarding the above-referenced Proposed Statement of Position (PP&E Accounting Proposal) to the Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants (AICPA).

Heartland REC is an electric cooperative in the state of Kansas, providing electricity to approximately 10,000 consumers-owners in 12 counties. Since we operate within the capital-intensive electric utility industry, the PP&E Accounting Proposal would significantly and negatively impact Heartland REC's accounting policies and administrative costs. Over the past three years, additions to our total utility plant have averaged $1,687,232 annually. During this same period, yearly reported patronage capital (margins) has averaged $706,324. We conservatively estimate that, if adopted, this PP&E proposal could decrease these margins by at least 116.4%. Resultant electric rates to our consumers would have to be increased substantially to cover the incremental costs associated with this proposal and to protect our financial integrity and credit rating.

Heartland REC is required to follow accounting requirements promulgated by the Rural Utilities Service (RUS). The PP&E Accounting Proposal raises significant ratemaking, operational, and accounting concerns for Heartland REC. The most significant of these concerns arise due to accounting inconsistencies between this proposal and the RUS Uniform System of Accounts and attendant RUS regulations and interpretations

(collectively, Electric Cooperative Accounting Requirements). The PP&E Accounting Proposal and the attendant detrimental impacts to Heartland REC include the following:

- Electric Cooperative Accounting Requirements specify capitalization of overheads in support of construction projects and permit capitalization of an appropriate portion of administrative and general (A&G) costs. In addition, Electric Cooperative Accounting Requirements specify capitalization of preliminary investigation and survey (PI&S) charges. The PP&E Accounting Proposal would prohibit capitalization of overheads, PI&S charges, and A&G costs.

  Implementation of these provisions would dramatically increase earnings volatility, as these overhead, PI&S charges, and A&G costs would be expensed, rather than capitalized as they are today. We estimate that the annual financial impact of these items would decrease our margins by at least $163,577 annually or more, depending upon the extent of the capital restrictions ultimately imposed. Furthermore, from the standpoint of rate-making fairness, failure to capitalize these costs would inequitably shift the burden of collection of these costs from customers using the plant asset over its useful life to existing customers at the time the plant asset is constructed.

- Electric Cooperative Accounting Requirements prescribe the use of the group method of depreciation for plant assets. The PP&E Accounting Proposal would require use of depreciation accounting by component, defined as "a tangible part or portion of [plant] that can be separately identified as an asset and depreciated or amortized over its own separate expected useful life". The PP&E Accounting Proposal generally prohibits the use of a group method of depreciation, unless it can be shown by the entity that the asset balances and operating results under the group method is not materially different from that obtained under the component method. Implementation of this provision would require administrative reorganization to comply with the data collection requirements, as well as expensive new automated accounting systems -- or at a minimum, significant upgrades to existing software. In addition, determination of material differences between the component and group accounting methods would require record keeping for both methods, adding significantly to plant record-keeping costs, as well as audit costs. The estimated costs to upgrade automated systems and provide additional administrative record-keeping and data input is projected to add at least $50,000 in one-time costs and will conservatively exceed $822,505 on an annual basis thereafter. If adopted, our staffing costs are projected to increase by at least $216,444 annually, or more than 25%, to support the extra administrative and reporting burdens of this requirement.

- Electric Cooperative Accounting Requirements, consistent with group depreciation accounting convention, generally prescribe that gains and losses on normal dispositions of mass assets be closed to the accumulated depreciation account, under the theory that over time gains and losses will net out. The PP&E Accounting Proposal would require that gains and losses be reflected in the results of operations in the current accounting period. Implementation of this provision would result in increased earnings volatility, as gains and losses on plant disposition are reflected in

the current results of operations. Annual gains / (losses) closed to the accumulated depreciation account over the past three years have averaged $270,710. Electricity rates would likely require significant upward adjustment to provide for this increased uncertainty of earnings.

- Electric Cooperative Accounting Requirements generally recognize the cost of removal of a plant asset over the useful life of that asset, as a component of the depreciation rate. The PP&E Accounting Proposal would require that cost of removal be reflected in the results of operations in the accounting period in which such cost was incurred. Removal costs we've incurred over the past three years have averaged $171,774 annually. Implementation of this provision would result in increased earnings volatility, as cost of removal would be reflected in a single accounting period. Furthermore, from the standpoint of ratemaking fairness, failure to recognize cost of removal over the asset's life would inequitably shift the burden of collection of these costs from customers using the plant asset to customers during the retirement of the plant asset.

Each of the above accounting inconsistencies pose operational problems and create significant administrative burdens for Heartland REC that will dramatically raise the cost of electricity our rural member owners. The detrimental impacts of each item should be carefully considered and weighed against any identifiable benefits before the AICPA AcSEC implements the attendant provision of the PP&E Accounting Proposal for electric utilities. Further, we recommend that any and all decisions and changes impacting PP&E be closely coordinated in advance with RUS and all other federal and state governmental authorities regulating electric cooperatives and the electric industry.

Heartland REC appreciates the opportunity to provide comments on the PP&E Accounting Proposal and respectfully urges the AICPA AcSEC to consider its views. If questions arise concerning these comments, please feel free to contact Janet Ashbacher at (620) 724-8251.

Sincerely Yours,

Dale Coomes
General Manager

U·S AIRWAYS

November 15, 2001

Mr. Marc Simon
Technical Manager, Accounting Standards
File 4210.CC
AICPA
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Mr. Simon,

US Airways appreciates the opportunity to comment on the exposure draft of AcSEC's Statement of Position, *Accounting for Certain Costs and Activities Related to Property, Plant and Equipment*. The airline industry is one of the most capital-intensive industries in the country. Therefore, we follow any accounting developments related to property, plant and equipment with great interest. This letter provides our comments on the Exposure Draft issued on June 29, 2001. We have identified herein for your consideration our comments and observations on the following issues that are of most concern to US Airways.

US Airways understands and support the efforts of AcSEC to provide additional guidance in accounting for capital costs. However, because of a series of issues that we will be discussing in this letter, we believe the Statement as proposed would have consequences that are in conflict with the desired goals of new accounting standards, namely to improve the relevance and reliability of accounting information in a cost-effective manner. We believe that our current practices represent a logical application of existing GAAP that have provided relevant, reliable and transparent accounting information to our financial statement users for many years. We have identified several issues that are of the most concern to our industry in general, and our company in particular.

AREAS REQUIRING PARTICULAR ATTENTION BY RESPONDENTS

Component Accounting

US Airways' response to Issue 12: Many parts on an airframe meet the theoretical definition of a "component" as defined in paragraph 49. For example, carpet, seats, paneling and exterior paint could all be considered "components." The costs that we would incur to track each of these items (additional accounting staff, systems, system modifications, etc) would far exceed the benefit that might result from possibly

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immaterially, more accurate financial reporting. Today, most airlines depreciate their airframes and engines individually. This consistency from one airline to the next offers financial statement users a "level playing field" when reviewing airline financial statements. We feel that the introduction of component accounting will impair that consistency as it is likely each airline will define components differently. Even different airlines with identical components will likely assign far different estimated service lives. If AcSEC decides to move forward with component accounting, we request that paragraph 52 be retained. This paragraph offers companies latitude with respect to choosing what components should be created. We support the proposed SOP empowering the financial statement preparers to choose the components using reasonable thresholds rather than the SOP selecting an arbitrary measure for component definition such as brightline test.

US Airways' response to Issue 14: Component accounting for large groups of homogeneous assets would be extremely impractical and cost prohibitive. Group depreciation is currently an acceptable method used by many industries and is supported by industry specific accounting literature. We therefore request that AcSEC remove the condition mentioned in paragraph A48 for using group depreciation or other accepted conventions.

Transition

US Airways' response to Issue 16: While we don't support component accounting, we feel that if retroactive application is a choice, the effective date of January 1, 2003 for calendar year companies is unrealistic and aggressive. Due to the level of work required to adopt component accounting (staffing, analysis, programming, etc.), we request that AcSEC change the effective date to January 1, 2005 for calendar year companies.

US Airways' response to Issue 17: We agree that the ordering of methods is appropriate. It is not necessary for the SOP to provide additional examples of what constitutes "another reasonable method."

We hope that you give sufficient consideration to these comments and that this letter has improved your understanding of the issues our industry would be facing should this SOP issued as proposed.

Respectfully submitted,

/s/ Anita P. Beier

Anita P. Beier
Vice President and Controller

Marc Simon

11/16/2001 08:27 AM

To: agadkins@uss.com, bdrake@kpmg.com, cdaugherty@dttus.com, james_ross@csx.com, jbrant@deloitte.com, leonard.gatti@us.pwcglobal.com, lmayshak@dttus.com, msimon@aicpa.org, richard.h.moseley@aexp.com, rrendino@pgrt.com
cc: Sharon Macey/NY/AICPA@AICPA
Subject: Correction - should be cl #256 not 255

----- Forwarded by Marc Simon/NY/AICPA on 11/16/01 08:32 AM -----

Marc Simon

11/16/01 08:23 AM

To: agadkins@uss.com, bdrake@kpmg.com, cdaugherty@dttus.com, james_ross@csx.com, jbrant@deloitte.com, leonard.gatti@us.pwcglobal.com, lmayshak@dttus.com, msimon@aicpa.org, richard.h.moseley@aexp.com, rrendino@pgrt.com
cc: Sharon Macey/NY/AICPA@AICPA
Subject: cl #255

----- Forwarded by Marc Simon/NY/AICPA on 11/16/01 08:28 AM -----

jlogan@avecc.com

11/15/01 04:11 PM

To: msimon@aicpa.org
cc:
Subject: AICPA proposed rule

Dear Mr. Simon:

I realize today is the deadline for making comments regarding the AICPA Proposed Rule "Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment" but I did want to briefly add my concerns. First, I question if the proposed rule considered the impact on all companies in the utility industry. Component depreciation is an accurate method to depreciate assets but the cost incurred to administer such a process exceeds the exact benefit. If I recall, all accounting procedures must have a benefit that is greater than the cost to perform the procedure warrant the validity of the rule. Please consider the thousands (possibly millions) of component items that are installed in an electric utility system. The administrative time and facility cost to record, monitor, and depreciate all items individually using specific installation dates would enormously expensive and, most importantly, would likely not provide a more accurate measure of plant valuation net of depreciation. Both the component and composite method require the use of estimates in calculating depreciation expense. The fairness or accuracy of either method is measured by comparing the entity's accumulated depreciation to the accepted Accumulated Depreciation Range. Would it be more relevant to research the accuracy of the

depreciation ranges first than to impose such costly mandates on the utility industry?

I have read comments on this proposed rule from other electric companies concerned of the resulting negative impacts. I concur with the reasoning to oppose the current expensing of overhead costs and the immediate recognition of losses on the retirement of plant and other assets. Please give close consideration to each of the comments and research the benefits expected to be gained to the costs incurred by utilities and to our customers.

Sincerely yours,

James D. Logan, CPA
Office Manager
Arkansas Valley Electric Cooperative Corp;
Ozark, AR

Marc Simon

11/16/2001 08:29 AM

To: agadkins@uss.com, bdrake@kpmg.com, cdaugherty@dttus.com, james_ross@csx.com, jbrant@deloitte.com, leonard.gatti@us.pwcglobal.com, lmayshak@dttus.com, msimon@aicpa.org, richard.h.moseley@aexp.com, rrendino@pgrt.com
cc: Sharon Macey/NY/AICPA@AICPA
Subject: cl #257

cl #257
----- Forwarded by Marc Simon/NY/AICPA on 11/16/01 08:34 AM -----

cbickel@ninnescah.com

11/15/01 02:19 PM

To: MSimon@aicpa.org
cc:
Subject: Re: Property, Plant & Equipment - Proposed Accounting Change

November 15, 2001

Mr. Marc Simon
Technical Manager, Accounting Standards
File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Exposure Draft - Proposed Statement of Position,
"Accounting for Certain
Costs and Activities Related to Property, Plant, and
Equipment"

Dear Mr. Simon:

Ninnescah Rural Electric Coop. appreciates the
opportunity to submit
written comments regarding the above-referenced
Proposed Statement of
Position (PP&E Accounting Proposal) to the Accounting
Standards Executive
Committee (AcSEC) of the American Institute of
Certified Public Accountants
(AICPA).

Ninnescah is an electric cooperative in the state of
Kansas, providing
electricity to approximately 3385 consumers-owners in
10 counties. Since we
operate within the capital-intensive electric utility
industry, the PP&E

Accounting Proposal would significantly and negatively impact our accounting
policies and administrative costs. Over the past three years, additions to
our total utility plant have averaged $1,270,996 annually. During this same
period, yearly reported patronage capital (margins) has averaged $344,095.
We conservatively estimate that, if adopted, this PP&E proposal could
decrease these margins by at least 100%. Resultant electric rates to our
consumers would have to be increased substantially to cover the incremental
costs associated with this proposal and to protect our financial integrity
and credit rating.

Ninnescah is required to follow accounting requirements promulgated by the
Rural Utilities Service (RUS). The PP&E Accounting Proposal raises
significant ratemaking, operational, and accounting concerns for us. The
most significant of these concerns arise due to accounting inconsistencies
between this proposal and the RUS Uniform System of Accounts and attendant
RUS regulations and interpretations (collectively, Electric Cooperative
Accounting Requirements). The PP&E Accounting Proposal and the attendant
detrimental impacts to Ninnescah include the following:

· Electric Cooperative Accounting Requirements specify capitalization of
overheads in support of construction projects and permit capitalization of
an appropriate portion of administrative and general (A&G) costs. In
addition, Electric Cooperative Accounting Requirements specify
capitalization of preliminary investigation and survey (PI&S) charges. The
PP&E Accounting Proposal would prohibit capitalization of overheads, PI&S
charges, and A&G costs.

Implementation of these provisions would dramatically increase earnings
volatility, as these overhead, PI&S charges, and A&G costs would be
expensed, rather than capitalized as they are today. We estimate that the

annual financial impact of these items would decrease our margins by at least $69,081 annually or more, depending upon the extent of the capital restrictions ultimately imposed. Furthermore, from the standpoint of rate-making fairness, failure to capitalize these costs would inequitably shift the burden of collection of these costs from customers using the plant asset over its useful life to existing customers at the time the plant asset is constructed.

· Electric Cooperative Accounting Requirements prescribe the use of the group method of depreciation for plant assets. The PP&E Accounting Proposal would require use of depreciation accounting by component, defined as "a tangible part or portion of [plant] that can be separately identified as an asset and depreciated or amortized over its own separate expected useful life". The PP&E Accounting Proposal generally prohibits the use of a group method of depreciation, unless it can be shown by the entity that the asset balances and operating results under the group method is not materially different from that obtained under the component method. Implementation of this provision would require administrative reorganization to comply with the data collection requirements, as well as expensive new automated accounting systems -- or at a minimum, significant upgrades to existing software. In addition, determination of material differences between the component and group accounting methods would require record keeping for both methods, adding significantly to plant record-keeping costs, as well as audit costs. The estimated costs to upgrade automated systems and provide additional administrative record-keeping and data input is projected to add at least $50,000 in one-time costs and will conservatively exceed $453,000 on an annual basis thereafter. If adopted, our staffing costs are projected

to increase by at least $88,420 annually, or more than 25%, to support the
extra administrative and reporting burdens of this requirement.

· Electric Cooperative Accounting Requirements, consistent with group
depreciation accounting convention, generally prescribe that gains and
losses on normal dispositions of mass assets be closed to the accumulated
depreciation account, under the theory that over time gains and losses will
net out. The PP&E Accounting Proposal would require that gains and losses
be reflected in the results of operations in the current accounting period.
Implementation of this provision would result in increased earnings
volatility, as gains and losses on plant disposition are reflected in the
current results of operations. Annual gains / (losses) closed to the
accumulated depreciation account over the past three years have averaged
$197,000. Electricity rates would likely require significant upward
adjustment to provide for this increased uncertainty of earnings.

· Electric Cooperative Accounting Requirements generally recognize the cost
of removal of a plant asset over the useful life of that asset, as a
component of the depreciation rate. The PP&E Accounting Proposal would
require that cost of removal be reflected in the results of operations in
the accounting period in which such cost was incurred. Removal costs we've
incurred over the past three years have averaged $99,307 annually.
Implementation of this provision would result in increased earnings
volatility, as cost of removal would be reflected in a single accounting
period. Furthermore, from the standpoint of ratemaking fairness, failure to
recognize cost of removal over the asset's life would inequitably shift the
burden of collection of these costs from customers using the plant asset to
customers during the retirement of the plant asset.

Each of the above accounting inconsistencies pose

operational problems and
create significant administrative burdens for
Ninnescah that will
dramatically raise the cost of electricity our rural
member owners. The
detrimental impacts of each item should be carefully
considered and weighed
against any identifiable benefits before the AICPA
AcSEC implements the
attendant provision of the PP&E Accounting Proposal
for electric utilities.
Further, we recommend that any and all decisions and
changes impacting PP&E
be closely coordinated in advance with RUS and all
other federal and state
governmental authorities regulating electric
cooperatives and the electric
industry.

Ninnescah appreciates the opportunity to provide
comments on the PP&E
Accounting Proposal and respectfully urges the AICPA
AcSEC to consider its
views. If questions arise concerning these comments,
please feel free to
contact me at (620) 672-5538 or cbickel@ninnescah.com.

Sincerely Yours,

Carla A. Bickel
Director of Finance

>
>
> cbickel@ninnes
> cah.com To:
msimon@aicpa.org
> cc:
rnikodym@kec.org
> 11/15/01 11:59 Subject:
Property, Plant &
Equipment - Proposed Accounting Change
> AM
>
>
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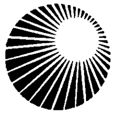
>

>
>
> Mr. Simon,
>
> We would like to register our concern over the above
proposed changes to
> our accounting processes. Please see the attached
letter with pertinent
> information as to the costs that will actually be
imposed on our
> Cooperative by such changes. Thank you for your
consideration. (See
attached
> file: ~$-op Response to AICPA1 .doc)
>
>



Northeast Utilities System

Northeast Utilities Service Company
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John J. Roman
Vice President and Controller

November 13, 2001

Mr. Marc Simon
Technical Manager, Accounting Standards
File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Comments of Northeast Utilities on the Proposed Statement of Position, "Accounting For Certain Costs And Activities Related To Property, Plant, and Equipment"

Dear Mr. Simon:

Northeast Utilities ("NU" or "the company") appreciates the opportunity to comment on the Proposed Statement of Position, "Accounting For Certain Costs And Activities Related To Property, Plant, and Equipment" as prepared by the Accounting Standards Executive Committee (AcSEC).

The NU system's regulated utilities furnish franchised retail electric service in Connecticut, New Hampshire and western Massachusetts and natural gas service in Connecticut with combined Utility Plant Assets in excess of $ 6.9 billion on a gross basis. This service is provided to over 2 million customers representing operating revenues of approximately $ 6.6 billion.

There are four issues in the proposed Statement of Position (SOP) which the company would like to provide its comments including accounting for cost of removal, impacts on depreciation from component accounting, capitalization of costs based on the project stage framework and the ability to capitalize administrative and general costs.

<u>Cost of Removal [Issue 7]</u>
The guidance in this SOP should be reconciled to the provisions of the recently issued SFAS 143, "Asset Retirement Obligation" which provides guidance on the cost of removal for certain assets.

<u>Component Accounting [Issues 12, 13 and 14]</u>
The company currently records the cost of its assets at a component or retirement unit level as prescribed by the FERC Uniform System of Accounts. The change which will result from the guidance in this SOP in paragraphs 49 through 56 will be seen in the method used to depreciate assets and as well as the accounting at the time of retirement. This will result in a significant change in method from what is practiced by not only this company but also throughout the electric and gas utility industry. The change is anticipated to increase the labor cost to support this practice as well as the costs required to change the company's existing accounting systems. The costs to the company to conform with this are expected to outweigh the benefits gained to the financial data being reported.

The company currently practices group depreciation methods for its mass assets making use of service lives for groups of similar assets. This recognizes that it is difficult to estimate service lives on an individual component level given the high volume of assets in place in the company. In addition, the remaining or undepreciated value at the time of retirement is recorded in the company's reserve for accumulated depreciation. This value is not charged to expense at the time of retirement. This treatment allows for levelized accrual rates and ensures full recovery of the company's plant investment. The company is concerned with the burden which would result from the adoption of the language related to component accounting in the proposed SOP.

Due to the magnitude of property, plant and equipment for Northeast Utilities, the depreciation practices and costs are closely scrutinized by our regulatory bodies. The development of the accrual rates used in the group depreciation method are derived from statistically and historically based depreciation studies that identify average service lives, retirement dispersion and net salvage. The resulting group depreciation estimate more closely represents the productive usefulness of the assets than what the results would be by applying the component method to the large volume of assets this capital intensive industry has. The current process has been shown to provide a sound mechanism for recognition of the significant investment made in PP&E over the useful life of the assets.

The company recommends that the Statement of Position on PP&E does not restrict the method of depreciation to those described in the draft document. We suggest that the language require companies to use a method which provides a systematic and rational approach. This would not limit companies to only component accounting but would recognize group depreciation accounting as a sound and acceptable method. We believe that this will allow for the continuation of the group depreciation practice and the sound results which it brings.

<u>Project Stage Framework [Issue 3]</u>
The company agrees with the inclusion of guidance as to when costs should begin to be capitalized during a project's life cycle. However, we recommend that recognition be included in this section that the ability to capitalize costs should not only be based on the timing but also on the nature of the activity being performed. Often times there may be work performed in what may be considered the Preliminary Stage of a project which may provide value to the asset ultimately constructed. This may include surveying of rights of way or engineering to define the technical specifications of the project. Based on the project schedule, this same work may also be done during what might be considered the Preacquisition Stage as defined in SOP.

The company recommends that language be included to allow for determination of the capital vs. expense treatment of the work by not only the timing but also the nature of the activity being performed.

<u>Accounting for Costs Incurred [Issue 4]</u>
The company believes that the guidance which directs that all Administrative and General costs be charged to expense is too restrictive. While most A&G related costs are treated this way by the company, there are a number of functions whose work is driven by the capital projects performed in the company. A study is done periodically to determine the level of effort of these groups to support the company's capital program. A corresponding cost level is subsequently capitalized. This approach provides a better reflection of the total capital costs of the company. In addition, this practice is consistent with the FERC Uniform System of Accounts which is followed by the company to determine the components of construction costs. The divergence

from this accounting prescribed by FERC will require the company to assess the needs to maintain additional accounting transactions to account for the differences of the accounting for regulatory vs. compliance with what is described in this SOP.

In conclusion, Northeast Utilities appreciates the opportunity to respond to the proposed Statement of Position. We hope that our comments will be helpful in the AcSEC's future deliberations.

Very truly yours,

John J. Roman
Vice President and Controller

November 15, 2001

Mr. Marc Simon
Technical Manager,
Accounting Standards File 4210.CC
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Mr. Simon

RE: Proposed Statement of Position, "Accounting for certain costs and activities related to property, plant and equipment"

Mirant Corporation has operations in 12 countries on five continents, and through these operations, Mirant develops, builds, owns and operates power generation and delivery facilities and provides a broad range of services to utilities and industrial companies. The power generated by Mirant is sold into various markets and to a variety of customers that include both retail and wholesale customers, as well as electricity marketing and trading companies.

We are pleased to offer our comments on the proposed Statement of Position ("SOP") entitled "Accounting for certain costs and activities related to property, plant and equipment". We note the issues addressed in the proposed SOP and would like to focus our response only on those issues that we believe are inconsistent or problematic to our capital-intensive industry.

Issue 4 "Internal Costs"

Mirant does not agree with the conclusion that only the "directly identifiable" costs as listed in paragraphs 23 and 28 of the proposed SOP can be capitalized, resulting in all general and administrative and overhead costs incurred, including all costs of support functions, to be charged to expense. There are a number of factors that support the principle to include such general and administrative overhead costs in the historical cost of any asset constructed for own use, as explained below.

Board Conclusions from SFAS 34

We believe that the conclusion drawn in Issue 4 of the proposed SOP is inconsistent with the conclusions drawn by the Financial Accounting Standards Board during their deliberations of SFAS 34, as detailed in paragraphs 37 through 48, where capitalized interest costs are analogous to other costs related to self-construction. The key excerpts of the Board's conclusions are:

> "...the historical cost of acquiring an asset should include all costs necessarily incurred to bring it to the condition and location necessary for its intended use [where] the cost incurred in financing expenditures for an asset during a required construction or development period is itself a part of the asset's historical acquisition cost."
>
> "Those Board members believe acquisition cost provides the most reliable measure of cash flow potential when assets are self-constructed or produced as well as when they are purchased in arms-length transactions...For such assets, therefore, acquisition cost should

> include all the cost components envisioned by the enterprise as being necessary to acquire the asset. The cost of financing the asset during the period of its construction or production is one of those cost components. Since the cash flow potential of an enterprise's assets is significant information in assessing the future net cash flows of the enterprise and hence the prospective cash receipts of investors and creditors, a measure of acquisition cost that includes interest cost is likely to be more useful to investors and creditors than one that does not."

The objectives of SFAS 34 for capitalizing interest are:

a) to obtain a measure of acquisition cost that more closely reflects the enterprise's total investment in the asset, and,
b) to charge a cost that relates to the acquisition of a resource that will benefit future periods against the revenues of the periods benefited.

These objectives apply equally to other costs incurred during construction as they do to interest costs incurred during construction. We believe that general and administrative overheads, as well as support functions, are similar to interest costs that should be considered to be part of the historical cost of acquiring an asset, and thus analogous to direct costs that are readily and objectively assignable to the acquired asset.

Matching Concept and Earnings Recognition

The conclusion drawn in Issue 4 is inconsistent with the "matching" concept discussed in the Statement of Financial Accounting Concepts No. 6 (paragraphs 146 to 149), and further addressed in APB Statement 4 (paragraphs 154 to 161) which describes three pervasive expense recognition principles: associating cause and effect, systematic and rational allocation, and immediate recognition.

SFAS 34 builds on that "cause-and-effect" principle as stated in paragraph 51: "That cause-and-effect relationship between the investment in the asset and the incurrence of interest cost makes interest cost analogous to a direct cost in those circumstances". SFAS 34 strengthens this argument by stating in paragraph 48:

> "The Board believes that failure to capitalize the interest cost associated with the acquisition of qualifying assets improperly reduces reported earnings during the period of acquisition and increases reported earnings in later periods."

Mirant and other similar capital intensive entities often have in-house departments or subsidiaries that are created specifically for self-construction projects. This ensures such construction is completed to the high specifications required in the power industry, and to ensure a resource is available for the continual capital enhancements and improvements, as well as ongoing repairs and maintenance. The engineers and supervisors are utilized on specific projects and keep time records to ensure correct allocation to the various projects. In some companies (such as a Distribution and Transmission company that improves, maintains and enhances the "wires") this workforce is a significant portion of the total number of employees. Therefore, a significant part of the general and administrative costs, as well as other support functions, are incurred to service and support those construction efforts.

Mirant believes that if the support costs and other overhead costs directly related and attributable to the capital component of an in-house engineering division are expensed, then it will incorrectly result in reduced reported earnings during the period incurred and enhanced future earnings.

Comparison of Internal Costs to External Costs

As mentioned above, many capital-intensive industries have in-house engineering and support functions, and such entities should not be penalized for choosing that business strategy as opposed to out-sourcing its engineering requirements. In support of this common practice, one must look at the scenario where two identical companies both carry out the construction of long-lived assets and the continual improvements, maintenance and repairs thereon. The two companies earn the same revenues based on those assets.

Company A out-sources all its engineering costs, while Company B uses an in-house engineering division. Company A will be billed for specific projects from a third party, Company X. Such bills will include a charge-out rate determined to recover all costs plus a profit margin for the stockholders of Company X. Company A will capitalize the external bills/costs in whole with no adjustment made for any embedded amounts representing Company X's overheads, support functions, and other costs.

Under the proposed SOP, Company B will only be allowed to capitalize payroll and payroll benefit related costs, whereas Company A is capitalizing externally embedded overheads and other costs (including a profit margin). Therefore, the comparable financial statements of Company A and B will contain different historical asset amounts, yet each company has the same cash flow potential of its assets. This will be misleading to investors and readers of those financial statements.

Under current GAAP Company B may capitalize the payroll costs and allocated overheads and support function costs. Those internal costs capitalized more closely equate to the external costs capitalized which will include a recovery of all types of costs including rent, depreciation, and interest as well as a buried profit component.

Mirant understands that entities without any in-house operations for construction and capital works should not be allowed to capitalize general and administrative costs. However, for entities that do have in-house resources directly attributable to capital projects, the allocated overheads, much like capitalized interest, should form part of the historical asset cost. Therefore the proposed SOP should specify conditions that allow companies to capitalize overhead costs where such conditions are met e.g. in-house employees dedicated wholly or in part to capital projects, adequate time recording processes, and substantiated methods of cost allocation.

Issue 12 to 14 "Component Accounting"

Mirant does not agree that the proposed SOP should require all entities to use component accounting, and should allow the group method to continue for the reasons discussed below.

ARB Chapter 9 - Depreciation

Depreciation is defined in Accounting Research Bulletin ("ARB") No.43, Chapter 9, Section C, Item 5, as follows:

> "The cost of a productive facility is one of the costs of the services it renders during its useful economic life. Generally accepted accounting principles require that this cost be spread over the expected useful life of the facility in such a way as to allocate it as

> equitably as possible to the periods during which services are obtained from the use of the facility. This procedure is known as depreciation accounting, a system of accounting which aims to distribute the cost or other basic value of tangible capital assets, less salvage (if any), over the estimated useful life of the unit (which may be a group of assets) in a systematic and rational manner. It is a process of allocation, not valuation."

The application of component accounting as defined in the SOP is contrary to this basic premise of depreciation accounting. It does not clearly provide for an equitable allocation over the periods from which services are obtained.

Let us consider a generating plant in its simplest form: a building, on land, with equipment inside. On the face of it we could break the PP&E into three components: 1) Land, 2) Building, and 3) Equipment. Each is a component that is separately identifiable with an individual life, and is expected to provide future economic benefit. The turbine can be broken into blades, rotors, stators, exciters, etc. Each component part having a separate life, but integrated in such a way that the life of the turbine is dependent on all of the parts as a whole and thus collectively provides economic benefit. The elimination of any one of the parts renders the rest of the integrated assets useless. The same argument can be demonstrated for the components making up the building.

If an entity were to apply the proposed SOP, we believe that the level of componentization that may result will become burdensome, and thus onerous to keep up to date, due to the level of detail. It is for this reason that the group method or composite method of depreciation has been developed which provides for a consistent depreciation expense over the average useful life of the asset at a level identified to provide economic benefit.

Group Depreciation

Group depreciation provides a "systematic" and "rational" allocation of costs over the average service life of the asset (i.e. the turbine) as prescribed in ARB 43. It is systematic as group depreciation is applied using a formula approach such as straight line, declining balance, SYD, etc. It is rational as it better allocates the cost of all assets over the "average" service life of individual assets that make up the whole. Using group depreciation better matches the revenues produced by the integration of all assets over the average period from which service is obtained. Component depreciation, as defined in the proposed SOP, may not always provide a rational allocation of the costs of assets to match the revenues produced by these assets.

If componentization was adopted by every entity, then due to the subjectivity of what components to recognize and what their useful life is, every entity will componentize assets differently, to differing levels and with different lives. The result being those entities in general will be no nearer to consistency than we are now. The proposed policy may appear to bring consistency in accounting policies, but it will not bring consistency in the financial statements. For example, two companies apply straight-line depreciation to the same equipment; the actual depreciation expense is subject to each company's individual estimate of expected useful life and residual value, resulting in different annual depreciation expense but the same straight-line depreciation policy.

In conclusion, Mirant believes that the proposed SOP will not achieve the consistency that it is trying to create, and if applied will be burdensome on companies where the costs of moving to the proposed component method largely outweigh the benefits that it may bring. We therefore

propose that the group and composite methods continue to be recognized as valid and acceptable depreciation methods in addition to the component method put forward in the proposed SOP.

We appreciate the opportunity to comment on the proposed Statement of Position.

Yours sincerely,

James A. Ward
Senior Vice President & Chief Accounting Officer, Mirant Corporation

cc: Raymond D. Hill, Chief Financial Officer, Mirant Corporation
Mark R. Bell, Arthur Andersen LLP

Mr. Marc Simon
Technical Manager, Accounting Standards
File 4210.CC
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Proposed Statement of Position: *Accounting for Certain Costs and Activities Related to Property, Plant and Equipment.*

Dear Mr. Simon,

I am writing on behalf of Duke University to submit comments on the Statement of Position (SOP): *Accounting for Certain Costs and Activities Related to Property, Plant and Equipment* proposed by the AICPA Accounting Standards Executive Committee. I thank you for the opportunity to share our concerns about the proposed SOP.

We strongly support the Council of Government Relations (COGR) position that the Accounting Standards Executive Committee should exempt private not-for-profit colleges and universities from the application of the Statement of Position. We believe the SOP, if applied to such colleges and universities, would have the unintended consequence of creating an increased administrative and cost burden without realizing any proportional benefit. Though we appreciate that current practice with respect to accounting for costs of PP&E may not be uniform and that this diversity may result in financial reports that are not fully comparable, we do not believe that it is critical that the financial statements of private universities and for-profit corporations be comparable. To achieve this uniformity, universities will have to make some level of investment in both time and money toward revision of both accounting/property management systems and business processes in order to comply with the SOP. Additionally, we agree with the COGR that the SOP could potentially have a negative effect on both federal research funding and tax-exempt financing.

Duke University is potentially impacted in three areas: 1) required business process changes to support the proposed SOP, 2) Facilities and Administrative (F&A) rate and recovery (and its residual repercussion), and 3) tax-exempt financing for future capital projects. The University will not be affected as significantly as many of our peers because we have a strong plant accounting function that already utilizes component accounting. Other institutions, especially smaller ones that do not have complex accounting/property management systems and do not utilize component accounting, will be more severely impacted.

1) Required Business Process Changes - The University would obviously be influenced by the new requirements for project stage accounting and the exclusion of general administrative cost and overhead from capitalized cost. Current construction projects often have "internal" costs that contain applicable departmental overhead costs. The SOP would require the University to reexamine capitalized internal costs and create a

business process, which excludes these costs from the capitalization process. It is difficult to quantify the repercussion of this requirement on the University's accounting/plant system until the SOP is finalized but we see this as an area of great potential administrative burden/cost.

2) F&A Rate and Recovery - The impact to the University's F&A Rate and Recovery is difficult to assess at this time. The impact in large part depends on the timing of construction projects relative to the base year for the University's F&A cost study. In other words, we do expect that there will be a shift between PP&E cost that is expensed as period cost versus capitalizable cost, which are amortized over time. However, the extent to which our federal research dollars are affected by this change will be determined in part by the impact of this shift in the base study year. The SOP will likely require the University to make changes to our cost accounting disclosure statements (DS-2), possibly request prior approval from the cognizant Federal agency and receive that approval before the implementation date. Again, this could result in significant administrative burden/cost.

3) Tax Exempt Financing - Section 147, Title 26 (the 120% rule) should not have an impact since we already utilize component accounting. This should not effect the current composite useful life of the university's assets associated with debt which is already well within the 120% guidelines. Section 145, Section 26 does potentially affect the University because it limits the use of tax-exempt debt to capital expenditure purposes. It is likely that the project stage accounting requirement will have some impact on the amount of expenses that can be capitalized associated with a project and hence the amount that can be financed by tax-exempt debt. This is significant especially in light of our current strategic plan that will rely significantly on tax-exempt financing for new capital projects. Additionally there would be additional general and administrative costs that would have to be expensed and could not be bond-financed. Thus, this could negatively impact the cost of financing capital projects.

Again, we appreciate this opportunity to comment on the proposed SOP. We believe that the consequences are sufficiently detrimental to warrant the exclusion of private not-for-profit colleges and universities. If you have any questions, please do not hesitate to contact me.

Sincerely,

Michael J. Mandl
Vice President
Financial Services

Cc: Nan Nixon

SOUTHWEST AIRLINES CO.

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November 15, 2001

Mr. Marc Simon
Technical Manager, Accounting Standards
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1211 Avenue of the Americas
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Via Electronic Mail

Dear Mr. Simon:

These comments from Southwest Airlines Co. are in response to the proposed Statement of Position, *Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment* (Proposed SOP). For a capital-intensive industry like the airlines, this Proposed SOP is disastrous. Implementing this Proposed SOP could not have some at a worse time.

In general, we are opposed to the Proposed SOP as we believe the additional costs required to implement the new requirements, specifically component accounting, will outweigh any possible benefits related to more precise depreciation accounting. In addition, we believe the elimination of alternative accounting methods for planned major maintenance activities, specifically the deferral and built-in methods, is not warranted and does not reflect an adequate understanding of these activities with respect to aircraft. Finally, if component accounting is required, we believe that entities should be permitted in transition to record the cumulative effect of the accounting change as a change in accounting principle in accordance with APB 20.

Component Accounting

While we do not object to the general accounting theory, the proposed component accounting requirements certainly will be onerous from an operational viewpoint. The value to financial statement users will be dubious, at best. In fact, complexity leads to less, not more, understanding. We believe that the implementation of these accounting requirements will necessitate significant technology and record keeping investments that outweigh any perceived benefits, especially for entities and industries that have significant capital assets. In addition, we are unaware of significant financial reporting concerns that are being addressed by this Proposed SOP. Consequently, we believe that

the implementation of component accounting will not improve financial statements for end users and an unnecessary burden for reporting entities.

Planned Major Maintenance
AcSEC rejected the deferral and built-in overhaul methods because it does not believe that all of the costs incurred as part of a planned major maintenance activity are capitalizable in accordance with criteria set forth in the Proposed SOP. In addition, AcSEC does not believe that planned major maintenance activities increase the service potential of PP&E; but rather in making the initial determination of the expected useful life (service potential) of a PP&E asset, an entity takes into account planned major maintenance or a shorter life would most likely be determined.

We believe if the proposed SOP is adopted, AcSEC will eliminate generally accepted accounting practice within the airline industry without sufficient understanding of aircraft major maintenance activities or sufficient input from the industry itself. There are many different variables between industries and a wide array of maintenance activities and requirements among the many types of PP&E assets. The choice of methods for planned major maintenance activities for the airline industry, as set forth in the AICPA Industry Audit Guide, *Audits of Airlines,* have allowed for choices of methods based on the facts and circumstance present in each case. We are unaware of any issues within the airline industry or the related investment community challenging the current financial reporting methods or seeking improved reporting. Consequently, we believe eliminating the current acceptable accounting methods is unwarranted.

We believe planned major maintenance for aircraft airframes are components that should be accounted for over their service periods. These costs meet the definition and characteristics of assets in accordance with Statement of Financial Accounting Concepts No. 6, *Elements of Financial Statements*. We also believe that airframe overhauls are not performed solely to maintain an aircraft's service potential, but also are required by law to meet high safety standards. Consequently, these airframe overhauls cannot be viewed in the same context as, say, an engine overhaul on ground equipment. Planned major maintenance for ground equipment is an activity that can be avoided, albeit possibly to the detriment of the service life of the asset. Planned major maintenance on aircraft airframes cannot be avoided and must be performed regardless of the apparent need, although some service life potential may accrue.

Both the deferral and built-in overhaul methods reflect the component value of the remaining overhaul service life. Aircraft values are contingent upon both the actual physical condition of the aircraft and the remaining time period until the next required planned major maintenance activity. Thus, any remaining service benefit until the next legally mandated major maintenance activity is performed is a component of the value of the aircraft. An aircraft that has recently undergone an airframe overhaul would be valued at a significantly higher value than a similar aircraft that has not undergone an overhaul, but is close to the time when one will be required. To the extent the overhaul benefits future periods, these alternative methods better match the costs of the overhaul

with the related benefits, recovered through future passenger revenues, and provide for less variability in financial statements.

Transition

The transition rules for component accounting are extremely confusing. Should the SOP be adopted, we believe permitting accounting for the transition as a change in accounting principle in accordance with APB 20 would be easier for financial statement users to understand and more straight forward for entities to implement.

Summary

We believe current accounting practices for PP&E are appropriate and there is no need for this additional guidance; therefore, we oppose the proposed SOP. However, if the SOP is issued, we believe it should include provisions for the use of the deferral and built-in overhaul methods for airlines and should allow for a cumulative effect adjustment related to the adoption of component accounting.

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Keith G. Butler
Senior Vice President & Corporate

November 15, 2001

Marc Simon
Technical Manager
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1211 Avenue of the Americas
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RE: Comments of Duke Energy Corporation on the Proposed Statement of Position - Accounting for Certain Costs and Activities Related to Property, Plant and Equipment

Dear Mr. Simon,

We appreciate the opportunity to comment on the proposed Statement of Position, *Accounting for Certain Costs and Activities Related to Property, Plant and Equipment.*

Duke Energy Corporation ("Duke Energy") is diversified multinational energy company, manages a portfolio of natural gas and electric supply, delivery and trading businesses -- generating revenues of more than $49 billion in 2000. Duke Energy, headquartered in Charlotte, N.C., is a Fortune 100 company traded on the New York Stock Exchange under the symbol DUK.

Duke Energy operates both regulated and non-regulated electric and gas utilities. The regulated entities are subject to the provisions of Statement of Financial Accounting Standards (SFAS) No. 71, "Accounting for the Effects of Certain Types of Regulation" and over-sight by the Federal Energy Regulatory Commission (FERC).

Duke Power, a regulated division of Duke Energy, is one of the nation's largest investor-owned electric utilities. Duke Power serves two million customers in a 22,000 square mile area of the Carolinas and operates three nuclear generating stations, eight coal-fired stations, 31 hydroelectric stations and numerous combustion turbine units.

Natural Gas Transmission provides interstate transportation and storage of natural gas for customers primarily in the Mid-Atlantic, New England and southeastern states. Its operations are conducted primarily through Duke Energy Gas Transmission Corporation. The interstate natural gas transmission and storage operations are subject to the rules and regulations of the FERC.

In the foreword of the proposed Statement of Position, it states that when the Financial Accounting Standards Board (FASB) reviews proposed documents, they look to ensure:

1. "The proposal does not conflict with current or proposed accounting requirements, unless it is a limited circumstance, usually in a specialized industry accounting, and the proposal adequately justifies the departure.
2. The proposal will result in an improvement in practice.
3. The AICPA demonstrates the need for the proposal.
4. The benefits of the proposal are expected to exceed the costs of applying it."

It is Duke Energy's position that, for regulated utilities, the proposed Statement of Position does not meet the above qualifications. Our reasons and conclusions, as well as specific comments on the issues raised by the proposed statement, are presented herein.

Qualification #1: A new statement does not conflict with current or proposed accounting requirements. The regulated utility industry is governed by the FERC along with state regulatory commissions. The FERC requires utilities to follow the FERC Uniform System of Accounts (USoA). The USoA's structure provides for the capitalization of indirect construction overhead and general and administrative expenses. It also permits utilities to use mass property accounting to track fixed assets. The proposed SOP requirements for component accounting are inconsistent with FERC accounting procedures. The proposed requirements would result in a significant deviation for the capitalization rules that are currently followed by regulated utilities. If a regulated utility is required to comply with the new statement as proposed, while still meeting the capitalization policies outlined by the FERC, it will have to maintain separate financial records for regulatory and GAAP purposes. The result will be increased record keeping expenses in an environment in which utilities are striving to provide effective rates to customers and consistently defending the expenses that are included in their cost of service and thus their rates.

Qualification #2: The statement will result in an improvement to practice. If the statement requires that regulated utilities follow component accounting, utilities will have to revise their entire accounting systems and method of capital recovery. Regulated rates in the utility industry rely on the recovery of a significant part of their large capital investments. The capital investment includes a large number of various items that are tracked most efficiently using group depreciation. Group depreciation is a means of depreciating assets by grouping assets that share similar service lives and other attributes and depreciating them by applying a single straight-line rate based on the average service life of the assets in the group. Utilities use actuarial and statistical research as well as statistical probabilities applied to groups of assets to determine when specific assets within a group will be retired. Historical practice has shown this to be a proven and valid technique. It is neither logical, nor an improvement in practice, for a utility to be required to track the vast number of different items based on the component system.

Qualification #3: The AICPA demonstrates the need for their proposal. As previously noted, the electric and gas utility industry is regulated either at a state or federal level with well-defined requirements that provide for clear and consistent financial reporting throughout the industries. Additional guidance is not necessary for regulated entities, as the current system for accounting for property, plant and equipment has been demonstrated to be efficient and effective.

Qualification #4: The benefits of the proposal are expected to exceed the costs of applying it. Component accounting for the regulated utility industry will be an overwhelming and nearly impossible requirement. For example, electric utilities have millions of utility poles, cross-arms, and miles of buried cable and above ground wire. Currently these assets are grouped by vintage year and depreciated based on proven past performance. It would be virtually impossible to apply component accounting to the overwhelming number of assets owned by such a utility and any attempt would be at a significant expense to a utility and ultimately, to every utility consumer they serve.

In conclusion, it is Duke Energy's position that regulated utilities should be excluded from the scope of the proposed Statement of Position, "Accounting for Certain Costs and Activities related to Property, Plant and Equipment." For regulated utilities, the statement does not meet the requirements set forth by the FASB to ensure that new guidance does not conflict with current accounting. Additionally, the proposal will not result in an improvement to practice nor will the benefits exceed the cost of applying it. The accounting for property of the regulated utility industry is already strictly governed by the FERC and state regulatory commissions, and, to avoid greatly increased expenses and complications, these regulatory accounting requirements, which currently qualify as GAAP, should not be changed.

In addition to the general comments regarding the overall parameters of this proposed statement of position, Duke Energy has some specific comments as noted herein.

Scope

Issue 1: No comment

Project Stage Framework

Issue 2: Generally, only very large projects have preliminary stage costs. This preliminary stage may last a year or more and the costs can be significant. Much of the work directly relates to the specific project to be undertaken and, is essential for the construction and acquisition phase to begin; and, therefore, creates future economic benefit and should be eligible for capitalization. If the project is ultimately not completed, the costs would be expensed when the decision to discontinue the project is made. In addition, FERC allows for recovery of these costs that are included in rate base and thus considered when the allowable return is determined by FERC. If these costs are no longer capitalized, either the allowable return to the utility will be reduced or FERC will be required to revisit its rate-making concepts. Also, if these costs are expensed, only existing customers would share in these costs as opposed to any new customers who will be actually utilizing the facilities to be built in the future.

Issue 3: Consideration should be given to consolidating the preliminary stage with the pre-acquisition stage as there is not a clear distinction between the two. Maintaining two separate stages would create greater uncertainty for operations personnel who would be making the decisions as to the status of the project. In Appendix A, paragraph 15, the AcSEC states that capitalizing certain preliminary stage costs, if specific conditions are met, requires establishment of capitalization criteria and the committee does not believe they could determine operational criteria that would be consistently and objectively applied. This is not a prudent reason for arbitrarily requiring that all costs be expensed.

Accounting for Costs Incurred

Issue 4: Duke Energy does not agree that general, administrative and overhead costs should be prohibited from capitalization. To the extent such costs can be reasonably attributed to a project, Duke Energy's position is that capitalization of such costs is appropriate. Based on guidance in paragraph 26 of the proposed SOP, the administrative and general costs embedded in a third party contractor's charges to an entity may be capitalized. This inconsistent treatment between third party contractors and internal overhead costs is not justified. Gas transmission companies are in the business of constructing and operating pipelines and have a wealth of knowledge that allow them to complete the construction and operation using their own manpower and expertise. The SOP proposes to encourage the use of third party, perhaps inferior capabilities, over the expertise currently in-house in order to receive a more favorable accounting treatment. AcSEC states in Appendix A, paragraph 12 that their conclusion regarding insourcing or outsourcing of administrative functions is based on the observation that costs of a similar nature should be treated similarly, yet they will allow these same costs to be capitalized as long as they are charged by a third party construction contractor. AcSEC also notes in Appendix A, paragraph 18 that depreciation is directly identifiable with the PP&E being constructed, and that an entity would be allowed to capitalize the rental cost of similar equipment if it did not utilize its own equipment. This same argument should apply to overhead costs. Third party contractors incur overhead costs, which are passed along to their customers and are capitalized in accordance with the proposed guidelines of this SOP. Internal overhead costs should be allowed the same treatment under the logic discussed in Appendix A, paragraph 18.

Issue 5: No comment

Issue 6: No comment

Issue 7: In many cases, such as gas pipelines, the cost of removal is an integral part of the capital cost of replacing the asset. For example, the ground must be excavated whether removing and replacing pipe or laying new pipe. The cost of these two actions is virtually the same. Why, in the case of replacement pipe, should the entire amount be expensed, but the whole cost be capitalized for new pipeline activities? The cost of removing utility property from service should be capitalized and depreciated over the estimated life of the asset. This method is consistent with the guidance outlined by SFAS 143, Asset Retirement Obligations, for legal obligations for retirement. Likewise, it is consistent with the treatment for regulated utilities. The FERC allows for recovery of the cost of removal of assets by permitting regulated entities to capitalize the cost and depreciate it over the estimated useful life of the asset.

Issue 8: No comment

Issue 9: No comment

Use of Inventory in Production of Internal-Use PP&E

Issue 10: No comment

PP&E-Type Assets Produced for Sale or Operating Lease

Issue 11: No comment

Component Accounting

Issue 12: Any depreciation method is only as good as the underlying estimates. Composite or group depreciation is a method that has long been recognized by GAAP, FERC and state utility commissions as an acceptable method for depreciating large groups of like assets such as those maintained by pipeline companies and electric generation utilities. If the average service life is correctly estimated, the impact on depreciation expense resulting from units with shorter than average lives will be offset by depreciation expense resulting from units with longer than average lives. By depreciating individual assets over their average life and taking the net book value of assets retired early to depreciation expense, depreciation expense is accelerated in the early years of the assets' lives is front end loaded. For example, a pipeline system is one earning asset eligible for rate recovery and return that is comprised of a complex set of parts. Revenues are generated by the system as a whole and are not affected by the day-to-day replacement of system components. AcSEC also states in Appendix A, paragraph 44, that "Control over PP&E may be reduced because detailed records may not be used." By the very nature of a gas pipeline, the level of detailed records maintained has no impact over the actual physical control of those assets. In addition, rates charged by the gas industry are generally developed using a cost-based rate-making methodology, with a portion of the cost of service representing depreciation based on the group method. For companies not currently following a component approach, the mandate of a component approach creates significant complexity, resulting in increased cost to the company and ratepayers, with little or no incremental benefit to the financial reporting.

Issue 13: A major component of regulatory rate-making is the allowance for a fair and equitable recovery of and return on a company's investment. This return is calculated with a formula that applies an entity's cost of capital to its rate base. As part of this regulatory process, the net book value of an asset retired is charged to accumulated depreciation, thus maintaining rate base at its level of investment. A charge of net book value to depreciation expense would reduce rate base thereby precluding a full return on investment and creating fluctuations in cost of service and earnings.

Issue 14: While the SOP acknowledges that other methods of depreciation may be acceptable, the required test involves actually depreciating assets both the prescribed way and the alternate way to make the determination that similar results are achieved. The substantial amount of effort required to do this on a regular basis ultimately precludes the use of an alternative method because of the duplicative work involved.

Issue 15: No comment

Issue 16: No comment

Issue 17: No comment

Issue 18: No comment

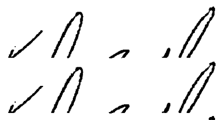
Issue 19: As stated in our comments to issue 12, Duke Energy does not support the inclusion of guidance on component accounting in the final pronouncement. In addition, Duke Energy is strongly opposed to restating prior years for purposes of this issue.

Additional General Comments

Duke Energy respectfully suggests that this topic is overly broad to be addressed in an AcSEC Statement of Position that is typically limited in scope and often tends to be industry specific. The guidance contained in this SOP results in a significant departure from current practices. As such, we believe that guidance on accounting for PP&E would be more appropriately addressed in an Exposure Draft issued by the FASB.

We appreciate the opportunity to provide comments to the Statement of Position and hope that our comments will be considered as deliberations on this proposed statement take place.

Sincerely,



Keith G. Butler

KGB/ENP/LRS

November 14, 2001

American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775
Attn: Marc Simon
Technical Manager, Accounting Standards

Re: File 4210.CC, Proposed AICPA Statement of Position (SOP), *Accounting for Certain Costs and Activities Related to Property, Plant and Equipment*

Dear Mr. Simon:

Reliant Resources is pleased to comment on the AICPA's June 29, 2001, Exposure Draft *Accounting for Certain Costs and Activities Related to Property, Plant and Equipment* (ED).

Reliant Resources is a diversified international energy services company, providing energy and energy services in North America and Western Europe. Reliant Resources invests in international and domestic electric utility privatizations, develops non-rate regulated power generation projects and engages in wholesale energy marketing and trading.

The scope of the ED appears to be appropriate and we commend the AICPA for their efforts on this project, as we concur with the project stage or timeline framework and that PP&E assets should be accounted for at a component level. As the AICPA expressly stated that it was interested in comments on issues outlined in the ED, we will frame our comments herein around the following:

- Issue 4: PP&E related costs incurred during the preacquisition, acquisition-or-construction, and in-service stages should be charged to expense unless costs are directly identifiable with the specific PP&E.

We believe that paragraph 28(b) and the related footnote number 7 are in conflict and appear inappropriate for power generation business.

During construction, generating facilities typically undergo testing prior to acceptance by the owner/operator. During the test period, the constructor controls how and when a unit runs. A normal function of testing a facility results in fuel being burned and power being generated. Typically this power is sold at spot and/or PURPA put prices on the grid due to the inability to accurately schedule power and/or reliably meet other contractual requirements.

In particular, paragraph 28(b) states that costs directly related to preproduction test runs can be capitalized but in footnote 7 states that PP&E is ready for its intended use when it is first capable of producing a unit of product.

Footnote 7 seems to negate the ability to capitalize the cost of preproduction test runs in a power generation environment as most testing in a power plant results in output. In addition, it implies that the facility is substantially complete once it produces the first megawatt and therefore subject to depreciation, the cessation of interest capitalization, etc.

Acceptance of a unit in general places the unit within the control of the owner and indicates a level of reliability that would permit the sale of the power to its intended customer or market. In many instances the recipient of the power prior to acceptance is not the ultimate customer who will receive the power or capacity, but rather a purchaser of last resort available to the owner. Also the mere fact that a unit of product has been produced does not lead to a presumption that the machine is substantially complete and ready for its intended use.

Until acceptance, events may result in numerous tests and retests over extended periods of time. This may cause the unit to run at levels that are inefficient, may require that the unit runs during non peak demand periods, and can result in many startups which can be very expensive. It may even result in the redesign of various components in order to meet its stated operating characteristics. With the inability to control the operations of the unit, it is very likely that the owner will incur losses during the early phases of the start-up even though power is being generated.

We recommend that the ED be revised to adequately address the above situation.

We appreciate the opportunity to comment on the ED and would be pleased to answer any questions about our comments.

Sincerely,

Kim Ousdahl
VP and Corporate Comptroller

November 15, 2001

Mr. Marc Simon
Technical Manager, Accounting Standards
File 4210.CC
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Exposure Draft – Proposed Statement of Position, "Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment"

Dear Mr. Simon:

Singing River Electric Power Association is an electrical distribution cooperative serving nearly 60,000 consumers. Our company was formed as a not-for-profit cooperative in 1938 to provide power to rural families that could not receive power at that time. We have continued to operate on a not-for-profit basis for over 60 years and strive to provide power to our members at the most economical and efficient rates. Our utility is a borrower from the Rural Utilities Service (RUS) and follows the accounting rules in the Uniform System of Accounts issued by RUS. The RUS Uniform System of Accounts is substantially similar to that of the Federal Energy Regulatory Commission (FERC).

This letter represents our company's response to the recently released exposure draft of a proposed AICPA Statement of Position (SOP), Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment, particularly as this SOP relates to utilities.

We have several areas of concern related to the possible adoption of the proposed SOP. The areas that we are addressing are by no means all-inclusive of our concerns, but hopefully, will give you an idea of the possible ramifications to utilities.

1. General ratemaking principles provide that a utility, with the approval of its regulator, defer or accelerate certain current-period costs in order to maintain level rates for the consumer. The current method of capitalization and depreciation provide for level recognition of the cost of plant over the service life of the plant and helps to stabilize the rate base for the consumer. The proposed SOP is inconsistent with the ratemaking practices for utilities. The adoption of such a rule would force utilities and their regulators to address this change in cost recognition and likely have an adverse affect on consumer

utility rates. For utilities already facing deregulation and fluctuating energy costs, ratemaking practices should not be driven by a change in accounting rules.

2. Capitalization criteria for utilities are well established and followed. In fact, most utility borrowings are based solely on the assets established through the capitalization process. To break this capitalization process into a timeline approach would create inconsistencies in the industry. Furthermore, a utility's timeline is much longer than one operating cycle. A utility typically has a 10-year work plan for construction, a 2-year work plan for construction and in the case of an electric utility, a 25-year power requirements study. It is not reasonable that costs previously capitalized and depreciated into the rate base are now all borne in one year. In other words, today's utility consumer will bear costs for which there is a 20 to 40 year future benefit.
3. When a business uses a contractor for plant construction, the costs of the plant placed in service is all-inclusive. Under the proposed SOP, a system such as our company, that self constructs assets would have restrictions on what general and administrative expenditures it could capitalize. A system that uses both contractor constructed assets and self-constructed assets will have inconsistencies in its own capitalized cost for similar assets. The proposed SOP should provide for consistent application between contractor and self-constructed assets.
4. Component accounting is the method used by most industries. This method was found to be unworkable in the utility industry. A utility has numerous assets of a similar nature that are combined under the group accounting method. An example of this would be a telephone or electric utility that has thousands of utility poles. The group accounting method provides a reasonable basis for the allocation of asset costs over their useful lives. The proposed SOP presumes that component accounting would provide more precise records. Because component accounting is already used in most industries, no improvement in precision will be seen. For those regulated industries using group accounting, any deemed gains in precision would not likely be offset by the additional costs of applying the component accounting method.

We appreciate the opportunity to provide comments on the PP&E proposal and respectfully urge the AICPA AcSEC to consider withdrawing this proposed SOP.

Sincerely,

Tammy Hultz, Controller
Singing River Electric Power Associaton

November 15, 2001

Mr. Marc Simon
Technical Manager, Accounting Standards, File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Mr. Simon:

This letter presents our firm's comments to the Exposure Draft (ED) of a proposed Statement of Position (SOP), "Accounting for Certain Costs and Activities Related to Property Plant Equipment". Our primary concerns with items in the ED are with how the proposed guidance will affect our clients in the utility industries.

Our firm has extensive experience in the telecommunications and electric utility industries — we currently serve as auditors and/or consultants for over 200 utilities. In our roles with our utility clients and in our association with other CPA firms with extensive utility practices, we have not observed the significant "diversity in accounting" cited in the ED. We feel current guidance and industry practice are adequate in the accounting for property, plant, and equipment (PP&E) costs and activities. In our opinion, the proposed SOP would provide little benefit and would place a significant administrative burden on utility entities.

Our comments related to specific issues addressed by the ED follow.

Issue 3

This issue deals with the timeline approach and the accounting for costs in the preliminary stage vs. after the transition to the preacquisition stage. As the Appendix B, Capitalization - Expense Matrix indicates, certain activities such as surveying, zoning, engineering and designing may occur in either stage. The SOP criteria provides for different accounting for such items depending on whether or not it is probable (at the time costs are incurred) that management will go forward with the project.

Our concerns with this are as follows:

1. The timeline approach focuses more on the timing of a decision than on the nature of the expenditure.

2. Introduces a subjective determination in "probable" that may not always be easily made.

3. Could lead to differing capitalized costs for similar PP&E as a result of when a decision is made.

The items we presented above could actually increase inconsistencies between entities in their accounting. This is contrary to the objective of the ED.

We feel it would be more appropriate to defer costs associated with the identified activities until the project decision is made. Then costs associated with the construction project would be capitalized and those related to an abandoned project would be expensed. We recognize that this approach could cause some issues when costs are expensed in periods other than when they are incurred. However, in our experience we have not seen this as a significant problem. We feel the potential problems the proposed guidance could create are more significant.

Issue 4

For the most part we concur with most of the ED proposals in this area. However, utilities have some costs that could be considered G&A costs that we believe should be capitalized rather than expensed. Utilities have plant supervisors who oversee the construction department. Because of the nature of the supervisors' work, it is not always possible to directly assign their efforts to specific projects. However, there are costs incurred that do relate to PP&E construction activities, and these costs should be capitalized.

We believe the ED should provide guidance on determining the link between such costs and construction projects to provide for capitalization. This should be done rather than simply expensing all administrative costs.

Issue 6

Our concern here is that there is no provision made for capitalizing amounts that are expended to extend the useful lives of assets. Any expenditure that extends the useful life of an asset should be capitalized and expensed over the period the expenditure benefits. We feel the guidance should provide for this.

Issue 7

For a utility, the cost of plant removal is a cost associated with providing service to its rate-paying customers. Utilities estimate these costs and incorporate them into the development of their depreciation rates. As a result, the cost of removing a plant asset is recognized over the useful life of the asset. At the end of the asset's life, the costs to remove the asset have been recovered from those customers benefiting from the use of the asset. We feel such accounting is appropriate for utilities. We do not agree with the ED's statement that costs of removal should be expensed as incurred.

Issue 12

This issue deals with the use of component accounting for PP&E and depreciation.

Component accounting is a method that most industries could use. However, with utilities, this could be done only with very significant additional costs. Utilities are very capital asset-intensive entities and own numerous assets of a similar nature. Utilities have employed group depreciation and composite life systems because of the cost-prohibitive nature of trying to track individual components. The group accounting methods used by utilities provide a rational and systematic basis for allocating costs over the useful lives of the assets. We have not seen the evidence that contradicts this.

Other comments on this issue:

1. While component accounting is more precise, we do not feel the depreciation differences our clients might see if the component accounting were used would be significant. The additional costs to switch to a new method would be significant.

2. Historically, the composite lives that utilities use are developed through the use of depreciation studies that consider factors such as establishing group asset subaccounts, weighting of items within a group, remaining lives, technological changes, and the adequacy of accumulated depreciation balances. The depreciation rates are reviewed periodically. We do not agree with the contention in the SOP that the composite approach conceals inaccurate estimates for long periods of time.

Issue 13

Group depreciation methods used by utilities provide for rational and systematic cost allocations. Since average service lives are used, it stands to reason that some assets are retired before the depreciation life is reached and some last longer. If these estimates are made with due care and reviewed periodically, the charges to expense and the plant net book values are reasonable. Tracking the net book values of individual components will not significantly improve the degree of accuracy of cost allocation, but most certainly will add significant costs to the accounting process.

Issue 14

For the most part, our response to this issue has been covered in Issue 12. We feel that the group methods used in the utility industries are reasonable and systematic cost allocation methods. Issue 14 states that group methods under the ED could be used only if they result in the same PP&E, depreciation expense, net book value, etc. as the required component accounting. In order to prove this, entities would have to convert their records anyway. This seems burdensome to us.

Issue 16

We feel that if the proposed changes are made, having alternatives for adoption is not the best approach. Our understanding is that the major reason for the proposed changes is a perception that there is diversity in accounting. To offer alternatives in the initial adoption does not help in dealing with any diversity.

Conclusion:

As we stated in our opening paragraphs, we have concerns with how this proposed guidance would affect utilities. We have not seen the diversity of accounting problem the ED addresses. We believe current guidance along with the established industry practices provide consistent cost capitalization and systematic and rational cost allocations to depreciation expense. We do not believe the proposed SOP provides significant benefits as compared to the costs that utilities would incur to implement changes.

We urge AcSEC to consider modifying or withdrawing the guidance in this proposed SOP.

Respectfully Submitted,

Olsen Thielen & Co., Ltd.

November 15, 2001

Mr. Marc Simon
Technical Manager, Accounting Standards
File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

RE: Comments on the Proposed Statement of Position (SOP), "Accounting for Certain Costs and Activities Related to Property, Plant, & Equipment."

Dear Mr. Simon:

Consolidated Edison, Inc. (the Company) appreciates the opportunity to comment on the exposure draft on proposed accounting rules for Property, Plant, & Equipment (PP&E). We are one of the nation's largest investor-owned energy companies with approximately $10 billion in annual revenues and $17 billion in assets. The Company provides a wide range of energy-related services and products to its customers through its regulated and unregulated subsidiaries.

The proposed SOP has two main proposals: 1) to standardize the diversity in practice concerning capitalizing project stage costs for eligible PP&E; and 2) to standardize the depreciation methodology used by all non-governmental entities for recovery of PP&E (component accounting).

The Company is greatly concerned that the AICPA's proposals will: 1) conflict with current state and federal regulatory accounting requirements; 2) result in no appreciable improvements in practice; and 3) that the costs of implementing the proposal will far exceed the benefits of applying it. The Company supports the positions taken by the Edison Electric Institute (EEI) and American Gas Association (AGA) and feels it necessary to emphasize several issues raised in their comment letters. We offer the following comments for consideration by the Accounting Standards Executive Committee (AcSEC).

Accounting for Costs Incurred – Preliminary stage costs

Issue #3 of the proposed SOP states that all costs incurred during the preliminary stage of a project should be charged to expense as incurred. The Company believes that the decision to capitalize or expense costs should not be based solely on the project stage. Capitalization based on the stage approach seems arbitrary. It is more appropriate for costs to be capitalized based on the activity performed and kinds of costs incurred.

Furthermore, the Company's rate-regulated utilities may be requested by various regulatory agencies to perform "preliminary engineering studies" to determine project feasibility. Rate regulated utilities are currently permitted to account for these costs by applying SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation." As a result, such costs are either deferred for future capitalization if a project is constructed or potentially treated as a regulatory asset for future rate treatment. Under this SOP, these costs would be expensed regardless of whether construction took place. This is contrary to regulatory accounting requirements and would

result in charges to earnings that otherwise would be deferred and capitalized as a component of construction costs. Based on the unique nature of rate-regulated utility operations, we would request that such companies be exempt from the application of this proposal if adopted.

Accounting for Costs Incurred – Overhead costs

Issue #4 of the proposed SOP states that most PP&E related costs incurred in the pre-acquisition, acquisition-or-construction, and in-service stages should be expensed unless directly identifiable to specific PP&E. We do not agree with this proposal and feel that rate-regulated utilities should be exempt from applying it. For the Company's capital-intensive rate-regulated utilities, these costs include administrative and general support (A&G), engineering, transportation related costs, and costs of maintaining inventory for construction. Such costs represent an integral part of the total cost of a capital project and are incurred to create assets that provide future benefit to customers. In order to ensure that only the appropriate overheads are capitalized, our rate-regulated utilities perform detailed studies to ensure that only the capital portion of such costs are applied to capital projects. This is standard industry practice supported by both the Federal Energy Regulatory Commission (FERC) and our state regulatory agency guidelines that permit utilities to capitalize such costs as indirect construction overheads. In 2000, the Company's rate-regulated utilities capitalized approximately $27 million in A&G costs. Similar to Issue #3, charging A&G costs to expense would result in charges to current earnings that otherwise would be capitalized and recovered from customers over the economic life of the asset.

Application of the proposed SOP would also create significant differences in the recognition of costs under Generally Accepted Accounting Principles (GAAP) compared with the accounting required for rate-regulated utilities. The Company accounts for its rate-regulated operations by applying SFAS No. 71. Under SFAS No. 71, rate-regulated utilities are permitted to capitalize for future recovery the overhead costs associated with a capital project. The proposed SOP would require that utilities establish a large number of additional regulatory assets and liabilities to account for the differences in GAAP and rate-regulated accounting mechanisms. This would require significant, additional record-keeping requirements since utilities would need to defer and track the differences between the SOP and regulatory accounting requirements. The costs of maintaining two sets of books to comply with both requirements would be significant and clearly outweigh any perceived benefits.

Lastly, this proposal seems biased in favor of independent contractors since it would permit 3rd party vendor costs to be capitalized fully during each stage of construction. Vendor costs contain the same overheads discussed above yet the accounting treatment appears different. It seems there is a bias away from self-construction because entities that perform their own construction would be required to expense most costs under this SOP while independent 3rd parties' costs for construction can be capitalized.

Accounting for Costs Incurred – Removal costs

Issue #7 of the proposed SOP states that costs of removal (COR) for assets should be charged to expense as incurred. We do not agree with this proposal. The Company accrues the COR through depreciation over the useful life of an asset. This practice should be allowed to continue. The proposed SOP would prevent COR from being capitalized unless the Company removed an existing asset for site preparation of newly acquired real estate. Additionally, the Company agrees with the EEI and AGA that this proposal seems in direct conflict with SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 requires that tangible assets with associated liabilities for removal should include the fair market value of the liability as part of the asset cost, with an offsetting entry to a liability account. The relationship between this proposed

SOP and SFAS No. 143 must be clarified before the AICPA moves ahead with this part of the proposed SOP.

Component Accounting

Issues #12, 13,and 14 of the proposed SOP deal with the implementation of component accounting. The main requirements of the component accounting issues are that if a component of PP&E has a different useful life than the PP&E itself, it should be depreciated or amortized separately; if existing PP&E is removed from service and the replacement is capitalized, the net book value of the replaced item should be charged to expense in that period; and depreciation should be based on individual identified components. Composite or group life depreciation methods are only acceptable to determine depreciation if they produce the same results for gross PP&E, depreciation expense, and accumulated depreciation as the component accounting method required by the proposed SOP.

The Company is strongly against these proposals believing that they are inappropriate for rate-regulated utilities, which should therefore be exempt from applying them. We offer several reasons to support this conclusion.

In response to issues #12 and 14, the Company's regulated utilities use a group depreciation method. The group depreciation method reflects a cost-based rate-making methodology that is supported by regulatory agencies that acknowledge the reliability of using this method. It is based on the use of statistical studies and empirical analysis to project the retirement of large amounts of individual assets by grouping them. Historically, the group depreciation method recognizes the fact that any estimate of annual depreciation yields more accurate results when it reflects the average behavior of a great number of units, rather than the behavior of individual units. It also recognizes the fact that the actual service life of one particular unit of a great many in a class of property is usually never the same as that of its counterparts. For instance, the Company maintains dozens of building-related accounts. Because of this detail, the Company is able to confidently rely on group depreciation for expensing fixed assets of similar nature. Component accounting would not improve this reliability and implementing this SOP would shift the emphasis from a reliable methodology to one that creates an inordinate amount of depreciation record keeping.

In response to issue #13, we submit that the Company's regulated utilities are provided the opportunity for fair and equitable recovery of their total investment in PP&E. One feature of this framework is that the net book value of retired PP&E is maintained in the utilities accumulated depreciation in order to maintain rate base at its level of investment and ensure recovery of all prudently incurred costs. Implementation of the proposed SOP would require an immediate charge to expense for the undepreciated book cost of a retired asset. This would result in large expenses for GAAP reporting purposes that currently remain in the accumulated reserve for depreciation for ratemaking purposes in accordance with SFAS No. 71. Under the proposed SOP, two sets of books would also be required to record and track the depreciation expense calculated under the proposed SOP versus the depreciation expense calculated under the group method for recovery in rates. Additional regulatory assets or liabilities would need to be created to account for these differences.

To further our argument against Issue #14, we note that the proposed SOP also allows for alternative methods of depreciation, if those methods yield similar results as component accounting. However, a company must implement component accounting to determine if the results are not materially different than their current depreciation method. Therefore, the proof required for continued use of current methods would be prohibitively expensive. We also point out that regardless of whether implementation of this proposal is required, rate-regulated utilities must continue to account for depreciation in accordance with regulatory guidelines.

As a general comment, the application of this SOP for component accounting would require the Company to estimate component accounting depreciation costs for millions of items and thousands of miles of cable. This individual component accounting is impractical and would obviously result in significant costs. These costs would include expanded staffing to deal with the additional information and reprogramming systems to capture and track this information. These additional costs would certainly outweigh the uncertain benefits that may result from this SOP. In addition, these costs would ultimately be paid by ratepayers, without a corresponding improvement in recording financial performance or utility service. We understand that the AcSEC is encouraging more detailed records for recording fixed assets. However, we also feel that the group depreciation method does not hinder or discourage this detail in any way.

Conclusion

The Company agrees with the positions of the EEI and AGA and would appreciate the AcSEC's careful consideration of these arguments before making any decision regarding this proposed SOP. The Company would like to see utility industry exemptions where requirements are overly onerous and provide little benefit.

Sincerely,

Edward J. Rasmussen

Mr. Marc Simon
Technical Manager, Accounting Standards
File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

RE: June 29, 2001 Exposure Draft, *Accounting for Certain Costs and Activities related to Property, Plant, and Equipment*

Dear Mr. Simon,

An adhoc Consortium made up of ALLTEL Corp., BellSouth Corp., Cincinnati Bell Telephone, Qwest Communications International, Inc., SBC Communications Inc., and Verizon Communications (hereafter referred to as the Consortium) wishes to comment on the June 29, 2001 exposure draft of the proposed Statement of Position, *Accounting for Certain Costs and Activities related to Property, Plant, and Equipment* (SOP). We are very concerned about the proposed component accounting requirements and that group depreciation is not offered as an alternative method for capital-intensive companies with large amounts of homogenous assets. We do not agree with some of the assumptions supporting component accounting and perceived shortcomings of group depreciation. The telecommunications industry has a long history of using group depreciation and we believe it meets the objectives of the Board without the massive administrative burden that component accounting would require.

We also believe the expensing of cost of removal is inconsistent with FASB Statement 143 and does not provide a proper matching of the removal costs to the periods that benefit from the asset.

Below are our more specific comments on these items. We believe the proposed SOP should be amended to include group accounting as an alternative method for depreciation and that current accounting methods described below for removal costs be continued.

General Comments

The AICPA's proposed SOP provides guidance on accounting for certain costs and activities related to property, plant and equipment ("PP&E") in financial statements prepared in conformity with generally accepted accounting principles. PP&E accounting practices are complex and require continuous detailed review of estimates and assumptions – particularly for asset-intensive companies like the Consortium members.

We understand that the scope of the SOP was expanded from certain costs associated with real estate outside the scope of FASB Statement No. 67 due to a perception by the AICPA that "diversity" in accounting exists for costs and activities associated with PP&E. Diversity is very different from abuse and misapplication of existing accounting standards. Companies' operations are different, due to industry, size, location and many other factors. Accounting standards to date have generally recognized the differences and provide higher-level guidance that allows for flexibility in meeting the goals of those standards.

The FASB Concepts Statements are excellent examples of such guidance. The AICPA and the FASB should refrain from prescribing specific methodology. Rather, if abuse or misapplication is noted then the issuance of an audit risk alert or additional interpretive guidance, either generally or specifically to one industry, would seem the more appropriate way to the address the problems.

AcSEC has defined the problem and has proposed one way to solve it. We suggest that there are issues and ramifications peculiar to different industries. Alternative solutions have been established, in many cases for decades, which indeed solve the problem at hand, without using the exact prescription that AcSEC suggests, and have received authoritative accounting industry and regulatory acceptance. Alternative methods of applying the concepts should be accepted by the AICPA and the FASB. Without recognition of industry differences, regulatory bodies, stock exchanges, institutional investors, professional investment

analysts, creditors, shareowners or the general investing public as well as the Companies themselves will have to spend additional time and resources to discover what is the true financial health of the company.

The Consortium does not support the proposed SOP in its current form. If the SOP is issued, we believe it must: 1) clarify the definition of support cost, 2) revise its position on cost of removal accounting, and 3) recognize that the group method of depreciation for PP&E, when appropriately applied, is a legitimate alternative for asset-intensive companies.

Comments on Specific Issues

Issue 4: The proposed SOP states that PP&E-related costs incurred during the preacquisition, acquisition-or-construction, and in-service stages should be charged to expense unless the costs are directly identifiable with the specific PP&E. Directly identifiable costs include only (a) incremental direct costs incurred with independent third parties for the specific PP&E, (b) employee payroll and payroll benefit-related costs related to time spent on specified activities performed by the entity during those stages, (c) depreciation of machinery and equipment used directly in the construction or installation of PP&E and incremental costs directly associated with the utilization of that machinery and equipment during the acquisition-or-construction stage, and (d) inventory (including spare parts) used directly in the construction or installation of PP&E. All general and administrative and overhead costs incurred, including all costs of support functions, should be charged to expense. See paragraphs 24, 25, 29, and 30. Do you agree with those conclusions? If not, what alternatives would you propose and why?

The Consortium agrees that general and administrative ("G&A") costs should be expensed as incurred, but we do not agree that "all costs of support functions" should be charged to expense. The Consortium members construct their own assets using centralized engineering groups that can support more than one function and/or multiple areas. These centralized staff costs are appropriately allocated between expense and capital.

The Consortium believes that the following accounting guidance for indirect and overhead costs in paragraph 7 of FASB Statement 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects*, is appropriate for PP&E:

> "Project costs clearly associated with the acquisition, development, and construction of a real estate project shall be capitalized as a cost of that project. Indirect project costs that relate to several projects shall be capitalized and allocated to the projects to which the costs relate. Indirect costs that do not clearly relate to projects under development or construction, including general and administrative expenses, shall be charged to expense as incurred."

The conclusion reached in the SOP that all support costs associated with PP&E should be expensed as incurred per the guidance in FASB Statement 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*, and SOP 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*, does not take into consideration the true nature of these costs and their relationship to the investment involved. In an industry with significant constructed assets, such as the telecommunications industry, significant support functions are required in order to engineer, construct/acquire and install assets. These centralized functions are a direct incremental cost of construction and would not exist without the construction activities. Often these functions reside in centralized environments for the sake of efficiencies of scope and scale. As such, these costs are allocated to the PP&E assets based on a consistent, systematic and cost effective process. The Consortium members have a long history of managing comprehensive construction programs and have procedures to address the allocation of costs. These processes have been codified and endorsed over decades by authoritative accounting bodies.

The Consortium does not suggest that a portion of all support costs be assigned to PP&E and does recognize that the type of cost assigned to PP&E assets should be limited to those support functions that can be directly associated with and are incremental to construction and installation activities. While it may

not be feasible to directly report these support salary costs to the PP&E construction projects and activities as they are incurred, the costs are just as much an incremental part of the PP&E assets as the cost of employees or contractors constructing/installing the assets. For example, specific centralized engineering staff functions provide direct support for multiple construction projects. These costs would appear at face value to be of a "general support" nature, but are actually an engineering activity that is in direct support of the acquisition/construction projects. Thus, a consistent, cost effective, systematic and rational allocation process should be used to associate the cost to the appropriate PP&E assets.

Issue 7: Paragraph 39 of the proposed SOP states that costs of removal, except for certain limited situation demolition costs, should be charged to expense as incurred. Do you agree with that conclusion? If not, what alternative would you propose and why?

The Consortium does not agree that cost of removal should be charged to expense as incurred. AcSEC bases its conclusion on "the observation that removal costs are the last costs in the life cycle of an asset and should remain associated with the removed asset rather than being capitalized into the cost of the replacement asset." Expensing removal costs as incurred is one method to prevent the capitalization of removal costs "into the cost of the replacement asset". However it is not the only solution. The Consortium supports a more appropriate method that ensures costs "remain associated with the removed asset"; that is, those costs should be included in the capitalization of the original asset, and expensed via depreciation during its useful life.

The telecommunications industry's approach does ensure that removal costs remain with the removed asset and are not "capitalized into the cost of the replacement asset." By including cost of removal of a given group of assets in depreciation calculations, telecommunications companies ratably recognize the costs associated with these assets over their useful lives. As a result, the liability for future costs of removal is embedded in accumulated depreciation. When the assets are actually retired and removal costs are incurred, these costs are recorded as a reduction to accumulated depreciation. This methodology ensures that the cost of removal remains associated with the asset to be removed, and that the cost of the asset is adequately recognized over the asset's life.

The Consortium recommends that the approach used today of including cost of removal in the group depreciation methodology be allowed to continue. ARB 43 (Chapter 9C, paragraph 5) indicates that depreciation "... aims to distribute the cost or other basic value of tangible capital assets, less salvage (if any), over the estimated useful life of the unit (which may be a group of assets) in a systematic and rational manner. It is a process of allocation, not of valuation." For the telecommunications industry, this is best accomplished by including both gross salvage and cost of removal in the depreciation process.

The Consortium's current method for cost of removal accounting works well with the group depreciation approach used by the telecommunications industry. As described in the Consortium's comments on Issue 14 for the group depreciation method, an estimate is made of the useful life of a group of homogeneous asset units; similarly, future net salvage (salvage less cost of removal) is estimated for this group of homogeneous assets. Expensing removal costs for each item is contrary to these fundamental group methodology principles. The Consortium members review and reset future net salvage estimates as appropriate when new depreciation rates are established.

An advantage of including cost of removal in the depreciation process is that it helps ensure that the costs associated with the asset correspond to the asset's useful life. This meets the GAAP specification that, "some expenses, such as depreciation ... are allocated by systematic and rational procedures to the periods during which the related assets are expected to provide benefits" (Concepts Statement 5, par. 86). Expensing removal costs in the current period disassociates these asset-related costs from the period during which the asset lives. AcSEC's proposed solution would therefore result in the opposite result of its stated intent. Including cost of removal in the depreciation calculations, as the telecommunications industry generally does today, ensures that asset-related costs correspond to the asset's useful life.

The Consortium does not suggest that its own practice is the only solution or even the best solution for *all* circumstances, but we do assert that it is the correct solution for these circumstances. AcSEC should therefore find that the telecommunication's industry practice is an acceptable solution, if not in every case, at least under specific conditions.

A second point should be noted in that this SOP is not in agreement with SFAS No. 143. The issue of taking cost of removal out of the depreciation process was dealt with recently in Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations", issued in June 2001. This standard states (page 15, paragraph 11), "Upon initial recognition of a liability for an asset retirement obligation, an entity shall capitalize an asset retirement cost by increasing the carrying amount of the related long-lived asset by the same amount as the liability. An entity shall subsequently allocate that asset retirement cost to expense using a systematic and rational manner over its useful life." The standard makes it clear (page 10, paragraph 2) that "This Statement applies to legal obligations associated with the retirement of a tangible long-lived asset that result from the acquisition, construction, or development and (or) the normal operation of a long-lived asset...." As used in this Statement, "a legal obligation is an obligation that a party is required to settle as a result of an existing or enacted law, statute, ordinance, or written or oral contract or by legal construction of a contract under the doctrine or promissory estoppel." This is obviously a different treatment for cost of removal than that specified in this proposed SOP. Therefore, it appears that for those companies for whom Statement of Financial Accounting Standards No. 143 applies, there is a conflict with the proposed SOP.

Issue 12: Paragraphs 49 through 56 of the proposed SOP discuss component accounting and state that if a component has an expected useful life that differs from the expected useful life of the PP&E asset to which it relates, the component should be accounted for separately and depreciated or amortized over its separate expected useful life. Do you agree with this approach to accounting for PP&E? If not, what alternative would you propose and why?

We agree with the general concept that PP&E with different expected useful lives should be accounted for separately and depreciated over the appropriate useful life. This is the current practice in the telecommunications industry where PP&E is divided into homogenous groupings for depreciation purposes. However, we are concerned that the proposed SOP sets a standard that is too narrow for practical application. For example, in its extreme, the proposed SOP could require different depreciation schedules for the various engine components and the body of an automobile. The proposed SOP should recognize that group depreciation is practiced by many capital-intensive industries, such as the telecommunications industry, and is an alternative form of component accounting. Applying depreciation at a component level to a group of assets that have a similar expected useful life significantly increases the administrative burden with little, if any, improvement in the expense allocation.

In the telecommunications industry, there is a long established practice of using group depreciation to determine an appropriate expense allocation based on the useful life of the group. The Consortium uses group depreciation because the tremendous number of asset records makes it impractical to do otherwise. The Consortium currently has millions of property record units and billions of dollars of investment in its telecommunications operations.

Under the group depreciation approach, assets are separated into groups of homogeneous assets that are similar in character, used in the same manner, operated under the same general conditions, and have similar expected lives. The Consortium members' chief assets are their telecommunications networks, which are made up of switches, transmission equipment, cables, etc. For each asset group or component type, each Consortium Company determines the appropriate depreciation expense based on a group specific expected useful life estimate. For example digital switches have depreciable lives and depreciation rates that are separately determined from the depreciable lives and depreciation rates of digital transmission equipment. Each entity typically has 30 to 40 depreciation life categories.

The Companies develop separate lives and depreciation rates for each asset class because that is a reasonable, practical, effective and appropriate grouping of homogenous assets with similar use and similar

lives. Attempting to assign an individual life and depreciation rate beyond this level, for example, to each telephone pole, would provide little, if any, benefit. The determination of the useful lives used to develop depreciation rates for each of its asset groups is a very detailed, methodical, and thorough process which reviews network modernization and deployment plans, changes in technology, the impact of competition, historical mortality data, industry studies, corporate strategy, and regulatory commitments.

Although all Consortium members have not estimated the conversion cost of moving to component accounting, we are very concerned about the on-going systems and administrative costs of calculating depreciation expense for tens of millions of additional detailed records. We do not believe this proposal meets the criteria stated by the FASB on page 12 of the proposed SOP, "the benefits of the proposal are expected to exceed the costs of applying it". Moving to component accounting for all PP&E would be unproductive and tremendously costly for the Consortium members and other companies in the telecommunications industry. For example, the proposed SOP uses buildings as a good example of component accounting. The typical Consortium member has thousands of buildings spread over a wide geographic area. Subdividing each building into many components and establishing specific expected useful lives for each component would be an incredibly costly undertaking. And when completed, it would require a sizable staff to track the activity and maintain the database. In the end, we do not see how all this effort would create a better matching of expense to asset life than the current process.

In addition, the Consortium believes the component depreciation in the proposed SOP would not add the desired precision to the depreciation process. In Issue 14 we describe what we believe are the shortcoming of depreciation at the component level when applied to large asset bases of homogenous units. Depreciation at the component level should not be mandatory. Other depreciation methods are just as accurate or may be more accurate without the large administrative burden required by component depreciation.

Issue 13: Paragraphs 38 and 51 of the proposed SOP state that when existing PP&E is replaced or otherwise removed from service and the replacement is capitalized, the net book value of the replaced PP&E should be charged to depreciation expense in the period of replacement. Do you agree with this approach to accounting for PP&E? If not, what alternative would you propose and why?

Under component accounting, we would agree with this approach. However, this immediate charge to expense is inconsistent with group accounting and not necessary to ensure proper expense recognition for large groups of homogeneous assets with similar expected useful lives. The immediate charge to expense should be limited to unit depreciation and recognition should be given to alternative methods that provide a reasonable, consistent allocation of expense to periods. As described in Issue 14 comments below, group depreciation is an alternative method that achieves results consistent with paragraphs 38 and 51 by charging accumulated depreciation rather than the expense account.

Issue 14: The proposed SOP requires the use of component accounting to depreciate identified components over their respective expected useful life. As noted in paragraph A48 of the proposed SOP, entities have developed and utilized various conventions to depreciate assets, including group depreciation or use of composite lives. Those conventions are acceptable only if they result in approximately the same gross PP&E, depreciation expense, accumulated depreciation, and gain or losses on disposals of PP&E as the component accounting method required by this proposed SOP. Do you agree with this approach? If not, what alternative would you propose and why?

The proposed SOP assumes that component accounting will always give the most accurate accounting of PP&E. The Consortium disagrees with this premise. For companies with a limited number of assets with wide ranging expected useful lives, this approach may provide a better matching than a simple composite life approach. However, for companies like the Consortium members, with a large number of assets, the component approach would create record keeping far more detailed than what is needed to effectively manage the business. The expense associated with this additional administrative burden would exceed any

possible benefit from the "better" information, especially in asset categories with large numbers of homogeneous units with similar expected useful lives. In those cases, the additional detail may generate less accurate information than intended. In our comments below on paragraph A44 we explain this concern.

In the telecommunications industry and many other industries, there is a long-standing practice of using group accounting to depreciate PP&E. Group depreciation is a method that depreciates a group of homogeneous units of plant, which are alike in character, used in the same manner in a limited service territory and operated under the same general conditions. There are many refinements of the basic process, for example, Vintage Group (VG), Equal Life Group (ELG) and Remaining Life, that minimize the administrative burden and still provide a high degree of matching expense recognition with the useful life. For instance, Equal Life Group depreciation is also known as unit summation depreciation, because it will result in the same depreciation expense as the sum of the straight-line depreciation expense for all units with individual life estimates.

The AcSEC states that it considered composite depreciation as an alternative to component accounting and chose component accounting for a number of reasons. We disagree with this conclusion. We believe group depreciation is a good substitute for component accounting and should be considered as an alternative method. When PP&E is homogeneous and has a reasonable expectation of a similar useful life, group depreciation is equivalent to component accounting with significantly less administrative burden. When group depreciation is combined with other grouping methodologies like ELG and Remaining Life, the matching of expense to useful life is superior to component accounting. Attachment One provides an example and description of ELG. For large telecommunications companies with tens of millions of plant records in many asset categories, the additional detail required by component accounting would create a tremendous administrative burden for marginal improvements, at best, in expense allocation. The Consortium members have been using group depreciation for decades and methods such as ELG and Remaining Life since the early eighties with consistent, good results.

We would like to review and express our concerns regarding the points raised in paragraph A44 from the perspective of a telecommunications company with tens of millions of detailed PP&E records. We suspect that other industries with large investments in homogeneous assets would have the same general concerns.

"AcSEC considered composite depreciation as an alternative to component accounting. Composite depreciation is defined as a process of averaging the service life of a number of property units and taking depreciation on the entire lot as if it were an operating unit. AcSEC chose component accounting rather than the composite method for a number of reasons:"

"a. Component accounting more precisely allocates the cost of PP&E to the periods benefited by that PP&E"

Whether or not the allocation of the cost matches the actual use of the asset is more a function of the estimate of the useful life than the cost allocation method. For example, in the telecommunications industry, each company has hundreds of thousands of telephone poles. Experience shows that not all poles will have the same life; some will be retired prematurely because of storms, automobile accidents, road relocations, etc. and some poles may have a useful life that far exceeds the expected useful life. Under the proposed SOP, the telephone pole that is retired early, for whatever reason, is underdepreciated and in the year of the retirement the company would take an expense charge for the remaining net book value. If the pole's actual life exceeds the estimated useful life, the investment would be fully accrued and the company would have no expense allocation for the additional years the asset is still in service and productive. While one solution is different lives for different poles, the company has no way of reasonably determining which telephone pole will have the short life and which will have the long life.

Telecommunications companies typically use actuarial methods to develop a reasonable estimate of the useful life for all poles within an operating unit. This is no different than the actuarial principles used in the insurance industry or in pension accrual calculations. This expected useful life estimate recognizes that some telephone poles will be prematurely retired and some telephone poles will have longer than expected

lives. However, most telephone poles will have a useful life close to the actuarially based estimate. Since the company periodically updates the expected useful life, this process will result in an expense allocation that mirrors the company's total activity. To develop the actuarially based expected useful life, the companies typically maintain detailed databases of mortality experience.

"b. A composite life may not be determined with a high degree of precision and may not reflect the weighted average useful lives of the PP&E asset's principal components."

Although this may be true for assets dissimilar in character and usage, for homogeneous assets with the same general usage and life expectations, a grouping methodology using actuarial methods may result in a better expected useful life and expense allocation as shown in the pole example above. It is difficult, if not impossible, to determine the precise life of an individual telephone pole or any individual asset. But, because telephone poles are used in the same manner under the same general conditions a reliable expected useful life estimate can be made for the group. The telecommunications companies typically have hundreds of thousands of telephone poles with thousands installed and retired each year. By tracking the mortality data for this activity, a telecommunications company can make an estimate of the group's expected useful life that will be better than any estimated life of any individual pole. In short, individual expected useful lives will almost always be wrong, but the estimated useful life of the group may be very precise.

"c. The composite approach may conceal inaccurate estimates of expected useful life for long periods."

Both composite and component methods may conceal inaccurate estimates of the expected useful life if the assets are long lived. For example, telephone poles, which are typically expected to have useful life of thirty years or longer, will normally have low replacement rates the first third of their life. If the actual useful life is forty years, it would probably take ten plus years before variances are significant enough to signal the expected useful life is incorrect under the proposed SOP. However, under group accounting, companies periodically review the accounting activity for the group. Variances in the expected accruals and accumulated depreciation are detectable and changes in the useful life can be made if necessary. The Consortium members typically review the useful life estimate annually.

"d. By not recognizing gains or losses, the approach may not correct for changes in asset usage or other factors affecting actual useful lives as compared to expected useful lives."

In the telephone industry, this potential problem with group accounting was recognized decades ago. For many years, the problem was corrected via the triennial review process with governing state and federal agencies. Although the process of periodic reviews of useful lives continues, in the early 1980s the process was supplemented with the adoption of Remaining Life in most companies. Remaining Life includes the accumulated depreciation in the development of the accrual rate, which provides a self-correcting mechanism that adjusts the accrual rate to accommodate changes in the actual and expected useful life. As a result, a PP&E category with a large number of homogeneous units with constant additions of new plant and retirements of old plant would see an expense recognition pattern in each period very comparable to the expense pattern recognizing gains and losses. If ELG were also used, there would be almost exact matching in the aggregate. In the unlikely case that a company would incur an extraordinary event, group accounting does allow extraordinary treatment of the event and the recognition of a gain or loss.

"e. Control over PP&E may be reduced because detailed records may not be used."

Neither component nor composite depreciation relieves a company from maintaining a reasonable level of accounting detail. In our industry, as with many other capital-intensive industries, there are regulatory oversight requirements that require a certain level of accounting detail. Most telecommunications companies capitalize components of assets at a detailed level that results in millions of continuing property records. When a component is replaced, the previously capitalized component is retired and the new component is capitalized. Adopting component depreciation would not change these requirements.

However, there would be tremendous costs to calculate and record depreciation at this level. We believe this additional detail would not generate any substantial benefit to management or the financial community to offset the additional administrative cost. To mitigate the administrative burden, companies may be forced to increase the capitalization threshold of a property record. This may result in less accounting detail under component accounting than group depreciation.

"f. If individual property units become idle, depreciation on those idle units may not be determined with the same precision as if those units were depreciated individually."

The term idle asset has different meanings in different industries. In most, we assume that any periods of idleness are incorporated into the expected useful life. In the telecommunications industry, this is not an issue. PP&E that is idle is held in special accounts until it is returned to productive use. The assets that typically fall into this category are so small they have no impact on any expected useful life for any asset group. Under component or group accounting the impact of any idle plant would not change the expected useful life or any calculation of depreciation expense.

We would like to thank you for the opportunity to respond to the proposed SOP, to express our concerns, and for giving our comments due consideration.

ALLTEL Corp.
David Gatewood
Controller

BellSouth Corp.
W. Patrick Shannon
Vice President, Finance and Supply Chain Services

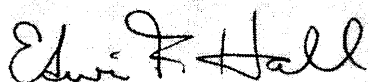
Cincinnati Bell Telephone
Gary Cornett
Controller

Qwest Communications International, Inc.
Mark Schumacher
Vice President and Controller

SBC Communications Inc.
Peter A. Ritcher
Vice President and Controller

Verizon Communications
Edwin Hall
Vice President

Signed on Behalf of the Consortium Members



Vice President, Verizon Communications

Attachment One – Equal Life Group Example

To understand the Equal Life Group (ELG) methodology, one first needs to understand a few basic concepts of actuarial life analysis. Actuarial analysis is the process of using statistics and probability to describe the retirement history of property. The process is used as a basis for estimating the probable future life characteristics of a group of property. However, this estimate must be refined to reflect the impact of variables such as technology, network deployment plans, or market dynamics which may not be embedded in the historical mortality experience. To perform this actuarial analysis, telecommunications companies typically used the historical data in the Continuing Property Records (CPR). From this detailed data, mortality tables that stratify the investment within a plant category by age (vintage) and proportion surviving (amount of original investment that has survived retirement) are developed. The CPR data also allows the calculation of a survivor curve, which depicts the expected pattern of future retirements based on the historical experience of the group.

Under the straight-line method of depreciation accounting, the book investment, less its net salvage, is depreciated over the average service life of the property in the group. The average service life is estimated by blending past experience with forecasts of the future. The blending process in the telecommunication industry is the generation arrangement. In the generation arrangement, the past experience is the vintage investment and proportion surviving from the CPR data. The future is the remaining life developed from a projection life (an estimate of the expected useful life of newly placed plant) and the survivor curve. For each vintage an average service and remaining life is calculated and then the vintage results are weighted to develop an average service and remaining life for the entire category. This process of grouping the investment by age is called Vintage Group (VG). If the asset category is a homogenous group of plant, the process will generate a very good estimate of the expected useful life of the group and the expected retirement pattern of the assets within the group.

VG was designed to charge to depreciation expense the cost of property installed in a single year (vintage) over the property's useful life. Under VG an average percentage rate is applied annually to the surviving plant investment throughout the life of the vintage. The total cost of the vintage is fully allocated to expense when the last surviving unit in the vintage is retired. Equal Life Group (ELG) is a refinement of VG where the vintages are subdivided using the survivor curve into subgroups having equal probable lives. ELG is designed to charge to depreciation expense the investment in each equal life group by the time each group is completely retired. For example, under ELG, if a group has a probable life of three years, the original capital cost is allocated over three years; if the probable life is ten years, the original cost is allocated over ten years.

The following example illustrates the use of the ELG methodology in determining the appropriate depreciation expense for a homogeneous group of assets. Assume the asset group has 100,000 units with an expected useful life of 15 years. Salvage and cost of removal is assumed to be zero for simplicity. Based on an appropriate survivor curve, Column B reflects the number of units still in service at the end of each year. Subtracting the ending balance from the previous year ending balance, Column C, shows the expected retirements; that is, in year three 1,638 units, in year ten 4,480 units, etc. Note that roughly half of the units retire in less than the 15 years and some units survive up to nine years longer than the expected useful life. For the proper depreciation of all investment in all units, the amount of investment (Column C) for each vintage should be allocated over the expected useful life (Column A). For example, for year three 1,638 units with an investment of $1,638 (1,638 units times $1) should be allocated over the three-year useful life. Columns D through AB show the straight-line allocation of expense for each year. Column AC shows that over all years (the sum of columns D through AB) all vintages are fully depreciated. The total depreciation expense for any year (columns D through AB) is the summary of the expense allocation for each vintage. For example, the total depreciation expense for year three would be $546 + $513 + $495 + … + $332 = $8,244.

The ELG methodology takes the expected depreciation expense for each year and investment weights it to determine an average remaining life for the group of assets. The average remaining life is then used to

develop a depreciation rate that will ensure the depreciation accrual will match the expected expense (i.e. $8,244 for year three).

SOP PP&E
ELG Example

Number of units 100,000
Cost per unit 1
GS 0
CR 0
Expected Useful Life 15

		Amount	Expense Year																								Total
Year	Amount in Service	Retired During Year	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	Allocated Expense
A	B	C	D	E	F	G	H	I	J	K	L	M	N	O	P	Q	R	S	T	U	V	W	X	Y	Z	AA	AB	AC
0	100,000	294	294																									294
1	99,706	860	860																									860
2	98,846	1,240	620	620																								1,240
3	97,606	1,638	546	546	546																							1,638
4	95,968	2,052	513	513	513	513																						2,052
5	93,916	2,475	495	495	495	495	495																					2,475
6	91,441	2,898	483	483	483	483	483	483																				2,898
7	88,543	3,325	475	475	475	475	475	475	475																			3,325
8	85,218	3,728	466	466	466	466	466	466	466	466																		3,728
9	81,490	4,122	458	458	458	458	458	458	458	458	458																	4,122
10	77,368	4,480	448	448	448	448	448	448	448	448	448	448																4,480
11	72,888	4,796	436	436	436	436	436	436	436	436	436	436	436															4,796
12	68,092	5,052	421	421	421	421	421	421	421	421	421	421	421	421														5,052
13	63,040	5,265	405	405	405	405	405	405	405	405	405	405	405	405	405													5,265
14	57,775	5,390	385	385	385	385	385	385	385	385	385	385	385	385	385	385												5,390
15	52,385	5,445	363	363	363	363	363	363	363	363	363	363	363	363	363	363	363											5,445
16	46,940	5,408	338	338	338	338	338	338	338	338	338	338	338	338	338	338	338	338										5,408
17	41,532	5,304	312	312	312	312	312	312	312	312	312	312	312	312	312	312	312	312	312									5,304
18	36,228	5,094	283	283	283	283	283	283	283	283	283	283	283	283	283	283	283	283	283	283								5,094
19	31,134	4,826	254	254	254	254	254	254	254	254	254	254	254	254	254	254	254	254	254	254	254							4,826
20	26,308	4,480	224	224	224	224	224	224	224	224	224	224	224	224	224	224	224	224	224	224	224	224						4,480
21	21,828	4,074	194	194	194	194	194	194	194	194	194	194	194	194	194	194	194	194	194	194	194	194	194					4,074
22	17,754	3,630	165	165	165	165	165	165	165	165	165	165	165	165	165	165	165	165	165	165	165	165	165	165				3,630
23	14,124	3,151	137	137	137	137	137	137	137	137	137	137	137	137	137	137	137	137	137	137	137	137	137	137	137			3,151
24	10,973	2,664	111	111	111	111	111	111	111	111	111	111	111	111	111	111	111	111	111	111	111	111	111	111	111	111		2,664
25	8,309	8,309	332	332	332	332	332	332	332	332	332	332	332	332	332	332	332	332	332	332	332	332	332	332	332	332	332	8,309
		100,000	10,018	8,864	8,244	7,698	7,185	6,690	6,207	5,732	5,266	4,808	4,360	3,924	3,503	3,098	2,713	2,350	2,012	1,700	1,417	1,163	939	745	580	443	332	100,000

Note: The 8,309 units surviving (column B) in year 25 are the sum of several years. Typically a survivor curve trails off slowly. The curve in this example was truncated at 25 years for simplicity.

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November 15, 2001

Marc Simon, Technical Standards, Accounting Standards, File 4210.CC
AICPA
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Dear Sir:

Re: Proposed Statement of Position: Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment

Enbridge Inc. is pleased to submit our comments on the exposure draft of the proposed Statement of Position (SOP).

Enbridge Inc. is a NYSE-listed Canadian energy company with pipeline and utility operations primarily in Canada and the U.S. Enbridge Inc. could be affected by the guidance in the proposed SOP in several ways. First, we hold a general partner interest in a limited partnership that must prepare financial statements in accordance with U.S. GAAP. This partnership is a U.S. pipeline operation listed on the NYSE. Second, we must reconcile our Canadian GAAP financial statements to U.S. GAAP for filing with the SEC. The guidance in the proposed SOP would create large differences between accounting standards in Canada and the U.S. Third, this exposure draft runs counter to the trend toward harmonization of accounting standards internationally. Lastly, the proposals are contrary to methods accepted by regulators for rate-making purposes.

We are pleased to provide the following comments on some of the specific issues identified in the exposure draft. The paragraphs are numbered to correspond with the issues in the proposed SOP.

2. We do not agree with characterizing costs based on a time line framework. We believe that this approach may increase the subjectivity in determining whether a cost should be capitalized or expensed as incurred. This approach is arbitrary and could create diversity in practice. For example, one company may consider a project to be in the preliminary stage whereas evaluation criteria adopted by another company might classify the same project in the pre-acquisition stage. Thus

one company would consider certain costs eligible for capitalization whereas the other company would expense the costs as incurred. We believe that it is more appropriate to classify costs as capital or expense based on the nature of the costs.

3. As indicated in the previous comment, we do not agree with characterizing costs based on the stage of completion of the underlying project. Rather we believe that costs should be characterized based on their nature. Some costs incurred during the preliminary stage, such as engineering costs, may meet the definition of assets and should be capitalized.

4. We do not agree with the proposed requirement that all general and administrative costs and overhead be charged to expense as incurred. We believe that this requirement would introduce a bias against internally constructed PP&E. Costs incurred with third parties include a charge for general and administrative costs and overhead. These costs would be eligible for capitalization under the proposed SOP. However, costs of this nature incurred internally would always be expensed. In an industry where internal expertise in PP&E construction is valued as generally the most efficient means of developing new PP&E, the SOP is unfairly punitive.

   We suggest that companies constructing PP&E using internally developed expertise be permitted to capitalize the costs of related general and administrative expenses and overhead. This would lead to equal accounting treatment of PP&E constructed using external and internal expertise.

6. We disagree. We suggest that costs incurred for betterments should be capitalized to the extent that the costs enhance service potential.

7. FAS 143 requires accrual of the costs of asset retirement and capitalization of these costs as part of the carrying amount of the asset. The SOP would require these costs to be expensed as incurred. We are unsure of how the SOP would interact with FAS 143.

12. We disagree with the proposed use of component accounting. Because of the massive numbers of components that make up our PP&E, the cost of component accounting would be excessive. Any improvements in the quality of financial information realized by adopting component accounting would be very small and would not justify the costs. Grouping homogenous items and depreciating them at an average rate provides financial information that is probably not significantly different from that which would be generated using component accounting.

13. We disagree because, using an average depreciation rate for a group of homogenous items will likely produce similar balances, including depreciation expense, as calculating and charging any remaining net book value of replaced items to depreciation expense. For example, if a group of items has an average useful life of five years, not all of the items will last the full five years. However, some of the items will last longer than five years. Charging the undepreciated value of items replaced early to depreciation expense does not add meaningful

financial information. It would create volatility in depreciation expense where there is no real volatility in the underlying asset group and thus reduce the predictive value of the financial information. In addition, the use of regular depreciation studies validates the estimate of the useful life of each group of assets.

14. We disagree with allowing group depreciation or composite lives only if it results in approximately the same balances as the component accounting method. We are unsure of how we could determine whether our current methods of calculating and tracking these balances would result in the same balances as the component accounting method except by recalculating all of our balances using the component accounting method. As noted above, the cost of gathering and analyzing all the data needed to perform this exercise would be prohibitive. Thus providing this alternative does not mitigate the extreme impracticality of component accounting.

    Given the large volumes of similar items that make up the PP&E in the pipeline and utility industries, it makes sense to use group depreciation methods. Also, these methods are accepted by regulators, such as the FERC, who prescribe methods of accounting for companies in these industries.

16. For capital intensive industries, identifying and valuing all components on the date of adoption would be extremely costly because of the large number of components that would have to be identified and valued. Therefore retroactive adoption is not feasible.

Enbridge is a member of the American Gas Association and we support the issues raised in their letter regarding the proposed SOP. Further, it is our belief that the component accounting method described in the SOP would be very costly and that the benefits of adopting this method would not justify the costs. We question the need to change current standards as it is our opinion that financial information regarding costs and activities related to PP&E is generally good. We do not believe that the guidance proposed in the exposure draft will significantly improve the management estimates used to calculate depreciation expense nor the financial disclosures of most entities.

Enbridge appreciates the opportunity to be involved in the standard setting process. If you required further clarification of the issues raised in our comments, please do not hesitate to call me.

Sincerely,

Karyn A. Brooks
Vice President & Controller

Marc Simon
Technical Manager, Accounting Standards
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Subject: Comments Regarding AcSEC Proposed SOP, "Accounting for Certain Costs and Activities related to Property, Plant, and Equipment".

Dear Mr. Simon:

Thank you for the opportunity to express our concerns regarding the Exposure Draft for the Proposed Statement of Position, "Accounting for Certain Costs and Activities Related to Property, Plant and Equipment".

We prepared our response to the SOP in 2 sections: Section 1 contains our general comments on issues raised by the Proposed SOP. Section 2 contains responses to the specific questions contained in the exposure draft. Our comments in Section 2 are in *Ariel font #12,* while the draft text is in Book Antiqua font #10. We would like to draw particular attention to our responses to issues 2, 4, 8, 12, 13, 14, and 16.

Section 1

A. Capitalization Rules

What should be capitalized?

We believe that the costs incurred for the self-construction of assets should be capitalized on a full cost rather than an incremental direct cost basis. The incremental concept applies over a relatively narrow relevant range. Approximately 30% of our operational activity is for the construction of capital assets. Because of the importance of self-constructed activity, the labor cost of many additional employees that are hired for capital projects would be expensed under this Proposed SOP. The incremental direct cost concept fails to acknowledge the large amount of labor investment we have committed to the self construction of capital assets and cause legitimate capitalizable costs to be charged to General and Administrative expense. This would add to earnings volatility and / or render a basic mismatching of revenues with expenses due to reporting capital costs as if they were current expenses.

The Proposed SOP penalizes companies that construct their fixed assets. If the choice is between making and purchasing fixed assets, the cost should almost always be less expensive to make the assets, even including the allocation of overhead charges. A normal purchase price would include all the overhead items that this SOP excludes, plus an additional profit margin if assets were purchased from a third party contractor. This argument is distinct from the argument that the accounting profession model is moving toward adopting "fair value reporting". Moving from a full cost concept to a direct incremental costing is reversing the trend toward valuing the balance sheet at fair value.

In addition, the Proposed SOP contradicts the capital cost guidelines issued by regulators. These guidelines are an integral part of the ratemaking process. A major tenet of the regulatory ratemaking framework is the allowance for a return on investment. The return is calculated from a formula that applies a measure of an entity's cost of capital to rate base. Some of the costs incurred during the preliminary stage or that would be expensed to G&A per this Proposed SOP, would be capitalized for regulatory accounting purposes. The resulting difference could force us to create and maintain two alternate sets of books for regulatory reporting and for financial reporting under this new Proposed SOP.

Is it true that only the incremental direct costs listed would be allowed to be capitalized? If this is true, we could no longer capitalize interest as is currently allowed. The omission of interest capitalization causes the Proposed SOP to be inconsistent with current accounting standards.

Furthermore, this Proposed SOP is inconsistent with the new SFAS 143, "Accounting for Retirement Obligations", whereby, if a company has a legal liability, the liability must be capitalized.

When it should be capitalized?

Because the utility industry devotes a significant amount of operations to the construction of Capital Assets, the nature of the costs should be considered instead of the timing of when they occur. We do not always have a string of various isolated projects whereby each project is evaluated individually on its own merits. The timing of when a project is classified as preliminary or pre-acquisition may be very arbitrary or subjective since similar types of costs may be incurred in either stage. It would not be cost beneficial to develop the additional data identification systems to capture the timing of expenses in the preliminary stage separately from when they occur in the pre-acquisition stage.

If, however, we are forced to adopt the SOP, we would prefer to use the project stage boundary between the preliminary and pre-acquisition to be when the work is budgeted.

Impact of Component Reporting

As far as the issue of component reporting, we report based on retirement units that are very similar to components. As such, we have over 700,000 line items of specific capital assets. Most of these assets would fit well under the component concept. However, it would be virtually impossible to apply component accounting to our mass plant assets. (1) The quantity

of line items would make the conversion and maintenance of the data very difficult and expensive.

(1) For local gas distribution companies, mass plant consists primarily of mains, services, and meters (purchases and installations). Such plant would be virtually impossible to maintain at the retirement unit level, as the sheer volume of such retirement units would require too much space. Additionally, retirement activity would be difficult to track, as the activity would not necessarily reference a specific retirement unit. Therefore, maintaining vintage records (by year of ~~installation)~~installation), within kind (Steel, Iron, Synthetic, etc.) and size is preferable, including recognizing retirement activity on an average cost (per foot) basis.

B. Group Depreciation

We capitalize fixed assets based on "asset retirement units" and they are very similar to components. The restriction against the composite method is the most difficult aspect of the Proposed SOP because we currently have in excess of 700,000 line items in our fixed assets subledger, without including additional mass items. As noted earlier, identifying individual mass plant items would be almost impossible and therefore, calculating depreciation on individual items would also be nearly impossible.

As alluded to earlier, a major tenet of the regulatory ratemaking framework is the allowance for a return on investment. The return is calculated from a formula that applies a measure of an entity's cost of capital to rate base. In applying group accounting to the entity's fixed assets, the remaining book value of an asset that is retired is charged to the property and to accumulated depreciation, thus maintaining rate base at its level of investment. The Proposed SOP requires that the unamortized value of property, plant, and equipment be charged to depreciation expense. If depreciation expense is charged, the net assets will decrease resulting in the rate base to decrease at an accelerated rate.

Weighted composite remaining life (WCRL) is a method of adjustment whereby systematic and rational recovery of capital expenditures is enabled, prospectively. The mechanics behind this method involve dividing net depreciable property of a group of assets, at the time of measurement, by the WCRL. Use of WCRL allows for a smoother recovery process, as adjustment to the remaining life is made based upon the analysis of ongoing activity, within the group. Furthermore, via the group analysis, WCRL permits continued recognition of depreciation beyond the original life of the asset. This concept recognizes the fact that exact prediction of a useful life is impossible but, averaged over a whole group, the predicted life becomes more precise.

We also do not have the data or systems to capture line-item depreciation. This SOP would increase our administrative costs substantially for the number of additional employees needed to convert to and subsequently to maintain a new system.

A basic problem with the Proposed SOP for us is the bias against the composite method of accounting for depreciation purposes. We believe a simple test that could compare the results under a component method to the composite method is needed.

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There also seems to be an underlying assumption that line-item depreciation is more accurate. We would dispute that because the composite method records a more accurate and level depreciation when the group has a large number of homogeneous items.

C. SFAS 143, "Asset Retirement Obligations" conflicts

SFAS 143, "Asset Retirement Obligations", was just released and it conflicts with this SOP. Legal obligations for retirement expenses are required to be capitalized and by inference those that are not legal liabilities can not be capitalized. Yet in paragraph 45 (a), the Proposed SOP requires "pay-as-you-go" expense treatment with no mention of the retirement obligation liability. Since the FASB is a "class A" authority while the AICPA is a "Class B" authority, the Proposed SOP should be changed for this exception.

D. Costly and time-intensive conversion process

If and when this Proposed SOP is adopted, it would take more than a year to implement it due to the need for new operational and fixed asset systems. Such would be the case because we are currently using composite method depreciation and the data collection systems are not geared to project stage reporting or line item capitalization. Some of the direct costs that are capitalizable under this SOP are allocated as construction overhead, as opposed to being captured on a project basis.

Because we currently have over 700,000 line items (excluding mass plant) and would likely expand this total, conservatively, we would need to increase our property accounting department from 14 to at least 20 employees, when the new systems have been created and are fully functional.

The conversion costs for a system to accommodate our needs would be very expensive if the system merely replaces the old system. However, we face the very real possibility of needing to create two systems: one for the regulatory reporting based on full cost; and one for GAAP reporting based on incremental direct cost. This could significantly increase the number of people we need in property accounting.

E. The FASB's exposure draft requiring interim reporting to be the same as the annual reporting would introduce earnings volatility.

In one of our nonregulated companies, when there are highly seasonal power sales contracts, we record depreciation on a different method for interim reporting than for annual reporting. By using a method that is similar to units of production within the year but straight line on a year to year basis, we have reporting that provides superior matching of expenses to revenues in a highly seasonal environment.

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Section 2

Scope

Issue 1: Paragraph 10 of the proposed SOP states that the SOP does not provide specific guidance on lessor or lessee accounting for reimbursements of costs incurred by a lessor that are directly recoverable from lessees under the terms of one or more leases, and that the lessor and lessee should refer to FASB Statement No. 13, *Accounting for Leases*, and related lease accounting literature for guidance on accounting for such reimbursements. In many instances, depending on the terms of the lease, those reimbursements may constitute minimum lease payments or contingent rentals under FASB Statement No. 13. As discussed in paragraph A2 of the proposed SOP, AcSEC elected not to address the accounting for such transactions in this SOP because AcSEC did not want to create conflicts with existing lease accounting guidance and AcSEC did not believe it was appropriate to address the accounting under all of the various reimbursement scenarios and arrangement structures within the scope of this SOP. Are there significant practice issues or concerns related to the accounting for contractually recoverable expenditures that should be addressed in the proposed SOP? Do you believe that there are other areas addressed in the proposed SOP that, with respect to their application to lessors and lessees of PP&E, could create conflicts with existing lease accounting standards?

No.

Project Stage Framework

Issue 2: The guidance in this proposed SOP is presented in terms of a project stage or time line framework and on the basis of the kinds of activities performed during the stages defined in the proposed SOP rather than on whether an expenditure fits into certain classification categories such as ordinary repairs and maintenance, "extraordinary" repairs and maintenance, replacements, betterments, additions, redevelopments, renovations, rehabilitations, retrofits, rearrangements, refurbishments, and reinstallations. Do you agree with that approach?

No, the type of cost should govern the expense or capital nature of the expenditure rather than the timing of its incurrence. In the utility industry, the construction of capitalizable assets is a large part of operations. Since the costs incurred in the preliminary and preacquisition stages are frequently very similar, and the company is staffed to construct its own capital assets, the nature of the cost should be used rather than the timeframe in which the cost is incurred. Frequently the costs that would be incurred during the first stage for one project would still be applicable to an alternative capital project.

If not, what alternative would you propose and why?

Capitalize or expense the charges based on the kind of activity rather than the project stage in a manner consistent with the treatment recommended for the purchased options of property, plant and equipment. Charge the expenditures to construction in progress until resolution is reached as to whether or not to proceed. If the project is not completed, expense the accumulated costs when the project or alternative is determined not to be viable.

Issue 3: Paragraph 16 of the proposed SOP states that the preliminary stage ends and the preacquisition stage begins when the acquisition of specific property, plant, and equipment (PP&E) is considered probable. Paragraph 22 of the proposed SOP states that, other than the costs of options to acquire PP&E, all costs incurred during the preliminary stage should be charged to expense as incurred. Do you agree with that conclusion?

No.

If not, how would you propose to modify the guidance and why?

We believe the recording of capital costs should be based on the type of activity. Once a project has proper budget approval, the costs clearly associated with that project should be accumulated in construction in progress. Such costs should be expensed if and when the project was not completed.

Accounting for Costs Incurred

Issue 4: The proposed SOP states that PP&E-related costs incurred during the preacquisition, acquisition-or-construction, and in-service stages should be charged to expense unless the costs are directly identifiable with the specific PP&E. Directly identifiable costs include only (a) incremental direct costs incurred with independent third parties for the specific PP&E, (b) employee payroll and payroll benefit-related costs related to time spent on specified activities performed by the entity during those stages, (c) depreciation of machinery and equipment used directly in the construction or installation of PP&E and incremental costs directly associated with the utilization of that machinery and equipment during the acquisition-or-construction stage, and (d) inventory (including spare parts) used directly in the construction or installation of PP&E. All general and administrative and overhead costs incurred, including all costs of support functions, should be charged to expense. See paragraphs 24, 25, 29, and 30. Do you agree with those conclusions? If not, what alternatives would you propose and why?

We would separate this into two questions- Are the incremental directly identifiable costs defined correctly? Should all G&A and overhead costs be expensed?

Directly identifiable costs are not complete because they do not include asset retirement obligations or capitalized interest. Also, the term incremental should be eliminated. Either a cost is directly identifiable or it is not. In our company, the activity is too large a percentage of total operations, whereby the incremental concept fails. Because we construct approximately 30% of our assets, we hire many additional employees to support self-construction of assets and the recognition of only incremental direct cost is inappropriate and too restrictive.

We believe that if G&A costs can be directly identified to the self-construction of assets, the costs should be capitalized. For instance, if we rent an office for the design team for the project, the rent for that office should be capitalized. It would not be under this SOP. Likewise, our Legal Department will charge a project for the hours that they work specifically on it, just as an engineer would. We would not have as large a Legal Department as we have, if they did not engage in this type of construction activity. We also capitalize certain field supervision cost. When a field office is established where the supervisor is directing crews that perform work that is 60% capitalizable and 40% operational repairs, the supervisor's time and benefits are also allocated 60%/40% based on the reported hourly workers time cards. Is the supervisor's cost a direct incremental cost? We record the capital portion. Our regulating commission supports this accounting treatment. Generally, the way this SOP is drafted is too restrictive.

This Proposed SOP penalizes companies that construct their own capital assets. Because of our high volume of activity, we are more efficient and cost effective constructing our capital assets and pass our efficiencies to our customers by way of lower rates. Indirect costs, however, are unavoidable. The thrust of paragraphs 25 and 29 requiring the expensing of internal overhead costs, appears to conflict with paragraphs 23a and 26, which allows the capitalization of overhead inherent in third-party transactions and encourages the purchase of

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capital assets from third parties. Companies that purchase their capital assets may pay more but they can justify it by allocating the expense over the assets' useful lives. The proposed SOP encourages purchasing by creating higher valuations of purchased items than when those same items are constructed. The constructed items were less expensive to build, but many costs would be forced to current expense.

Issue 5: Paragraph 32 of the proposed SOP states that for real estate that is not being used in operations, costs of property taxes, insurance, and ground rentals should be capitalized, to the extent of the portion of the property that is under development, during the time that activities that are necessary to get the asset ready for its intended use are in progress. Do you agree with that conclusion? If not, what alternative would you propose and why?

Yes.

Issue 6: Paragraph 37 of the proposed SOP states that the costs of normal, recurring, or periodic repairs and maintenance activities should be charged to expense as incurred. It also states that all other costs related to PP&E that are incurred during the in-service stage should be charged to expense as incurred unless the costs are incurred for (a) the acquisition of additional PP&E or components or (b) the replacement of existing PP&E or components of PP&E. Do you agree with those conclusions? If not, what alternatives would you propose and why?

Yes, we agree. This is essentially the way we account for repairs, currently. We use the term "Asset Retirement Units." However, we do not think that our mass plant items would adapt to this accounting.

Issue 7: Paragraph 39 of the proposed SOP states that costs of removal, except for certain limited situation demolition costs, should be charged to expense as incurred. Do you agree with that conclusion? If not, what alternative would you propose and why?

We believe this issue is governed by SFAS 143, "Accounting for Retirement Obligations".

Issue 8: Paragraph 44 of the proposed SOP states that the total of costs incurred for planned major maintenance activities does not represent a separate PP&E asset or component. It states that certain of those costs should be capitalized if they represent acquisitions or replacements and that all other costs should be charged to expense as incurred. Paragraph 45 prohibits alternative accounting treatments including – (a) the accrual of a liability for the estimated costs of a planned major maintenance activity prior to their being incurred, and (b) the deferral and amortization of the entire cost of the activity. Do you agree with those conclusions? If not, what alternatives would you propose and why?

Yes, we agree, although the financial reporting may cause our operating results to be more volatile and give the impression that we are not carefully managing our major planned maintenance. Since the new SFAS Exposure Draft states we should recognize interim expense using the same standards as annual reporting, the FASB should consider modifying their position to allow companies to spread the cost over the year. To charge all the cost of planned major repairs only in the month they occur presents a volatile earnings pattern that the financial community would most likely penalize.

We have a related problem with the SFAS Exposure Draft "Accounting in Interim and Annual Financial Statements for Certain Costs and Activities Related to Property, Plant, and Equipment" due to requiring the interim reporting practices to conform to annual reporting practices. In one of our nonregulated businesses, we receive 90% of our revenues in 3 months. Therefore, to obtain a better matching of revenues and expense we depreciate on a

straight-line basis for annual reporting, but on a units-of-production basis during the interim periods.

Issue 9: Paragraph 45 of the proposed SOP further prohibits, as an alternative accounting treatment, the "built-in overhaul" method for costs incurred for planned major maintenance activities. Under that method, additional depreciation expense is recognized currently to give effect to the decline in service potential that is subsequently restored once the major maintenance activity occurs. When the major maintenance activity occurs, its cost is considered capitalizable. In lieu of the built-in overhaul method, AcSEC concluded that better cost allocation would result from the use of component accounting and limiting the major maintenance activities that would be capitalizable to costs that represent replacements of components of PP&E. Should the costs of restoring PP&E's service potential, in addition to the cost of replacements that would be capitalizable under this proposed SOP, be eligible for capitalization? Do you believe that prohibiting the built-in overhaul method is appropriate, or should it be allowed as an alternative method? If you believe that the built-in overhaul method should continue to be allowed, what industries or entities should be allowed to use it, and why?

We agree with this treatment.

Use of Inventory in Production of Internal-Use PP&E

Issue 10: Paragraphs 47, 48, and A41 of the proposed SOP discuss the situation in which an entity owns an asset that it intended to sell as inventory but subsequently decided to retain for use in its own internal operations. Those paragraphs state that the entity should evaluate for impairment amounts included in PP&E that were previously capitalized as inventory but should not redetermine their carrying amount as PP&E using the guidance in the proposed SOP, unless the entity has a pattern of changing the intended use of assets from inventory to PP&E. Do you believe that guidance is appropriate, or should an entity be required to redetermine the carrying amount of PP&E assets previously capitalized as inventory, and why? Should AcSEC provide additional guidance on what kinds of changes in intended use constitute a "pattern," and why?

Not applicable to us.

PP&E-Type Assets Produced for Sale or Operating Lease

Issue 11: The proposed SOP requires assets that are produced by an entity to be leased to a lessee under an operating lease to be accounted for under the provisions of this SOP. As discussed in paragraph A43 of the proposed SOP, AcSEC recognizes that some entities routinely construct or manufacture products, some of which are sold directly and some of which are leased to lessees under sales-type leases whereas others are leased to lessees under operating leases. In some situations, the entity does not know the form the transaction will take until it occurs, and the customer decides whether its acquisition of product will be accomplished through purchase or lease. The proposed SOP requires an entity to accumulate costs differently for similar assets depending on whether the asset is sold outright or leased to a lessee under a sales-type lease (in either case, inventory cost accumulation rules would apply) or leased to a lessee under an operating lease (in which case, the cost accumulation provisions of the proposed SOP would apply). Do you agree with that conclusion and, if so, do you believe the proposed SOP should provide additional guidance on such cost accumulation? Or would it be preferable for a single cost accumulation model to apply during the production process and that there should be a presumption that the assets should be accounted for all as inventory or all as PP&E? If so, which presumption should be applied and why?

Although the issue does not apply to us, we would prefer to see a single cost-accumulation model, so that the emphasis is on keeping the rules as simple as possible.

Component Accounting

Issue 12: Paragraphs 49 through 56 of the proposed SOP discuss component accounting and state that if a component has an expected useful life that differs from the expected useful life of the PP&E asset to which it

relates, the component should be accounted for separately and depreciated or amortized over its separate expected useful life. Do you agree with this approach to accounting for PP&E? If not, what alternative would you propose and why?

For utilities, operating units take precedence. Therefore, the lives applicable to new components would not exceed the remaining life of the corresponding operating unit, as a whole. This seems to make more sense than a separate life for a component, unless the component can be used again after the asset is retired.

Issue 13: Paragraphs 38 and 51 of the proposed SOP state that when existing PP&E is replaced or otherwise removed from service and the replacement is capitalized, the net book value of the replaced PP&E should be charged to depreciation expense in the period of replacement. Do you agree with this approach? If not, what alternative would you propose and why?

Because the Utility Industry uses the composite method of depreciation, with the going-concern concept prevailing, assets are assumed to have accumulated full depreciation, on average, for normal retirements. Thus, no income statement effects are recognized. For abnormal (inordinate) retirements, we would agree to the recommended treatment.

Issue 14: The proposed SOP requires the use of component accounting to depreciate identified components over their respective expected useful lives. As noted in paragraph A48 of the proposed SOP, entities have developed and utilized various conventions to depreciate assets, including group depreciation or use of composite lives. Those conventions are acceptable only if they result in approximately the same gross PP&E, depreciation expense, accumulated depreciation, and gains or losses on disposals of PP&E as the component accounting method required by this proposed SOP. Do you agree with this approach? If not, what alternative would you propose and why?

As noted earlier, the WCRL method provides for a systematic and rational recovery of capital expenditures. For entities that incorporate group depreciation, such as our utilities, it would be impractical and extremely expensive to create the suggested comparison basis. Moreover, once it is created, whether or not it calculates similar results to the prior method, it would be senseless not to carry forward with the proposed method. Thus, there is no real choice provided. Furthermore, no statements are made as to: whether continued comparisons are required (and, if so, in what intervals); what is considered material; or, how to account for the differences.

Amendments to Other Guidance

Issue 15: Paragraphs 61 and 63 of the proposed SOP list amendments to SOP 85-3, *Accounting by Agricultural Producers and Agricultural Cooperatives*, and the AICPA Audit and Accounting Guide *Audits of Agricultural Producers and Agricultural Cooperatives*, respectively. Do you agree with the proposed amendments? Do you believe that there are unique aspects of agricultural accounting, such as the accounting for breeding and production animals and the accounting for plants and vines, that should not be amended by the proposed SOP, and why?

Not applicable.

Transition

Issue 16: Paragraph 71 of the proposed SOP states that the prescribed component accounting guidance should be

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initially adopted for existing PP&E using one of two alternatives, the election and disclosure of which should be made when the SOP is adopted. Do you agree with that approach and, if so, do you agree with the choice of the two alternatives from which the election is to be made? If you do not agree with that approach for existing PP&E, what approach would you propose and why?

Our first choice would be neither and to exempt the utility industry from this Proposed SOP. While we do not have a strong preference between the two methods, we do hope we will be given at least a year to implement the final findings.

Since this Proposed SOP will force us to change from the composite method, we will require much time, energy and money to change software and data collection systems to achieve compliance with the Proposed SOP.

Issue 17: Under paragraph 71(a) of the proposed SOP, the allocation of existing net book value to components at transition should be based on (a) allocation of original accounting records, if available, (b) relative fair values of components at date of transition, if original accounting records are not available, or (c) another reasonable method, if relative fair value is not practicable. Do you agree that that ordering of allocation methods is appropriate? If you believe that a different order would be appropriate, what order would you propose and why? Should the proposed SOP provide additional examples to illustrate what constitutes "another reasonable method"?

We agree that the order is correct.

Issue 18: Paragraph 72 of the proposed SOP states that the SOP should be applied prospectively for all costs incurred after the adoption of the SOP. It also states that costs incurred prior to the adoption of the proposed SOP should not be re-characterized (as capital or expense items) to conform to the guidance in the SOP, with the exception of certain costs of planned major maintenance activities. Do you agree with that approach? If you do not agree with that approach, what approach would you propose and why?

Yes we agree with the approach. However, many utility companies currently have “accrued retirement obligation” as part of the gross assets and accumulated depreciation. This is distinct from accruing for major overhaul projects. What accounting treatment is prescribed for these costs?

Because only capitalizing incremental directly identifiable costs, as defined, is much more restrictive than current industry practice, do we need to disclose the pro forma impact on Net Income? Any trend analysis of capital spending could portray the impression that we are reducing our investment in the infrastructure of our gas distribution systems.

Issue 19: Under paragraph 71(a) of the proposed SOP, and as illustrated in Example 3 in appendix C, an entity applying component accounting retroactively at date of adoption may calculate a difference between the pre-adoption balance of accumulated depreciation and the balance recalculated based on the estimated useful lives of components that previously were not accounted for as separate components. Under that paragraph, the difference is allocated back to the accumulated depreciation of each component based on the net book values of the components. Two alternatives considered were recording the difference as a cumulative effect type adjustment at adoption and recording the difference as additional depreciation expense at adoption. Do you agree with the proposed approach or either of the alternatives, and why?

Our first choice would be neither and to exempt the utility industry from this Proposed SOP. Otherwise, our answer would depend on the materiality of the adjustment as to which of the methods, if either, we would prefer. Although accounting inconsistencies may result, we

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believe the choice should reside with the individual company. The method should be disclosed in the principals of accounting footnote or in the implementation of the new accounting standards section of the Annual Report.

Once again, thank you for the opportunity to express our concerns about how this Proposed SOP could adversely affect us and drive up our operating costs, while not significantly improving our fixed asset accounting. We are also concerned about the real possibility of needing to create separate sets of books for regulatory accounting and GAAP accounting, if this is passed as is.

Sincerely,

Linda Kallas
Assistant Controller
Peoples Energy Corporation
Chicago, Illinois 60601

312-240-3877

Marc Simon

11/16/2001 10:18 AM

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cc:
Subject: cl #270

cl #270
----- Forwarded by Marc Simon/NY/AICPA on 11/16/01 10:23 AM -----

pgass@ucemc.com

11/15/01 03:32 PM

To: msimon@aicpa.org
cc:
Subject: Exposure Draft - Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment

Dear Mr. Simon:

Upper Cumberland Electric Membership Corporation (UCEMC) is a rural electric distribution cooperative that provides electric service to approximately 43,000 member-owners in a nine-county area in the State of Tennessee. The cooperative has operations and electric facilities in Smith, Putnam, Jackson, Overton, White, Dekalb, Clay, White and Macon Counties. UCEMC is a member of the national trade organization called National Rural Electric Cooperative Assocation (NRECA). Also, UCEMC is a Rural Utilities Service (RUS) borrower and derives its power supply from the Tennessee Valley Authority (TVA).

UCEMC hereby respectively submits written comments regarding the above referenced Proposed Statement of Position (PP&E Accounting Proposal) to the Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants (AICPA).

The electric distribution cooperative utility business is a capital-intensive, rate-based, member-owned, and regulated industry. With that in mind, the PP&E Accounting Proposal would significantly impact the operational and accounting policies of this organization and potentially cause harm to our member-owners through increased cost with little or no evidence of benefits derived from the accounting change. Considerable discussion should take place with utility regulators, such as the Federal Energy Regulatory Commission (FERC), RUS, and TVA before any standing practices are overturned by the proposed accounting change.

UCEMC follows the Uniform System of Accounts of FERC and RUS and is regulated by TVA in its cost-of-service studies, accounting, and rate-making process. This Uniform System of Accounts for utilities along

with FASB #71 reflects best the rates required and the most consistent matching of revenues with expenses and presents the fairest representation of financial position and results of operations to its financial statement users, the member-owners and regulatory bodies.

UCEMC believes that uniformity and standardization exists in its industry and any attempt to unite with other dissimilar industries is not desirable due to increased costs and is not necessary. Implementation of the PP&E Accounting Proposal by electric distribution systems raises specific concerns.

First, strictly limiting the types of costs that could be capitalized as part of PP&E would ultimately result in rate volatility and inequitably shift the burden of collection of these costs from members using the plant asset over its useful life to members during the construction of the plant asset. Second, requiring component depreciation accounting instead of grouping similar assets together (group/composite method of depreciation) in a large volume capital-intensive industry would require a great deal of time and resources to comply with the data collection requirements. Automated plant accounting systems would require major changes resulting in increased costs to the member-owners. Finally, requiring the results of operations as incurred rather than written off over the plant's life (as a component of the depreciation rate) would result in increased earnings volatility and inequitably shift the burden of collection of these costs from the members using the plant asset to members during the retirement of the plant asset.

The above, comments are concerns raised not only because of the impacts it would have on the cooperative's internal procedures and policies but the detrimental impact it would have on the electric rates charged to our member-owners. Each item should be discussed with the appropriate utility entities and a cost-benefit review carefully contemplated before moving forward with implementation of the PP&E Accounting Proposal provisions for rural electric distribution cooperatives.

UCEMC urges the AICPA AcSEC committee to consider its comments and views before making a final recommendation, and we appreciate the opportunity presented for making such comments.

Sincerely,

Patty Gass
Accountant
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November 15, 2001

Mr. Marc Simon
Technical Manager
Accounting Standards File, File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of Americas
New York, NY 10036-8775

Proposed Statement of Position, "Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment" (File 4210.CC)

Dear Mr. Simon:

The Financial Reporting Committee (FRC) of the Institute of Management Accountants is pleased to provide our response to the exposure draft on the proposed AICPA Statement of Position, *Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment* (Proposal). We do not support issuance of a final SOP because we strongly disagree with the Proposal to require a component depreciation approach. In addition, we have other concerns with regard to the Proposal, as discussed below.

Component Depreciation

We strongly object to requiring the use of component accounting due primarily to practical issues related to the implementation and accounting for components. We believe that many entities are likely to incur significant implementation costs, outweighing the benefits of employing component accounting. Companies that replace property, plant and equipment frequently may have to acquire or modify existing information systems, and/or hire additional personnel, to record and monitor each replacement of a component. As a result, we believe that the accounting for property, plant, and equipment, does not require such dramatic change as component accounting. Further, we do not believe paragraph A46 of the Proposal that allows entities to continue the use of group depreciation methods if they can demonstrate that those conventions can be used and produce results that are

similar to those obtained under component accounting, is a practical solution because to make the assertion, companies would still have to incur virtually the same costs. Many companies have been using a composite approach to record depreciation for decades and the long-standing practice has not given rise to any concerns about the quality of financial reporting. AcSEC has just not made its case that there is any reason to change.

We believe that the component method of depreciation suggests a false sense of greater precision. Because neither the Proposal nor GAAP in general, specify the use of particular depreciation lives or methods, adopting the component approach would result in greater comparability among companies only by accident. Further, properly applied to situations involving large numbers of similar assets, composite depreciation based upon historical survivor rate studies may actually produce a more rational allocation of the cost of such assets to the periods of benefit than the component method proposed and at substantially less cost to the preparer. Thus, there is no real benefit to users and the costs to preparers would be substantial, as noted above.

Project Stage Framework

We disagree with the Proposal to disallow certain costs from being capitalized solely because site selection on a construction project has not occurred. For example, we believe a company should be able to capitalize architectural design costs related to a building, when construction of the building is considered probable, even though the specific site where the building will be constructed has not been chosen. AcSEC should recognize that these costs are transferable and that it is possible to have costs related to the same project that could be viewed as being incurred in different stages. For instance, in the example above, the building costs could be considered pre-acquisition stage costs because it is probable that the building as designed will be constructed, while those costs related to the land (e.g., traffic studies for three alternative sites) could be considered preliminary stage costs.

Overhead costs

We believe that AcSEC should adopt a full costing approach with respect to the construction of property, plant and equipment, by allowing entities to capitalize overhead costs if incurred during the pre-acquisition or acquisition or construction stages. By allowing their capitalization, it will eliminate the inconsistency in the costs that are capitalized when assets are self-constructed versus acquired from third parties. More importantly, the accounting treatment would be consistent with the inventory model, which we believe is appropriate (overhead is a cost of construction), and would eliminate the problem of determining costs for the many companies manufacturing equipment both for sale and lease.

We disagree with AcSEC's attempt to defend its decision to exclude overhead from the definition of cost on the basis that the guidance in FAS 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*, (FAS 91), and SOP 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use* (SOP 98-1), is more recent than FAS 67, *Accounting for Costs and Initial Rental Operations of Real*

Estate Projects, and therefore, they are the more appropriate literature to analogize to. We do not believe that AcSEC should rely on guidance developed for loan originations and internal software development, on the theory that such guidance is more recent, when we have well-established and well-understood "Level A GAAP" for tangible assets (i.e., real estate projects and inventory) that are similar, if not identical, to the assets intended to be covered by the Proposal. Further, the argument that FAS 91 and SOP 98-1 are the most recent pronouncements to address the subject is not accurate as well. Indeed, the most recent pronouncement that might shed light on the FASB's current thinking on this subject is FAS 143, *Accounting for Assets Retirement Obligations,* (and arguably the most relevant guidance, given that the general subject of both the Proposal and the new standard is long-lived tangible assets). That standard specifically requires that indirect overhead costs be included in the estimated cash flows to be used to measure both the initial asset retirement obligation liability and the related asset that is capitalized and depreciated with the fixed asset to which the asset retirement obligation relates regardless of whether the entity intends to perform the retirement activities itself or contract with a third party.

Planned Major Maintenance Activities

The FRC believes that AcSEC should allow entities to use one of two methods to account for planned major maintenance activities, specifically, 1) the "Expense as Incurred" method as proposed in the Proposal and 2) the "Defer and Amortize" method. The majority of the FRC believes that both methods are conceptually sound and would limit the number of acceptable practices currently used to these two methods. The Defer and Amortize method recognizes that it is necessary to incur these costs to continue using the asset and thus they should be capitalized. Further, we believe a proper application of the Defer and Amortize method would require separation of the original acquisition cost into its two component parts (i.e., the core asset and the built-in overhaul) with each part being depreciated/amortized over its expected useful life. Otherwise, the periods of use of a newly-acquired asset from acquisition until the first overhaul get a "free ride" from these expenses, since they would be spread over the entire life of the asset as depreciation expense.

It should be noted that a minority of FRC members agreed with AcSEC's proposal to limit the accounting for planned major maintenance activities to only the Expense as Incurred method.

Other

AcSEC should address whether the Proposal impacts companies that have regulated operations meeting the criteria of FASB Statement FAS 71, *Accounting for the Effects of Certain Types of Regulation* (FAS71). For instance, an enterprise subject to the provisions of FAS 71 may be permitted to capitalize a cost that would otherwise be expensed under the Proposal. Although we assume that these enterprises should continue to follow FAS 71 if the criteria within that statement have been met, this fact should be addressed.

We do not believe there is a need for additional property, plant and equipment disclosures, as those currently required by existing generally accepted accounting principles are adequate. AcSEC has neither provided justification for adding these disclosures, which may be burdensome to prepare, nor addressed what benefits, if any, users will reap from them. In particular, we strongly disagree with

the Proposal's requirement to have entities disclose in the financial statements the nature and total amount of the costs they characterize as repairs and maintenance expense. Besides not providing particularly useful information, without an operational definition of repairs and maintenance expense and guidance as to how companies should identify such costs, there is likely to be a divergence in practice on what constitutes such expense.

******

Representatives of the FRC would be pleased to meet with AcSEC or its staff to discuss our comments.

Sincerely,

John J. Perrell III
Chair, Financial Reporting Committee
Institute of Management Accountants

Nemaha-Marshall Electric Cooperative Association,Inc.
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Axtell, Kansas 66403
785-736-2345

November 15, 2001

Mr. Marc Simon
Technical Manager, Accounting Standards
File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Exposure Draft - Proposed Statement of Position, "Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment"

Dear Mr. Simon:

Nemaha-Marshall Electric appreciates the opportunity to submit written comments regarding the above-referenced Proposed Statement of Position (PP&E Accounting Proposal) to the Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants (AICPA).

Nemaha-Marshall Electric is an electric cooperative in the state of Kansas, providing electricity to approximately 3,300 consumers-owners in 5 counties. Since we operate within the capital-intensive electric utility industry, the PP&E Accounting Proposal would significantly and negatively impact Nemaha-Marshall Electric's accounting policies and administrative costs. Over the past three years, additions to our total utility plant have averaged $406,566 annually. During this same period, yearly reported patronage capital (margins) has averaged $495,633. We conservatively estimate that, if adopted, this PP&E proposal could decrease these margins by at least 41.7%. Resultant electric rates to our consumers would have to be increased substantially to cover the incremental costs associated with this proposal and to protect our financial integrity and credit rating.

Nemaha-Marshall Electric is required to follow accounting requirements promulgated by the Rural Utilities Service (RUS). The PP&E Accounting Proposal raises significant ratemaking, operational, and accounting concerns for Nemaha-Marshall Electric. The most significant of these concerns arise due to accounting inconsistencies between this proposal and the RUS Uniform System of Accounts and attendant RUS regulations and

interpretations (collectively, Electric Cooperative Accounting Requirements). The PP&E Accounting Proposal and the attendant detrimental impacts to Nemaha-Marshall Electric include the following:

- Electric Cooperative Accounting Requirements specify capitalization of overheads in support of construction projects and permit capitalization of an appropriate portion of administrative and general (A&G) costs. In addition, Electric Cooperative Accounting Requirements specify capitalization of preliminary investigation and survey (PI&S) charges. The PP&E Accounting Proposal would prohibit capitalization of overheads, PI&S charges, and A&G costs.

  Implementation of these provisions would dramatically increase earnings volatility, as these overhead, PI&S charges, and A&G costs would be expensed, rather than capitalized as they are today. We estimate that the annual financial impact of these items would decrease our margins by at least $45,038 annually or more, depending upon the extent of the capital restrictions ultimately imposed. Furthermore, from the standpoint of rate-making fairness, failure to capitalize these costs would inequitably shift the burden of collection of these costs from customers using the plant asset over its useful life to existing customers at the time the plant asset is constructed.

- Electric Cooperative Accounting Requirements prescribe the use of the group method of depreciation for plant assets. The PP&E Accounting Proposal would require use of depreciation accounting by component, defined as "a tangible part or portion of [plant] that can be separately identified as an asset and depreciated or amortized over its own separate expected useful life". The PP&E Accounting Proposal generally prohibits the use of a group method of depreciation, unless it can be shown by the entity that the asset balances and operating results under the group method is not materially different from that obtained under the component method. Implementation of this provision would require administrative reorganization to comply with the data collection requirements, as well as expensive new automated accounting systems -- or at a minimum, significant upgrades to existing software. In addition, determination of material differences between the component and group accounting methods would require record keeping for both methods, adding significantly to plant record-keeping costs, as well as audit costs. The estimated costs to upgrade automated systems and provide additional administrative record-keeping and data input is projected to add at least $50,000 in one-time costs and will conservatively exceed $206,644 on an annual basis thereafter. If adopted, our staffing costs are projected to increase by at least $76,319 annually, or more than 25%, to support the extra administrative and reporting burdens of this requirement.

- Electric Cooperative Accounting Requirements, consistent with group depreciation accounting convention, generally prescribe that gains and losses on normal dispositions of mass assets be closed to the accumulated depreciation account, under the theory that over time gains and losses will net out. The PP&E Accounting Proposal would require that gains and losses be reflected in the results of operations in the current accounting period. Implementation of this provision would result in

increased earnings volatility, as gains and losses on plant disposition are reflected in the current results of operations. Annual gains / (losses) closed to the accumulated depreciation account over the past three years have averaged $23,624. Electricity rates would likely require significant upward adjustment to provide for this increased uncertainty of earnings.

- Electric Cooperative Accounting Requirements generally recognize the cost of removal of a plant asset over the useful life of that asset, as a component of the depreciation rate. The PP&E Accounting Proposal would require that cost of removal be reflected in the results of operations in the accounting period in which such cost was incurred. Removal costs we've incurred over the past three years have averaged $61,662 annually. Implementation of this provision would result in increased earnings volatility, as cost of removal would be reflected in a single accounting period. Furthermore, from the standpoint of ratemaking fairness, failure to recognize cost of removal over the asset's life would inequitably shift the burden of collection of these costs from customers using the plant asset to customers during the retirement of the plant asset.

Each of the above accounting inconsistencies pose operational problems and create significant administrative burdens for Nemaha-Marshall Electric that will dramatically raise the cost of electricity our rural member owners. The detrimental impacts of each item should be carefully considered and weighed against any identifiable benefits before the AICPA AcSEC implements the attendant provision of the PP&E Accounting Proposal for electric utilities. Further, we recommend that any and all decisions and changes impacting PP&E be closely coordinated in advance with RUS and all other federal and state governmental authorities regulating electric cooperatives and the electric industry.

Nemaha-Marshall Electric appreciates the opportunity to provide comments on the PP&E Accounting Proposal and respectfully urges the AICPA AcSEC to consider its views. If questions arise concerning these comments, please feel free to contact Fenton G. Norwood or Kathleen M. Brinker at (785) 736-2345.

Sincerely Yours,

Fenton G. Norwood, General Manager

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Edwin F. Hall
Vice President
Telecom Corporate Books

November 15, 2001

Mr. Marc Simon
Technical Manager, Accounting Standards
File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

RE: June 29, 2001 Exposure Draft, *Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment*

Dear Mr. Simon,

Verizon appreciates the opportunity to comment on the June 29, 2001 exposure draft of the proposed Statement of Position, *Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment*. We do not agree with the proposed requirements related to component accounting and the perceived shortcomings of group accounting. We believe that group accounting is an appropriate method for capital-intensive companies with large amounts of homogeneous assets. The telecommunications industry has a long history of using group accounting and it meets the objectives of GAAP without the massive administrative burden that component accounting would require.

We cannot stress enough the administrative burden of implementing the component accounting requirements of the SOP as currently written. Under group accounting, the company has **116 million asset records**. These records are currently adequate for management of the company, external reporting to the investment community, meeting all tax code requirements and all regulatory requirements placed on the company. Component accounting would require almost all of these asset records to be subdivided into smaller asset units. We estimate, that at a minimum, this would increase our asset records to over one billion. In addition, the need to maintain accumulated depreciation information on each new record would create an additional billion records to track the depreciation expense. To ensure that each new asset unit record is properly tracked and maintained, the company would need to bar code hundreds of millions of asset units. The sheer administrative effort required to: inventory and bar code all component assets; allocate current accounting asset records to the new component asset records; modify the current asset systems and supporting legacy systems to accommodate the increased number of records and additional detail will conservatively cost **$450 million**.

We do not believe it was the intent of AcSEC or FASB to create an administrative nightmare and force our company and similar companies to spend hundreds of millions of dollars to implement the SOP and then tens of millions more on an annual basis to main-

tain the additional detail the proposed SOP would require. The proposed SOP should be revised to eliminate the component accounting requirements. Group accounting as practiced in the telecommunications industry is a viable method for capital-intensive companies with large amounts of homogeneous assets that balances strong accounting controls over PP&E and a reasonable level of administrative effort. We strongly encourage the AcSEC and FASB members to eliminate the component accounting requirements and to examine more closely group accounting as an acceptable alternative.

We also believe the expensing of cost of removal is inconsistent with FASB Statement 143 and does not provide a proper matching of the removal costs to the periods that benefit from the asset.

Below are our detailed comments on these items.

Issue 4: The proposed SOP states that PP&E-related costs incurred during the preacquisition, acquisition-or-construction, and in-service stages should be charged to expense unless the costs are directly identifiable with the specific PP&E. Directly identifiable costs include only (a) incremental direct costs incurred with independent third parties for the specific PP&E, (b) employee payroll and payroll benefit-related costs related to time spent on specified activities performed by the entity during those stages, (c) depreciation of machinery and equipment used directly in the construction or installation of PP&E and incremental costs directly associated with the utilization of that machinery and equipment during the acquisition-or-construction stage, and (d) inventory (including spare parts) used directly in the construction or installation of PP&E. All general and administrative and overhead costs incurred, including all costs of support functions, should be charged to expense. See paragraphs 24, 25, 29, and 30. Do you agree with those conclusions? If not, what alternatives would you propose and why?

Verizon agrees that general and administrative ("G&A") costs should be expensed as incurred, but we do not agree that "all costs of support functions" should be charged to expense. As with most telecommunication companies, we construct most of our assets using centralized engineering groups that support more than one function and area. These centralized functions are a direct incremental cost of construction and would not exist without the construction activities. Often these functions reside in centralized environments for the sake of efficiencies of scope and scale. As such, these costs are allocated to the PP&E assets based on a consistent, systematic and cost effective process.

We believe the accounting guidance for indirect and overhead costs in paragraph 7 of FASB Statement 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects*, is appropriate:

> ***"Project costs clearly associated with the acquisition, development, and construction of a real estate project shall be capitalized as a cost of that project. Indirect project costs that relate to several projects shall be capitalized and allocated to the projects to which the costs relate. Indirect costs that do not clearly relate to projects under development***

> ***or construction, including general and administrative expenses, shall be charged to expense as incurred."***

The conclusion reached in the SOP that all support costs associated with PP&E should be expensed as incurred per the guidance in FASB Statement 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*, and SOP 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*, does not take into consideration the true nature of these costs and their relationship to the investment involved.

Issue 7: Paragraph 39 of the proposed SOP states that costs of removal, except for certain limited situation demolition costs, should be charged to expense as incurred. Do you agree with that conclusion? If not, what alternative would you propose and why?

Verizon does not agree that cost of removal should be charged to expense as incurred. We believe this position is inconsistent with Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations", issued in June 2001. In paragraph 11 this standard states:

> ***"Upon initial recognition of a liability for an asset retirement obligation, an entity shall capitalize an asset retirement cost by increasing the carrying amount of the related long-lived asset by the same amount as the liability. An entity shall subsequently allocate that asset retirement cost to expense using a systematic and rational manner over its useful life."***

Since FASB 143 does not apply to all PP&E, the proposed SOP would create different treatment for removal costs depending entirely on the legal status of the costs incurred.

For PP&E that does not require FASB 143 treatment, it is still appropriate to accrue removal costs over the life of the asset. In the telecommunications industry, there is a long-standing practice of accruing cost of removal in the depreciation process. As a result, the liability for future costs of removal are embedded in accumulated depreciation. When assets are retired, removal costs are recorded as a charge to accumulated depreciation. In the proposed SOP, the AcSEC states "removal costs are the last costs in the life cycle of an asset and should remain associated with the removed asset rather than being capitalized into the cost of the replacement asset". By including removal costs in the depreciation process, telecommunications companies ensure that removal costs are associated with the removed asset. This achieves the AcSEC's desired goal and makes expensing of removal costs as incurred unnecessary.

Including cost of removal in the depreciation process, under the group concept, also ensures that the removal costs associated with the asset correspond to the asset's useful life. This complies with Concepts Statement 5, paragraph 86c, "some expenses, such as depreciation ...are allocated by systematic and rational procedures to the periods during which the related assets are expected to provide benefits". Expensing removal costs in the current period disassociates these asset-related costs from the period during which the

asset lives. For long-lived assets, expensing could generate a significant mismatch between the periods benefiting from the asset and the period incurring the cost of removal.

Issue 12: Paragraphs 49 through 56 of the proposed SOP discuss component accounting and state that if a component has an expected useful life that differs from the expected useful life of the PP&E asset to which it relates, the component should be accounted for separately and depreciated or amortized over its separate expected useful life. Do you agree with this approach to accounting for PP&E? If not, what alternative would you propose and why?

We agree with the general concept that PP&E with different expected useful lives should be accounted for separately and depreciated over the appropriate useful life. This is the current practice in the telecommunications industry where PP&E is divided into homogeneous groupings for depreciation purposes. However, we are concerned that the proposed component accounting establishes a standard that is too narrow for practical application and in its extreme, could require different depreciation schedules for the engine and body of an automobile. The proposed component accounting requirements will not only be an administrative burden, but will result in the use of subjective estimates to allocate the cost of an asset to its components since most vendors do not detail costs by components. We believe applying component accounting to a group of assets that have a similar expected useful life significantly increases the administrative burden with little, if any, improvement in the expense allocation.

In the telecommunications industry, there is a long established practice of using group accounting to determine an appropriate expense allocation based on the useful life of the group. Verizon uses group depreciation because the tremendous number of asset records makes it impractical to do otherwise. The Verizon telephone companies currently have approximately 116 million asset records, which summarize more than 5 billion individual investment units with a dollar value of more than $135 billion.

Preferred paragraph

In the telecommunications industry, there is a long established practice of using group accounting to determine an appropriate expense allocation based on the useful life of the group. Verizon uses group depreciation because the tremendous number of asset records makes it impractical to do otherwise. The Verizon telephone companies currently have approximately 116 million asset records with a dollar value of more than $135 billion.

Under the group depreciation approach, assets are separated into "components" or groups of homogeneous assets that are similar in character, used in the same manner in a limited service territory, operated under the same general conditions, and have similar expected lives. The Verizon telephone companies' principal asset is its telecommunications network, which is made up of millions of individual pieces of equipment that connect hundreds of switches and thousands of miles of transmission cable into an integrated network

serving millions of customers. For each asset group or component in the network, Verizon determines the appropriate depreciation expense based on a group specific expected useful life. For example, a life estimate and depreciation rate is determined in each state for switching equipment. A different life estimate and depreciation rate is determined in each state for transmission equipment and so on through the 30 to 40 asset classes in each state.

Verizon develops separate lives and depreciation rates for each asset class because that is a reasonable, practical, effective and appropriate grouping of homogeneous assets with similar use and similar lives. Attempting to identify an individual life and depreciation rate beyond this level, for example, to each telephone pole or building component, would provide little, if any, benefit. The determination of the useful lives used to develop depreciation rates for each of its asset groups is a very detailed, methodical, and thorough process which considers network modernization and deployment plans, changes in technology, the impact of competition, historical mortality data, industry studies, corporate strategy, and regulatory commitments.

We are very concerned about the on-going systems and administrative costs of maintaining the hundreds of millions of additional detailed records that component accounting would require. We do not believe this proposal meets the criteria stated by the FASB on page 12 of the proposed SOP, "the benefits of the proposal are expected to exceed the costs of applying it". Adopting component accounting for all PP&E would be unproductive and tremendously costly for Verizon and other companies in the telecommunications industry. For example, the proposed SOP uses Buildings as an example of component accounting. Verizon has over 16,000 buildings spread over forty states. Subdividing each building into many components and establishing a specific useful life estimate for each component would be an incredibly costly undertaking. And when completed, it would require a sizable staff to track the activity and maintain the database. In the end, we do not see how all this effort would create a better matching of expense to asset life than the current process.

To highlight the administrative burden and the marginal, if any, benefit of the additional detail, consider the application of component accounting to one relatively small asset group in one of our many operating telephone companies. In this operating telephone company, there are slightly more than 600,000 telephone poles. These telephone poles represent less than 2 percent of the assets in the company. However, to maintain these telephone poles under group accounting the company has 31,000 property records. Under component accounting, the company would need to maintain 600,000 property records, almost twenty times the current number.

Since telephone poles are a very homogeneous asset group, under group accounting the company can use a single expected useful life estimate (usually 35 years). Using the Equal Life Group (ELG) method discussed in Issue 14 the company can estimate the telephone poles retiring each year and develop an appropriate depreciation rate for the entire asset group (account). The depreciation rate is then applied to the investment in the account to determine the depreciation accruals. Any telephone pole that is removed

from service is retired and the associated investment in the telephone pole is removed from the investment in the account. Under group accounting, the company can maintain one accumulated depreciation account for all telephone poles. Under component accounting, the company would need to maintain an individual accumulated depreciation account for each telephone pole. Otherwise, the company would be unable to determine the proper accruals and net book charge if the telephone pole prematurely retires or exceeds the useful life estimate. The net result of component accounting in this one small account in just one of our twenty odd operating telephone companies would be that 31,000 asset records would be increased to 1,200,000 records in our accounting systems.

In addition, Verizon believes the component accounting in the proposed SOP would not add the desired precision to the depreciation process. In Issue 14 we describe what we believe are the shortcomings of component accounting when applied to large asset bases of homogeneous units. Component accounting should not be mandatory. Other depreciation methods are just as accurate or may be more accurate without the large administrative burden required by component accounting.

Issue 13: Paragraphs 38 and 51 of the proposed SOP state that when existing PP&E is replaced or otherwise removed from service and the replacement is capitalized, the net book value of the replaced PP&E should be charged to depreciation expense in the period of replacement. Do you agree with this approach to accounting for PP&E? If not, what alternative would you propose and why?

Under unit accounting, we would agree with this approach. However, this immediate charge to expense is inconsistent with group accounting and not necessary to ensure proper expense recognition for large groups of homogeneous assets with the same expected useful life. The concept of group accounting assumes that some units in a particular asset group will be retired before the expected useful life. ELG recognizes this and depreciates each unit over its expected useful life. For some units in the asset group this may be one year as shown in the Attachment one example. This limits any possible charge to depreciation expense to the small variance that may occur between the ELG life estimate and actual experience. If this difference is significant for the particular asset category, group accounting does allow recognition of a gain or loss. If this difference does not warrant recognition of a gain or loss, the variance does impact the Remaining Life depreciation rate calculation, which in turn impacts the depreciation expense and Income Statement.

We believe the immediate charge to expense should be limited to unit accounting and recognition should be given to alternative methods that provide a reasonable, consistent allocation of expense to periods. As described in Issue 14 comments below, group accounting is a method that achieves results consistent with paragraphs 38 and 51 by charging the accumulated depreciation account rather than the expense account.

Issue 14: The proposed SOP requires the use of component accounting to depreciate identified components over their respective expected useful life. As noted in paragraph A48 of the proposed SOP, entities have developed and utilized various conventions to depreciate assets, including group depreciation or use of composite lives. Those conventions are acceptable only if they result in approximately the same gross PP&E, depreciation expense, accumulated depreciation, and gain or losses on disposals of PP&E as the component accounting method required by this proposed SOP. Do you agree with this approach? If not, what alternative would you propose and why?

The proposed SOP assumes that component accounting will always give the most accurate accounting of PP&E. Verizon disagrees with this premise. For companies with a limited number of assets with wide ranging expected useful lives this approach may provide a better matching than a simple composite life approach. However, for companies like Verizon, with a large number of assets, the component approach would create record keeping far more detailed than what is needed to effectively manage the business. The expense associated with this additional administrative burden would exceed any possible benefit from the "better" information, especially in asset categories with large numbers of homogeneous units with similar expected useful lives. In those cases, the additional detail may generate less accurate information than intended. In our comments below on paragraph A44 we explain this concern.

In the telecommunications industry and many other industries, there is a long-standing practice of using group accounting to depreciate PP&E. Group accounting is a method that depreciates a group of homogeneous units of plant, which are alike in character, used in the same manner in a limited service territory and operated under the same general conditions. In addition, there are many refinements of the basic process, for example, Vintage Group (VG), Equal Life Group (ELG) and Remaining Life that minimize the administrative burden and still provide a high degree of matching expense recognition with the useful life.

The AcSEC states that it considered composite depreciation as an alternative to component accounting and chose component accounting for a number of reasons. We disagree with this conclusion. We believe, group accounting, a form of composite accounting, is an appropriate method of accounting. When PP&E is homogeneous and has a reasonable expectation of a similar useful life, group accounting is equivalent to component accounting with significantly less administrative burden. When group accounting is combined with other grouping methodologies like ELG and Remaining Life, the matching of expense to useful life is superior to component accounting. Attachment one provides a description and example of ELG, which is also known as unit summation depreciation because it results in the same depreciation expense as the sum of the straight-line depreciation expense for all units with individual life estimates. For large telecommunications companies with hundreds of millions of plant records in many asset categories, the additional detail required by component accounting would create a tremendous administrative burden for marginal improvements, at best, in expense allocation. Verizon has been us-

ing group accounting for decades and ELG and remaining life since the early eighties with consistent, good results.

We would like to review and express our concerns regarding the points raised in paragraph A44 from the perspective of a telecommunications company with tens of millions of detailed PP&E records. We suspect that other industries with large investments in homogeneous assets would have the same general comments.

In paragraph A44a it is assumed that component accounting more precisely allocates the cost of PP&E to the periods benefited by that PP&E. Whether or not the allocation of the cost matches the actual use of the asset is more a function of the estimate of the useful life than the cost allocation method. For example, in the telecommunications industry, each company has hundreds of thousands of telephone poles. Experience shows that not all poles will have the same life; some will be retired prematurely because of storms, automobile accidents, road relocations, etc. and some poles may have a useful life that far exceeds the expected useful life. Under the proposed SOP, the telephone pole that is retired early, for whatever reason, is under depreciated and in the year of the retirement the company would take an expense charge for the remaining net book. But, the pole that exceeds the useful life would be fully accrued and the company would have no expense allocation for the additional years the asset still in service and productive. Different lives for different poles is not a viable solution since the company has no way of reasonably determining which telephone pole will have the short life and which will have the long life.

To resolve this issue, telecommunications companies typically use actuarial methods to develop a reasonable estimate of the useful life for all poles within an operating unit. This is no different than the actuarial principles used in the insurance industry or in pension and postretirement benefit cost calculations. This life estimate recognizes that some telephone poles will be prematurely retired and some telephone poles will have longer than expected lives. However, most telephone poles will have a useful life close to the actuarially based estimate. Since the company periodically updates the useful life estimate, this process results in an expense allocation that mirrors the company's total activity. To develop the actuarially based life estimate the companies typically maintain detailed databases of mortality experience.

In paragraph A44b it is assumed that a composite life may not be determined with a high degree of precision and reflect the weighted, average useful lives of PP&E assets. Although this may be true for assets dissimilar in character and usage, for homogeneous assets with the same general usage and life expectations, a grouping methodology using actuarial methods may result in a better life estimate and expense allocation as shown in the pole example above. It is difficult, if not impossible, to determine the precise life of an individual telephone pole. However, because telephone poles are used in the same manner under the same general conditions a reliable life estimate can be made for the group. Telecommunications companies typically have hundreds of thousands of telephone poles with thousands installed and retired each year. By tracking the mortality data for this activity, a telecommunications company can make an estimate of the group's

expected useful life that will be better than any estimated life of any individual pole. In short, individual useful life estimates will usually be wrong, but the estimated useful life of the group may be very precise.

In paragraph A44c it is assumed that a composite approach may conceal inaccurate estimates of expected useful life for long periods. Both composite and component methods may conceal inaccurate estimates if the assets are long lived. For example, telephone poles, which are typically expected to have a useful life of thirty years or longer, will normally have low replacement rates the first third of their life. If the actual useful life were forty years, it would probably take ten plus years before variances are significant enough to signal the life estimate is incorrect under the proposed SOP. However, under group accounting, companies periodically review the accounting activity for the group. Variances in the expected accruals and accumulated depreciation are detectable and changes in the useful life can be made if necessary. For many years when we were subject to rate of return regulation and subject to the requirements of SFAS No. 71, Accounting for the Effects of Certain Types of Regulation, this useful life estimate review was normally done on a three-year cycle. Now, Verizon and most telecommunication companies perform this review annually.

In paragraph A44d it is assumed that by not recognizing gains and losses, composite accounting does not correct for changes in asset usage affecting actual useful lives as compared to the expected useful lives. In the telephone industry, this potential problem with group accounting was recognized decades ago. For many years, the problem was corrected via the triennial review process with governing state and federal agencies. Although the process of periodic reviews of useful lives continues, in the early 1980s the process was supplemented with the adoption of Remaining Life in most companies. Remaining Life includes the reserve level in the development of the accrual rate, which provides a self-correcting mechanism that adjusts the accrual rate to accommodate changes in the actual and expected useful life. As a result, a PP&E category with a large number of homogeneous units with constant additions of new plant and retirements of old plant would see an expense recognition pattern in each period very comparable to the expense pattern recognizing gains and losses. If ELG were also used, there would be almost exact matching in the aggregate. In the case that a company would incur some out of the ordinary event, which impaired a significant amount of the PP&E in a particular asset category, group accounting does allow recognition of a gain or loss.

In paragraph A44e it is assumed control over PP&E may be reduced because detailed records may not be used. The use of unit or composite accounting does not relieve a company from maintaining a reasonable level of accounting detail. In our industry, as with many other capital-intensive industries, there are regulatory oversight requirements that require a certain level of accounting detail. Most telecommunications companies capitalize components of assets at a detailed level that results in millions of continuing property records. When a component is replaced, the previously capitalized component is retired and the new component is capitalized. Adopting component accounting would not change these requirements.

However, there would be tremendous costs to calculate and record depreciation at this level. We believe this additional detail would not generate any substantial benefit to management or the financial community to offset the additional administrative cost. To mitigate the administrative burden, companies may be forced to increase the capitalization level of a property record. This may result in less accounting detail under component accounting than group accounting.

In paragraph A44f it is assumed that depreciation on idle property units may not be determined with the same precision as if those units were depreciated individually. The term idle asset has different meanings in different industries. In most, we assume that any periods of idleness are incorporated into the expected useful life. In the telecommunications industry, this is not an issue. PP&E that is idle is held in special accounts and depreciation is discontinued until the PP&E is returned to productive use. The assets that typically fall into this category are so small they have no impact on any useful life estimate for any asset group. Under component or group accounting the impact of any idle plant would not change the expected useful life or any calculation of depreciation expense.

Issue 16: Paragraph 71 of the proposed SOP states that the prescribed component accounting guidance should be initially adopted for existing PP&E using one of two alternatives, the election and disclosure of which should be made when the SOP is adopted. Do you agree with that approach and, if so, do you agree with the choice of the two alternatives from which the election is to be made? If you do not agree with that approach for existing PP&E, what approach would you propose and why?

Verizon does not support the proposed requirements related to component accounting. We believe that group accounting is an appropriate method for capital-intensive companies with large amounts of homogeneous assets. For Verizon and other large, asset intensive companies, the adoption alternatives in Paragraph 71 would be extremely costly to implement requiring significant changes to our asset management systems. In addition, applying component accounting retroactively would require an additional administrative exercise to allocate the current depreciation reserves to the new components. This would require years to complete. Should the SOP be adopted as is, Verizon would have no choice but to apply the new standard prospectively. Even then, implementation would be burdensome since a significant amount of assets are retired daily triggering an assessment of the need for an additional component category and useful life estimate.

For all the reasons stated in this comment letter, we do not believe we would be able fully implement the proposed SOP by the implementation date in paragraph 70.

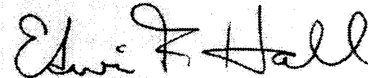
Issue 19: Under paragraph 71(a) of the proposed SOP, and as illustrated in Example 3 in appendix C, an entity applying component accounting retroactively at date of adoption may calculate a difference between the pre-adoption balance of accumulated depreciation and the balance recalculated based on the estimated useful lives of components that previously were not accounted for as separate components.

Under that paragraph, the difference is allocated back to the accumulated depreciation of each component based on the net book values of the components. Two alternatives considered were recording the difference as a cumulative effect type adjustment at adoption and recording the difference as additional depreciation expense at adoption. Do you agree with the proposed approach or either of the alternatives, and why?

As previously stated, Verizon does not support the proposed requirements related to component accounting. However, as discussed in Issue 16 above, should the SOP be adopted as is, Verizon would have no choice but to apply the new standard prospectively. If retroactive adoption were required, we would prefer the cumulative effect type adjustment. This alternative allows for depreciation expense for future periods to be more comparable and earnings per share of income from continuing operations would be more meaningful when comparing one period to another.

We appreciate the opportunity to comment on the proposed Statement. Members of my staff are available to discuss these comments with you and your staff.

Sincerely,



Edwin F. Hall
Vice President
Verizon Communications

Attachment: Equal Life Group Example

Attachment One

Equal Life Group Example

To understand the Equal Life Group (ELG) methodology, one first needs to understand a few basic concepts of actuarial life analysis. Actuarial analysis is the process of using statistics and probability to describe the retirement history of property. The process is used as a basis for estimating the probable future life characteristics of a selected group of homogeneous assets. However, this estimate must be refined to reflect the impact of variables such as technology, network deployment plans, or market dynamics which may not be embedded in the historical mortality experience. To perform this actuarial analysis, telecommunications companies typically used the historical data in the Continuing Property Records (CPR). From this detailed data, mortality tables that stratify the investment within a plant category by age (vintage) and proportion surviving (amount of original investment that has survived retirement) are developed. The CPR data also allows the calculation of a survivor curve, which depicts the expected pattern of future retirements based on the historical experience of the group.

Under the straight-line method of depreciation accounting, the book investment, less its net salvage, is depreciated over the average service life of the property in the group. The average service life is estimated by blending past experience with forecasts of the future. The blending process in the telecommunication's industry is the generation arrangement. In the generation arrangement, the past experience is the vintage investment and proportion surviving from the CPR data. The future is the remaining life developed from a projection life (an estimate of the expected useful life of newly placed plant) and the survivor curve. For each vintage an average service and remaining life is calculated and then the vintage results are weighted to develop an average service and remaining life for the entire category. This process of grouping the investment by age is called Vintage Group (VG). If the asset category is a homogeneous group of plant, the process will generate a very good estimate of the expected useful life of the group and the expected retirement pattern of the assets within the group.

VG was designed to charge to depreciation expense the cost of property installed in a single year (vintage) over the property's useful life. Under VG an average percentage rate is applied annually to the surviving plant investment throughout the life of the vintage. The total cost of the vintage is fully allocated to expense when the last surviving unit in the vintage is retired. Equal Life Group (ELG) is a refinement of VG where the vintages are subdivided using the survivor curve into subgroups having equal probable lives. ELG is designed to charge to depreciation expense the investment in each equal life group by the time each group is completely retired. For example, under ELG, if a group has a probable life of three years, the original capital cost is allocated over three years; if the probable life is ten years, the original cost is allocated over ten years.

The following example illustrates the use of the ELG methodology in determining the appropriate depreciation expense for a homogeneous group of assets. Assume the asset group has 100,000 units with an expected useful life of 15 years. Salvage and cost of removal is assumed to be zero for simplicity. Based on an appropriate survivor curve, Col-

umn B of the attached Table reflects the number of units still in service at the end of each year. Subtracting the ending balance from the previous year ending balance, Column C, shows the expected retirements; that is, in year three 1,638 units, in year ten 4,480 units, etc. Note that roughly half of the units retire in less than the 15 years and some units survive up to nine years longer than the expected useful life. For the proper depreciation of all investment in all units, the amount of investment (Column C) for each vintage should be allocated over the expected useful life (Column A). For example, in year three 1,638 units with an investment of $1,638 (1,638 units times $1) would be allocated over the three-year useful life. Columns D through AB show the straight-line allocation of expense for each year. Column AC shows that over all years (the sum of columns D through AB) all vintages are fully depreciated. The total depreciation expense for any year (columns D through AB) is the summary of the expense allocation for each vintage. For example, the total depreciation expense for year three would be $546 + $513 + $495 + ... + $332 = $8,244.

The ELG methodology takes the expected depreciation expense for each year and investment weights it to determine an average remaining life for the group of assets. The average remaining life is then used to develop a depreciation rate that will ensure the depreciation accrual will match the expected expense (i.e. $8,244 for year three).

SOP PP&E
ELG Example

Number of units	100,000
Cost per unit	1
GS	0
CR	0
Expected Useful Life	15

		Amount	Expense Year																									Total
	Amount	Retired																										Allocated
Year	in Service	During Year	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	Expense
A	B	C	D	E	F	G	H	I	J	K	L	M	N	O	P	Q	R	S	T	U	V	W	X	Y	Z	AA	AB	AC
0	100,000	294	294																									294
1	99,706	860	860																									860
2	98,846	1,240	620	620																								1,240
3	97,606	1,638	546	546	546																							1,638
4	95,968	2,052	513	513	513	513																						2,052
5	93,916	2,475	495	495	495	495	495																					2,475
6	91,441	2,898	483	483	483	483	483	483																				2,898
7	88,543	3,325	475	475	475	475	475	475	475																			3,325
8	85,218	3,728	466	466	466	466	466	466	466	466																		3,728
9	81,490	4,122	458	458	458	458	458	458	458	458	458																	4,122
10	77,368	4,480	448	448	448	448	448	448	448	448	448	448																4,480
11	72,888	4,796	436	436	436	436	436	436	436	436	436	436	436															4,796
12	68,092	5,052	421	421	421	421	421	421	421	421	421	421	421	421														5,052
13	63,040	5,265	405	405	405	405	405	405	405	405	405	405	405	405	405													5,265
14	57,775	5,390	385	385	385	385	385	385	385	385	385	385	385	385	385	385												5,390
15	52,385	5,445	363	363	363	363	363	363	363	363	363	363	363	363	363	363	363											5,445
16	46,940	5,408	338	338	338	338	338	338	338	338	338	338	338	338	338	338	338	338										5,408
17	41,532	5,304	312	312	312	312	312	312	312	312	312	312	312	312	312	312	312	312	312									5,304
18	36,228	5,094	283	283	283	283	283	283	283	283	283	283	283	283	283	283	283	283	283	283								5,094
19	31,134	4,826	254	254	254	254	254	254	254	254	254	254	254	254	254	254	254	254	254	254	254							4,826
20	26,308	4,480	224	224	224	224	224	224	224	224	224	224	224	224	224	224	224	224	224	224	224	224						4,480
21	21,828	4,074	194	194	194	194	194	194	194	194	194	194	194	194	194	194	194	194	194	194	194	194	194					4,074
22	17,754	3,630	165	165	165	165	165	165	165	165	165	165	165	165	165	165	165	165	165	165	165	165	165	165				3,630
23	14,124	3,151	137	137	137	137	137	137	137	137	137	137	137	137	137	137	137	137	137	137	137	137	137	137	137			3,151
24	10,973	2,664	111	111	111	111	111	111	111	111	111	111	111	111	111	111	111	111	111	111	111	111	111	111	111	111		2,664
25	8,309	8,309	332	332	332	332	332	332	332	332	332	332	332	332	332	332	332	332	332	332	332	332	332	332	332	332	332	8,309
		100,000	10,018	8,864	8,244	7,698	7,185	6,690	6,207	5,732	5,266	4,808	4,360	3,924	3,503	3,098	2,713	2,350	2,012	1,700	1,417	1,163	939	745	580	443	332	100,000

Note: The 8,309 units surviving (column B) in year 25 are the sum of several years. Typically a survivor curve trails off slowly. The curve in this example was truncated at 25 years for simplicity.

November 15, 2001

Mr. Marc Simon
Technical Manager, Accounting Standards
File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

RE: Comments of Baltimore Gas and Electric Company on the proposed Statement of Position, "Accounting for Certain Costs And Activities Related to Property, Plant, and Equipment."

Dear Mr. Simon:

Baltimore Gas and Electric Company (BGE) is pleased to submit its comments on the proposed Statement of Position (SOP), "Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment" as prepared by the Accounting Standards Executive Committee (AcSEC).

BGE is a public utility company that distributes gas and electric to more than one million customers. The service territory of BGE consists of the City of Baltimore and all or parts of ten counties in Central Maryland

BGE would like to express its overall agreement with, and support for, the comments made by the Edison Electric Institute (EEI) and the American Gas Association (AGA) in their letters commenting on this SOP.

In particular, BGE concurs with comments by EEI and AGA regarding criteria for consideration by the FASB listed as items one, two, and four in the Foreword of the SOP. Item one states that the proposal "(must) not conflict with the current or proposed accounting requirements, unless it is a limited circumstance, usually in specialized industry accounting, and the proposal adequately justifies the departure." Item two states that, "The proposal (must) result in an improvement in practice." Item four states that, "The benefits of the proposal are expected to exceed the costs of applying it." As further explained below, BGE agrees with EEI and AGA's position that these three criteria are not satisfied with regards to the regulated public utility industry.

With respect to Item one, BGE notes that several of the requirements of the SOP conflict with current regulatory accounting requirements for public utilities promulgated by the Federal Energy Regulatory Commission (FERC). As a result, implementation of the SOP for purposes of reporting to the Securities and Exchange Commission (SEC) while conforming to current FERC requirements for regulatory reporting purposes would result in BGE maintaining two "sets of books". This would create large regulatory assets or liabilities on BGE's financial

statements resulting from the application of SFAS 71 "Accounting for the Effects of Certain Types of Regulation," to synchronize regulatory and GAAP reporting and would in turn decrease the transparency of the financial statements and increase public confusion.

In response to Item two, BGE believes the use of component accounting, or a component-based depreciation system will not improve the accuracy of financial reporting. We concur with the assertions by EEI that it is inefficient and inaccurate to track the large number of assets placed in service by utility companies. Estimating the life and salvage values of large numbers of assets involves significant probability and raw, subjective judgement. The industry's use of actuarial studies, university research, and continual revalidation of modeling techniques removes much of the probability and subjectiveness of estimating for individual components. The proposed SOP strongly discourages the use of actuarial science and, according to EEI, "replaces it with a review mandating pure judgement," that, "cannot be seen as an improvement in practice."

Although the proposed SOP provides for the use of alternative methods of depreciation, this is only allowed if the result is not materially different than if the component method were used. Thus, the component method (with all its complexity and difficult requirements) must first be applied and demonstrated to have similar results as the alternative method before a company could use an alternative method. Due to the time investment and cost necessary to support the alternative method, this effectively discourages the use of alternative methods.

Item four requires that the benefits of the proposal should exceed the costs of applying it. Maintaining two "sets of books" would also significantly increase costs related to capturing and tracking asset costs, especially in the capital-intensive public utility industry. BGE would incur significant costs in complying with this complex statement but would not see an appreciable improvement in financial reporting accuracy. BGE has very large numbers of property items which would have to be separately tracked. It is in part because such separate tracking is inefficient that group depreciation, supported by actuarial studies, research and revalidation of modeling techniques, is used. Group depreciation using statistical and empirical analysis of useful lives is not only more efficient, but also provides more accurate balances than the use of individual judgement to determine useful lives under component depreciation. Thus, the costs of applying this SOP greatly outweigh any benefits of the proposal.

In addition to the comments above regarding the review criteria, BGE wishes to comment on specific issues as delineated by the AcSEC in the letter included with the draft SOP.

ISSUE 1:

BGE agrees with the guidance as currently stated in the proposed SOP.

ISSUES 2 and 3:

BGE agrees in principle with the framework established under the SOP, but does not agree with the stages outlined in paragraphs 16 through 21. We believe the decision to capitalize costs should be based on the type of activity performed and the type of cost incurred. We believe the current language in the SOP requires capitalization or charging to expenses based solely on the timing of the event. In the utility industry, some large projects are approved in stages, meaning that permits, engineering costs, etc. that would occur after approval in other industries and thus be capitalized, would be expensed in the utility industry if the proposed rules were issued. This could have significant financial impact on a utility where regulators do not allow a rate of return on regulatory assets through rate recovery.

ISSUE 4:

BGE does not believe that the costs listed in paragraphs 23 and 28 are an all-inclusive list of costs that should be capitalized. We agree with the assertions made and example presented by the EEI in its comment letter dated 11/9/01. There are certain costs in the utility industry that do not fall into the categories established by this proposed SOP and should be capitalized because they would not have been incurred if not for construction of an asset.

ISSUE 5:

BGE agrees with the guidance as currently stated in paragraph 32.

ISSUE 6:

BGE agrees in principle with paragraph 37 of the SOP. However, BGE also asserts that it is accepted practice in the regulated utility industry to place assets in service when they are able to safely and accurately perform their expected function. In such a situation, there may be continuing costs to fully complete the assets (such as first time painting, "punch list" items, etc.). We believe such costs should be capitalized as a cost necessary to construct an asset. BGE suggests that additional language be added consistent with the following suggestion by EEI: "...paragraph 37 be modified to include criteria 37(c) which would state the following: c) "that are necessary for the completion of the asset, but were not necessary for the asset to be placed in service.

ISSUE 7:

BGE disagrees with guidance presented in paragraph 39 on the premise that it conflicts with treatment required by SFAS 143, "Accounting for Asset Retirement

Obligations." SFAS 143 has been finalized and applied. The proposed SOP provisions should be reconciled with the treatments mandated under SFAS 143.

ISSUE 8:

BGE agrees with EEI's position on Issue 8. EEI's position is as follows: "Regulatory accounting and ratemaking practices recognize the fundamental economic differences between planned major maintenance activities and unplanned or routine maintenance... Accordingly, most regulators provide ratemaking mechanisms to levelize the annual impact of planned major maintenance activities. Notwithstanding the proposed proposed SOP's provisions in this regard, EEI's member companies with these types of regulatory mechanisms must continue to defer or accrue these costs, as applicable in each regulatory jurisdiction, under the provisions of SFAS No. 71."

ISSUE 9:

BGE is silent on this issue.

ISSUE 10:

BGE is silent on this issue.

ISSUE 11:

BGE is silent on this issue.

ISSUE 12:

BGE believes regulated utilities should be granted an exemption from the component accounting guidance outlined in the SOP. Implementing the provisions of component accounting would result in a significant, permanent increase in personnel and required resources for BGE. These costs must be passed onto ratepayers, but will not improve service to the ratepayer or financial reporting. BGE believes the reasons outlined in EEI's letter to the AcSEC provide ample evidence supporting an exemption for regulated electric and gas utilities. BGE also agrees with the following statement by EEI: "At a minimum, paragraph 52 of the proposed SOP should be supplemented to specifically exempt items of mass property from component accounting requirements, as the implementation of these requirements for mass property would be impracticable."

ISSUE 13:

BGE does not agree with the treatment identified in paragraphs 38 and 51 of the proposed SOP. BGE believes that regulated utilities should be exempt from provisions to charge net book value of replaced PP&E to depreciation expense.

Under the group accounting methods endorsed by regulatory ratemaking framework, net book value is charged to a utility's accumulated depreciation. This levelizes the rates to "ensure full recovery of all prudently incurred costs" (EEI).

A regulated utility implementing these provisions would incur significant costs to maintain two sets of books and two detailed asset listings. In addition, large regulatory assets and liabilities would result, making the financial statements more confusing to many readers. We do not believe the benefits of implementing the proposed SOP outweigh these costs.

In addition, retiring individual items of mass property is impractical.

BGE agrees with EEI's assertion that the proposed provisions conflict with the provisions of SEC Staff Accounting Bulletin Topic 5B. According to EEI's letter, "This guidance precludes charging depreciation expense for the net book value of replaced PP&E and recognizes the propriety of group or composite depreciation, including the charging of accumulated depreciation for gains and losses on replaced PP&E."

ISSUE 14:

BGE does not agree on a theoretical or practical basis with the proposed SOP provisions requiring individual depreciation accounting for each component. BGE uses group and composite depreciation methods to account for its assets. These methods are widely accepted in the industry and are well supported by actuarial studies, university research, and continual revalidation.

On a theoretical basis, BGE believes that group depreciation is a more accurate and statistically valid method of depreciation recovery. We concur with the support of this belief enumerated in the comments filed by EEI on page 14 and 15 of its comment letter.

On a practical basis, BGE believes the costs to produce a full comparison of individual and group methods to support use of one or another would far outweigh any benefits provided. BGE believes that the composite and group methods should continue to be permitted based on the established statistical validity of the method.

ISSUE 15:

BGE is silent on this issue.

ISSUE 16:

BGE agrees with the guidance in paragraph 71.

ISSUE 17:

BGE agrees with EEI in that the fiscal year-end effective date should allow at least 18 months from the issuance of the final standard to implement the guidance and requirements.

ISSUE 18:

BGE agrees with the guidance in paragraph 72.

ISSUE 19:

BGE agrees with the guidance as outlined in paragraph 71(a).

CONCLUSION:

BGE urges AcSEC to understand that the methods employed by the gas and the electric utility industries are subject to strict scrutiny by regulatory authorities. BGE believes the SOP should include certain exemptions referred to above in order to prevent duplicative accounting and costly record-keeping that will not result in improved financial reporting or a higher monetary benefit.

BGE appreciates the opportunity to respond to the proposed SOP and to provide input into the AcSEC's process.

Sincerely,

Anne Hahn
Manager - Finance & Accounting
Baltimore Gas & Electric Company

Marc Simon

11/16/2001 10:49 AM

To: agadkins@uss.com, bdrake@kpmg.com, cdaugherty@dttus.com, james_ross@csx.com, jbrant@deloitte.com, leonard.gatti@us.pwcglobal.com, lmayshak@dttus.com, msimon@aicpa.org, richard.h.moseley@aexp.com, rrendino@pgrt.com, Sharon Macey/NY/AICPA@AICPA

cc:

Subject: cl #275

cl #275

----- Forwarded by Marc Simon/NY/AICPA on 11/16/01 10:54 AM -----

Frank.Loughery@abbott.com

11/16/01 10:41 AM

To: MSimon@aicpa.org

cc: John.Tebbetts@abbott.com

Subject: Re: Response to SOP on PP & E

November 15, 2001

Mr. Marc Simon
Technical Manager, Accounting Standards
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Re: File 42 10.CC

Dear Sir:

We are pleased to respond to the Exposure Draft, "Accounting for Certain Costs
and Activities Related to Property, Plant, and Equipment" (SOP).

Abbott is a worldwide company engaged in the discovery, development,
manufacture and sale of human health care products. Of our total assets of
approximately $23 billion, gross property and equipment accounts for over 50
percent and annual additions to property and equipment total approximately $1
billion. In addition, Abbott manufactures medical instruments and devices for
both sale to end users and for internal use.

We have reviewed the SOP and have the following comments:

Overall, we believe that the SOP creates a fundamental

flaw in that overhead
should be capitalized when equipment is manufactured
for ultimate sale to end
users but overhead is not capitalized when equipment
is manufactured for
internal use. We do not believe that there should be
a different cost basis
assigned to manufactured equipment depending on its
ultimate disposition. If
property were constructed or manufactured by an
unrelated entity, that
entity's overhead would be capitalized as part of the
purchase price. This
results in a different cost basis even though the same
amount of resources
would have been consumed. This flaw causes the
following two specific
problems.

When manufacturing equipment, used for either sale or
internal use, it is
impossible to know which equipment will be sold to end
users and which
equipment will be used internally. Whether an Abbott
device or instrument
will be sold or used internally depends on several
economic factors affecting
both Abbott and the customer at the time of placement.
This could be several
months after the equipment is manufactured. Abbott
would need to design and
install manufacturing planning and control systems to
accommodate the SOP.

In implementing the SOP on Internal Use Software, we
have noted that the
inconsistency between make-versus-buy economics causes
poor decision making
when developing internal use software. This is due to
the SOP's requirement
to exclude the cost of certain activities and overhead
from the cost of the
capitalized property when it is developed internally.
If software were
purchased from a third party, most of these costs are
part of the purchase
price, and therefore capitalized. We believe that the
same poor decision
making will occur with this SOP's requirements to
exclude the cost of certain
activities and overhead from the cost of property
constructed versus
purchased.

Very truly yours,

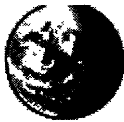
Frank J. Loughery
Assistant Corporate Controller

Marc Simon

11/16/2001 10:51 AM

To: agadkins@uss.com, bdrake@kpmg.com, cdaugherty@dttus.com, james_ross@csx.com, jbrant@deloitte.com, leonard.gatti@us.pwcglobal.com, lmayshak@dttus.com, msimon@aicpa.org, richard.h.moseley@aexp.com, rrendino@pgrt.com, Sharon Macey/NY/AICPA@AICPA
cc:
Subject: cl #276

cl #276
----- Forwarded by Marc Simon/NY/AICPA on 11/16/01 10:56 AM -----



JRamsay@naruc.org

11/15/01 03:47 PM

To: msimon@aicpa.org
cc: PLee@PSC.STATE.FL.US, diane.munns@iub.state.ia.us
Subject: NARUC COMMENTS ON THE PROPOSED SOP IN FILE 4210.CC

Mr. Simon - I've attached our comments as a "word file" and also "pasted
them in" to the body of the text below. Call or
e-mail me if you have any
questions. THANKS
BRAD RAMSAY

Submitted Electronically November 15, 2001 to the

Mr. Marc Simon
[]
Technical Manager, Accounting Standards
American Institute of Certified Public Accountants
Accounting Standards Executive Committee

)
American Institute Of Certified Public Accountants
)
Accounting Standards Executive Committee
)
Proposed Statement Of Position
) File 4210.CC
Accounting For Certain Costs And Activities
)
Related To Property, Plant, And Equipment
)

Initial Comments of the National Association of Regulatory Utility Commissioners

The National Association of Regulatory Commissioners (NARUC) sincerely appreciates the opportunity to comment on the proposed Statement of Position (SOP), "Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment" as prepared by the Accounting Standards Executive Committee (AcSEC).
NARUC is a quasi-governmental nonprofit organization founded in 1889. NARUC represents the government officials in the fifty States, the District of Columbia, Puerto Rico, and the Virgin Islands, charged with the duty of regulating, inter alia, the telecommunications common carriers and other gas, electric, and water utilities operating within their respective borders. Both the United States Congress and federal courts have recognized that NARUC is a proper party to represent the collective interest of the State regulatory commissions.

The proposals set forth in these proceedings could have an obvious and significant impact on State's ability to respond effectively to the duties imposed upon them by State Statute to protect their residents. Because of these concerns, NARUC's counsel has been specifically instructed, via the resolution passed November 14, 2001, to file these pleadings outlining the States position. A copy of that resolution is attached to this pleading.
The AcSEC proposes two purposes for this SOP: (1) to standardize the costs and stages of projects eligible for capitalization as Property, Plant and Equipment (PP&E) assets; and (2) to standardize the depreciation methodology used by all non-governmental entities for recovery of PP&E assets. As stated in the Foreword of the SOP, the accounting guidance contained in the

SOP has been cleared by the Financial Accounting Standards Board (FASB).
The criteria applied by the FASB for clearance of proposed documents, as stated on page 12 of the SOP, are: (1) the proposal should not conflict with current or proposed accounting requirements, unless it is a limited circumstance, usually in specialized industry accounting, and the proposal adequately justifies the departure; (2) the proposal will result in an improvement in practice; (3) the AICPA demonstrates a need for the proposal; and (4) the benefits of the proposal are expected to exceed the costs of applying it.
NARUC's comments focus on (1) the purpose of the SOP to standardize accounting for PP&E, (2) concerns that, for regulated utilities, the SOP will both (a) conflict with current regulatory accounting requirements and will not result in an improvement in practice; (c) the AICPA has not demonstrated a need for the proposal; and (d) the costs of applying the SOP will outweigh the benefits of its application, and (3) the applicability of the SOP to public utilities.

Standardization of Accounting for PP&E

As discussed above, the AcSEC provides two main purposes for the SOP: (1) standardization as to items capitalized to plant accounts, and (2) standardization of depreciation accounting methodology. Through regulatory accounting policy, such uniformity and standardization already exists within the utility industry. In addition, due to the unique regulated utility operating environment, complete accounting uniformity between utility-type entities and other types of businesses is not necessary or may not even be desirable. The utility industry is not only subject to uniform accounting policies, but it is a far more capital-intensive industry and, therefore, will be more heavily impacted by the SOP. In addition, while other non-regulated industries don't have depreciation studies to support the use

of group depreciation, such studies have been prevalent in the utility industry for many years. Therefore, the use of group depreciation by public utilities is much more acceptable than for non-utilities. While the accounting policies set forth in the SOP may or may not be necessary for non-regulated companies, it is highly questionable for the utility and similar industries.

Conflict with Current Accounting Requirements

Utilities are regulated by the Federal Energy Regulatory Commission (FERC), the Federal Communications Commission (FCC), and individual state regulatory commissions. NARUC's rules require utilities to follow the respective Uniform System of Accounts (USOA) established by the FERC and the FCC, as modified by a state regulatory commission. The USOA account structure sets forth requirements for the capitalization of costs such as indirect construction overhead and general and administrative costs, and gives the ability to track property using mass property accounting (18 CFR Part 101 Electric Plant Instructions 4.A, 3.A.12, and 10.B.2, 47 CFR Chapter I, Part 32.2000). The proposed SOP appears to be in direct conflict with regulatory guidance. Significant deviation from capitalization rules already established for regulated utilities would be required for compliance.

Conforming to FERC, FCC, and state regulatory reporting and the SOP for reporting to the Securities and Exchange Commission (SEC) will require multiple "sets of books" with different rules for reporting and ratemaking.

Having two sets of rules would also increase the number of regulatory assets that would be required.

Negligible Improvements in Practice

The use of component accounting, or a components based depreciation system will not improve the accuracy of depreciation while imposing unwarranted costs on utilities. For decades, the depreciation accounting for utility

plant has been accomplished using group accounting. It has long been recognized that depreciating by unit or component is not practical for most types of property because the procedure requires separate record-keeping for each unit. The costs associated with such record-keeping is cost prohibitive. As NARUC Public Utility Depreciation Practices states:

The group plan of depreciation accounting is particularly adaptable to utility property. Rather than depreciating each item by itself (unit depreciation) or depreciating one single group containing all utility plant, a group contains homogeneous units of plant which are alike in character, used in the same manner throughout the utility's service territory, and operated under the same conditions.

Of course there will be different lives for individual units within groups. For example, poles are generally combined in a single group. Some poles will be retired because of storms or automobile accidents. Some will decay, some will be displaced due to road relocations and some will be retired because of underground replacements. However, they are combined in the same group because they are homogeneous units. Years ago when some poles were untreated, there was a need for separate grouping as these poles were more susceptible to decay and termite infestation than treated poles. Likewise, concrete poles have unique characteristics and qualify to be grouped separately from wood poles. Buried, aerial, and underground (in conduit) cables are further examples of the same type of plant receiving different grouping because of different characteristics. Generally speaking, smaller groups yield more accuracy, but there are diminishing returns because more detailed accounting records are required.

Most utilities group properties by account and in some cases subaccount. Studies are made using various procedures

to determine the
appropriate life and salvage factors. These
procedures involve different
forms of grouping for weighting purposes and should
not be confused with the
group concept of depreciation.

Component depreciation requires a discrete estimate of
life and salvage for
each unit or component of property. This will involve
a higher degree of
judgment than currently employed with use of group
depreciation accounting.
Additionally, this procedure may not result in the
improved accuracy the
AcSEC believes it will while, at the same time,
imposing additional costs to
the utility. For utilities still subject to
rate-of-return regulation, this
means potentially higher rates for utility customers.
Furthermore, to the
extent that estimates of component lives are indeed
less accurate, utilities
may realize wide fluctuations in depreciation expense
and consequently
erratic earnings. In fact, earnings may be more
erratic as plant matures
resulting in more premature or unanticipated component
retirements.

Unit or component depreciation is not generally used
in regulatory
depreciation because of its impracticalities. The
basic concept behind this
approach is that each individual unit or component
should be fully
depreciated by the time of its retirement; if it lives
a bit longer than its
expected life, depreciation is stopped at full
recovery; in the case of
early retirement, the "unrecovered" amount is
immediately written off as a
loss. Unit or component depreciation is meaningful
only when the specific
remaining life of the unit or component is known to be
different from the
average of its group. In the case of an installation
being considered a
unit, it must be recognized that "unit" actually
consists of quite different
accounts - the commonality being that these various
components are sharing a
given dismantlement and retirement of the whole
installation.

The first problem with this approach is that almost nothing is bought with the certain knowledge of the period it will serve the public, so initially a group average life must be used, and ultimately there will almost certainly have to be a specific unit correction for the over or under service life experienced. This leads to the second problem, which is the substantially increased record keeping. The age of the item and its individual amount of accrued depreciation must be maintained, and the specifics adjusted when it retires or becomes "fully depreciated". Group depreciation accomplishes the same end-point with much less expenditure of effort.

Group depreciation works under the premise that, if the group universe lives in a fashion to produce that average life, the group will be fully recovered. If the group life and salvage presumptions are correct, the group, and every item in the group, will have been fully recovered. If the life and salvage presumptions are incorrect, the remaining life depreciation technique will ensure full recovery. The nature of group depreciation leads to the booking of the original cost of the retired asset to both plant in service and the reserve. According to Accounting for Public Utilities,

> Under the group concept each depreciable property group has some "average" life. For accounting purposes, every item in the group is assumed to have the life of the group and to be fully depreciated at the time of retirement. The average is the result of a calculation, and there is no assurance that any of the property items in the group is average.
>
> The use of the term "average service life" in the measurement of the mortality characteristics of utility property carries with it the concept of retirement dispersion (variation around the average service life). If every item was average, thereby having exactly the same life, there would be no dispersion. The concept of

retirement dispersion
recognizes that nearly half of the items in a group last to an age less than
the average service life, a few last to an age equal to the average, and the
rest last longer than the average.

The SOP states that "To the extent that an entity can demonstrate that those
[group depreciation] conventions can be used and produce the same results -
related to gross Property, Plant & Equipment (PP&E), accumulated
depreciation, depreciation expense, and gains or losses on replacements or
disposals of PP&E - that are not materially different from those obtained
under the component accounting prescribed in paragraphs 45 through 51, the
AcSEC believes this SOP should not preclude the use of such conventions."
NARUC is concerned that this will require utilities to show quantifiably
that the results using group depreciation accounting are not materially
different from those using component or unit depreciation accounting
prescribed by the SOP. If this is the case, utilities would incur
significant costs to calculate the gross PP&E, accumulated depreciation,
depreciation expense, and gains or losses on replacements or disposals of
PP&E obtained under component or unit depreciation accounting.
For the above reasons, NARUC asserts that the proposed SOP does not meet the
FASB requirement in which the benefits of the proposal should be expected to
exceed the costs of applying the proposal.

Lack of Demonstrated Need of SOP

As discussed above and on page 12 of the SOP, one of the criteria
applied by the FASB for clearance of proposed documents is that the AICPA
must demonstrate a need for the proposal. As has already been discussed in
these comments, the standardization of accounting for PP&E among regulated
utilities and other non-regulated industries is questionable, the SOP
conflicts with current regulatory accounting requirements, and the SOP will

not result in an improvement in accounting practice, at least for public utilities. In addition, as discussed below, the costs of implementing the SOP by public utilities, outweighs the benefits. Therefore, the AICPA has failed to demonstrate the need for the SOP, at least as it relates to public utilities.

Costs Outweigh Benefits

As discussed in NARUC's responses to specific issues, the application of the SOP to the utility industry would be extremely expensive. To the extent a utility is subject to rate-of-return regulation, this translates to higher, unnecessary costs to the utility ratepayer. For those utilities not subject to rate-of-return regulation and not able to pass such costs on to their ratepayers, these utilities must absorb the additional costs which increases the risk for these utilities. Examples of where the proposed SOP will impact utility costs and earnings, and may result in increased rates charged to customers are as follows:

a. The prohibition of capitalization of A&G and overhead costs will first of all result in increased earnings volatility, as these costs are expensed rather than capitalized. In addition, failure to capitalize these costs will unfairly shift the burden of collection of these costs from customers over the life of the applicable asset to current customers during the construction of the asset.

b. The SOP proposal would require that gains or losses from disposal of assets be reflected in results of operations in the current accounting period. This will also result in increased earnings volatility as regulatory requirements prescribe that such gains or losses on disposition of mass assets be closed to accumulated depreciation. Utility rates may likely require upward adjustment to provide for the increased uncertainty of earnings.

c. The SOP would require that cost of removal be reflected in the results of operations in the accounting period in which such cost is incurred versus current regulatory requirements which recognize cost of removal over the useful life of the asset. This provision will also result in increased earnings volatility as cost of removal is reflected in a single accounting period. In addition, failure to capitalize these costs will also unfairly shift the burden of collection of these costs from customers over the life of the applicable asset to current customers during the period of retirement of the asset.

d. The SOP would require that costs associated with planned major maintenance projects be expensed as incurred. In some cases, regulators allow the deferral of such costs over a number of accounting periods in an attempt to maintain stable rates. Implementation of this proposal would again result in increased earnings volatility as major maintenance costs are recognized in a single accounting period rather than spread over a number of accounting periods. To avoid earnings volatility, such costs would have to be reflected in utility rates in one year. The high cost of such maintenance would cause utility rates to spike in that year, an undesirable result for utility customers and a result regulators attempt to avoid.

AcSEC appears to recognize this problem, in issue 14, where it allows an entity to demonstrate that group depreciation can be used and produce the same results as component accounting. Unfortunately, this would require a utility to calculate the gross amount of its PP&E, accumulated depreciation, depreciation expense, and any gains or losses on replacements or disposals of its PP&E obtained under component accounting. This would be very costly, if not prohibitive.

Also, due to the capital-intensive nature of the utility industry,

utilities will have to make significant programming and operational changes
to their processes to comply with the SOP. Major changes will be needed for
capitalizing and tracking asset costs. This may require increased staffing
levels in order to track and maintain the additional level of detail to
implement the SOP. Most of these increased costs may be passed on to the
utility ratepayers in the form of increased rates. This will be further
complicated by the potential need for a large number of regulatory assets
due to the application of Statement of Financial Accounting Standards No. 71
(SFAS 71), Accounting for the Effects of Certain Types of Regulation,.

At least as it relates to public utilities, the SOP does not meet
the test that the benefits of the proposal should be expected to exceed the
costs of applying the proposal. The detrimental impact of the SOP should be
carefully considered and weighed against any identifiable benefits before
the SOP is implemented for public utilities.

Exemption for Regulated Utilities

If the SOP is approved as currently drafted, NARUC believes that regulated
utilities should be exempted from at least those provisions of the SOP that
contradict regulatory accounting rules. Regulated utilities are required to
follow accounting provisions set forth by state regulatory commissions, the
FERC, and the FCC. These system of accounts provide accounts and
sub-accounts of homogeneous assets. Requiring utilities to capitalize
assets or compute depreciation using a methodology contradictory to
traditional regulatory accounting practices and procedures and existing
state and federal rules would unnecessarily add accounting complexities at
significant costs while producing less accurate results.

If public utilities are not exempted from this SOP, then NARUC suggests that
AcSEC make clear if or how SFAS 71 applies in relation to the SOP. Revising

the SOP to recognize a number of the differences between regulatory accounting policy and the SOP will help mitigate some of the negative ratemaking impacts of the proposal. Some issues where the applicability of SFAS 71 should be recognized in the SOP include: capitalization of A&G and overhead costs, use of group and/or composite depreciation accounting, recognition of cost of removal of a plant asset over the asset's useful life, and deferral of certain major maintenance projects. The more consistent regulatory accounting is with GAAP, the better for public utilities, regulators, utility shareholders, and utility customers. To this end, NARUC encourages AcSEC to maintain an open dialogue with federal and state regulators and the public utility industry during the review and approval process.

However, the above suggestion will not help those public utilities that are no longer subject to SFAS 71. For these utilities, if they are not exempted, or even for the public utilities subject to SFAS 71, component accounting, if required, should be limited to more costly, material components. As drafted, the SOP would require public utilities to account and maintain information for thousands and thousands of individual plant assets. The impact of this could be greatly mitigated if the proposal was limited to the more costly assets. This would lower the costs of the proposal to utilities and utility ratepayers, and result in minimal differences in plant balances and operating results.

NARUC still encourages AcSEC to exempt public utilities from the SOP if it is approved as drafted. If AcSEC does not believe that utilities should be exempted from the SOP, it should at least make clear if and how SFAS 71 applies and also limit the SOP to the more costly material components.

In addition to the comments above, NARUC offers the following responses to specific issues set forth in the AcSEC letter included with the draft SOP.

Project Stage Framework

Issue 2: The guidance in this proposed SOP is presented in terms of a project stage or time line framework and on the basis of the kinds of activities performed during the stages defined in the proposed SOP rather than on whether an expenditure fits into certain classification categories such as ordinary repairs and maintenance, "extraordinary" repairs and maintenance, replacements, betterments, additions, redevelopments, renovations, rehabilitations, retrofits, rearrangements, refurbishments, and reinstallations.

The proposed project stage or timeline framework causes the same cost to be treated differently depending upon the timing. NARUC is not sure that a project stage or timeline framework best facilitates presentation and understanding of the relevant concepts in this SOP. The project stage or timeline framework set forth in this SOP raises the following questions:

1. Is there a clear differentiation between the stages, especially between the preliminary and preacquisition stage? This is important, since the capitalization criteria differs greatly between these two stages. For public utilities, these two stages are treated the same, except that in some states for certain utilities, precertification expenses are treated differently. Precertification expenses are those costs incurred prior to the utility receiving a certification authorizing the construction project.

2. Since the same capitalization policy seems to be followed in both stages, why is there a pre-acquisition stage and an acquisition stage?

3. According to current definitions, capital expenditures, which benefit future periods, add fixed-asset units or have the effect of increasing capacity, efficiency, life span, or economy of

operation of existing fixed
asset. By definition, these expenditures would be capitalized. According
to the project stage or timeline framework, however, these expenditures to
the extent they occur in preliminary stage as defined in SOP would be
expensed even though they benefit future periods.

Issue 3: Paragraph 16 of the proposed SOP states that the preliminary stage
ends and the preacquisition stage begins when the acquisition of specific
property, plant, and equipment (PP&E) is considered probable. Paragraph 22
of the proposed SOP states that, other than the costs of options to acquire
PP&E, all costs incurred during the preliminary stage should be charged to
expense as incurred.

As discussed under issue two, capital expenditures which benefit future
periods and which are capitalized under current accounting would no longer
be capitalized to the extent they occur in the preliminary stage as defined
in SOP. NARUC supports accounting for such expenditures as is provided for
under the existing USOA for public utilities. Under the USOA for public
utilities, all expenditures for preliminary surveys, plans, investigations,
etc., made for the purpose of determining the feasibility of utility
projects under contemplation, and costs of studies and analyses mandated by
regulatory bodies related to plant in service are capitalized if
construction results. If the work is abandoned, the charge is made to the
appropriate operating expense account.

Accounting for Costs Incurred

Issue 4: The proposed SOP states that PP&E-related costs incurred during the
preacquisition, acquisition-or-construction, and in-service stages should be
charged to expense unless the costs are directly identifiable with the
specific PP&E. Directly identifiable costs include

only (a) incremental
direct costs incurred with independent third parties for the specific PP&E,
(b) employee payroll and payroll benefit-related costs related to time spent
on specified activities performed by the entity during those stages, (c)
depreciation of machinery and equipment used directly in the construction or
installation of PP&E and incremental costs directly associated with the
utilization of that machinery and equipment during the acquisition-or-construction stage, and (d) inventory (including spare parts)
used directly in the construction or installation of PP&E. All general and
administrative and overhead costs incurred, including all costs of support
functions, should be charged to expense.

NARUC believes that, in general, all normal expenditures of readying an
asset for use should be capitalized. However, unnecessary expenditures that
do not add to the utility of the asset should be charged to expense. In
addition, all expenditures that provide a discernible future benefit should
be capitalized.
NARUC agrees that all costs directly identifiable with a specific PP&E
should be capitalized. NARUC, however, questions AcSEC's belief that all
general and administrative costs and overhead costs, including costs of
support functions, should be charged to expense as incurred.

As to whether general and administrative costs and overhead costs should be
included in the cost of construction, NARUC maintains that, subject to a
showing to the contrary, such costs considered to have discernible future
benefits should be capitalized. According to accounting literature, there
are two alternative views:

1. Allocate only incremental overhead costs to asset. Incremental costs
represent cost that management considered in making decision to construct.
Fixed costs are period costs since they would have been incurred in any
case.

2. Allocate a portion of all overhead costs to self-constructed assets.
Relate all costs incurred in accounting period to output of period.

According to the system of accounts prescribed by the FERC for electric and
natural gas utilities, all overhead construction costs, such as engineering,
supervision, general office salaries and expenses, construction engineering
and supervision by others than the utility, law expenses, insurance,
injuries and damages, relief and pensions, taxes and interest, shall be
charged to particular jobs or units on the basis of the amounts of such
overheads reasonably applicable thereto, to the end that each job or unit
shall bear its equitable proportion of such costs.

The FERC USOA is consistent with alternative two set forth above. NARUC
supports alternative two and believes that the FERC USOA provides for the
proper allocation of such general and administrative costs and overhead
costs between accounting periods. To expense costs that are properly
allocable to future periods, results in current customers being charged for
costs that are more appropriately chargeable to future customers.

Issue 6: Paragraph 37 of the proposed SOP states that the costs of normal,
recurring, or periodic repairs and maintenance activities should be charged
to expense as incurred. It also states that all other costs related to PP&E
that are incurred during the in-service stage should be charged to expense
as incurred unless the costs are incurred for (a) the acquisition of
additional PP&E or components or (b) the replacement of existing PP&E or
components of PP&E.

Issue 8: Paragraph 44 of the proposed SOP states that the total of costs
incurred for planned major maintenance activities does not represent a
separate PP&E asset or component. It states that certain of those costs

should be capitalized if they represent acquisitions or replacements and that all other costs should be charged to expense as incurred. Paragraph 45 prohibits alternative accounting treatments including-(a) the accrual of a liability for the estimated costs of a planned major maintenance activity prior to their being incurred, and (b) the deferral and amortization of the entire cost of the activity.

NARUC agrees that normal, recurring, or periodic repairs and maintenance activities should be expensed as incurred. Such activities serve to keep property in operable condition and restore the capital asset to full productive capacity without increasing the estimated service life or productive capacity. As such, these costs should be expensed as an operating expense.

Regarding planned major maintenance, NARUC disagrees with AcSEC. Expenditures that benefit future periods by increasing the capacity or operating efficiency, or extending the useful life of an asset, if substantial, should be capitalized. If the planned major maintenance only serves to keep property in operable condition and restore the capital asset to full productive capacity without increasing the estimated service life or productive capacity, then NARUC agrees with AcSEC and the cost should be expensed. Expenditures that meet the definition of an improvement or betterment appear to be the area where NARUC has the biggest disagreement with AcSEC. Such expenditures do not qualify as an acquisition of additional components or the replacement of existing components. Such expenditures, however, do have the effect of extending the useful life of an existing fixed asset, increasing its normal rate of output, lowering its operating cost, increasing efficiency, or otherwise adding to the worth of benefits it yields. Generally, all three, replacements, acquisitions, and improvements, are treated the same and capitalized to

PP&E.

Regarding AcSEC's rejection of the deferral and amortization of the entire cost of a planned major maintenance project, NARUC does not disagree, but points out that according to SFAS 71, "Rate actions of a regulator can provide reasonable assurance of the existence of an asset." Regarding public utilities, therefore, if regulation provides assurance that incurred costs of a planned maintenance project will be recovered in the future, SFAS 71 requires companies to capitalize those costs. Regulators use such deferrals to spread the cost of planned major maintenance projects across a number of accounting periods in an attempt to maintain stable rates.

ISSUE 7: Paragraph 39 of the proposed SOP states that costs of removal, except for certain limited situation demolition costs, should be charged to expense as incurred.

NARUC disagrees with the SOP's proposed expensing of the total cost of removing utility assets in the period in which the related asset is retired and removed from service. In the 1934 Supreme Court decision Lindheimer v. Illinois Bell Telephone Company, 292 U.S. 151, (1934), the Court stated that depreciation expense should be based on original cost:

> The method is designed to spread evenly over the service life of the property the loss which is realized when the property is ultimately retired from service. According to the principle of this accounting practice, the loss is computed upon the actual cost of property as entered upon the books, less the expected salvage, and the amount charged each year is one year's pro rata share of the total amount. (Emphasis added)

Additionally, some accepted definitions of depreciation refer to depreciation as a loss in service value. "Service value" is used in a special sense, meaning the cost of plant less net salvage (net salvage is

gross salvage less the cost of removal). The USOA recommended by NARUC defines "service value" as follows:

> The difference between the original cost and the net salvage value of the utility plant.

NARUC believes the "loss in service value," therefore, must be understood and construed in light of its specially defined meaning.

Furthermore, the AICPA in Accounting Research and Terminology Bulletin #1 defines depreciation accounting as follows:

> Depreciation accounting is a system of accounting which aims to distribute cost or other basic value of tangible capital assets, less salvage (if any), over the estimated useful life of the unit (which may be a group of assets) in a systematic and rational manner.

It has been understood by regulated utilities and regulatory agencies that the reference to "salvage" refers to net salvage. The proposed SOP contradicts Bulletin #1.
Under the majority of regulatory accepted concepts, the amount of depreciation to be accrued over the life of an asset is its original cost less net salvage. Net salvage is the difference between the gross salvage that will be realized when the asset is disposed of and the cost of retiring it. The goal of accounting for net salvage historically has been to allocate the net cost of an asset to accounting periods, making due allowance for the net salvage, positive or negative, that will be obtained when the asset is retired. This concept carries with it the premise that property ownership includes the responsibility for the property's ultimate abandonment or removal. Hence, if current users benefit from its use, they should pay their pro rata share of the costs involved in the abandonment or removal of the property and also receive their pro rata share of the benefits of the proceeds realized.

This treatment of net salvage is in line with the AICPA Bulletin #1 and
tends to remove from the income statement any fluctuations caused by
erratic, although necessary, abandonment and removal operations. It also
has the advantage that current consumers pay or receive a fair share of
costs associated with the property devoted to their service, even though the
costs may be estimated.
Furthermore, the current accumulated depreciation accounts include
depreciation expenses attributed to gross salvage and cost of removal that
have historically been included as part of the depreciation rate design. If
the accounting procedures for net salvage now change, guidance is needed
regarding the allocation of the accumulated depreciation between that amount
associated with the life of each component or group of assets and the amount
associated with the salvage component of the depreciation rate. Additional
guidance will be needed regarding how to account for the embedded
accumulated depreciation associated with historical net salvage components
in the depreciation rate.
Finally, NARUC believes that for this issue, the SOP conflicts with SFAS
143, Accounting for Asset Retirement Obligations. Under SFAS 143,
retirement costs are capitalized as part of the cost of the related
long-lived asset. NARUC believes that the SOP should be consistent with
SFAS 143. NARUC believes that the relationship between the SOP and SFAS 143
should be clarified.

Component Accounting

ISSUE 12: Paragraphs 49 through 56 of the proposed SOP discuss component
accounting and state that if a component has an expected useful life that
differs from the expected useful life of the PP&E asset to which it relates,
the component should be accounted for separately and depreciated or
amortized over it separate expected useful life.

Issues 12, 13, and 14 are of paramount importance to

state regulatory
agencies. NARUC believes that if the SOP is approved as currently drafted,
regulated utilities should be granted an exemption from the component
accounting guidance outlined in the SOP. Current regulatory accounting
practices already contain many of the concepts underlying component
accounting. The implementation of the SOP provisions will result in a
significant increase in costs to the utility and possibly to the utility's
customers without a commensurate increase in quality or accuracy in
reporting. The following list contains several reasons why regulated
utilities should be exempted from the component accounting provisions of the
SOP:

1. The regulated utility industries are the most
capital-intensive industries in the country.

2. A significant portion of a utility's fixed assets are
comprised of "mass" property - high volume, low cost assets such as utility
poles, cable, line transformers, meters, etc. The implementation of
component accounting for these categories of assets would create millions of
additional immaterial transactions.

3. Many utilities continue to be subject to cost-based
ratemaking. As a utility's largest asset category, PP&E is subject to an
extensive and well-developed regulatory framework surrounding accounting for
PP&E. The regulatory framework's primary focus is the fair and equitable
recovery of the investment in PP&E from ratepayers. Historically, utilities
have applied these regulatory requirements for PP&E accounting in their
external financial statements.

4. The regulatory framework for PP&E includes the "retirement
unit" accounting concept, which is very similar to the component accounting
concept in the proposed SOP.

5. Regardless of whether or not regulated utilities are required to implement the component accounting provisions of the proposed SOP, these entities will be required, for ratemaking purposes, to continue to account for PP&E in accordance with regulatory guidelines. Accordingly, regulated utilities would be faced with the burdensome and expensive requirement to maintain different sets of detailed records for their PP&E assets. Any differences between these records would be recorded as regulatory assets or liabilities because of the applicability of SFAS 71 and would likely not affect reported results of operations. NARUC believes that this financial reporting result will add confusion rather than information and outweigh the resultant costs.

For some of the above reasons, in the utility industry, companies have argued for years that regulatory accounting requirements for PP&E are overly burdensome. As a result, regulators have been reviewing proposals to eliminate accounting and reporting requirements. For example, in the FCC proceeding, Comprehensive Review of Accounting and ARMIS Reporting Requirements, the FCC eliminated more than 100 accounts. This SOP will have the opposite affect and result in more accounting and reporting requirements for an industry that already has far more requirements than most or all other industries.

For the reasons outlined above, NARUC believes that the proposed SOP's components accounting approach is not appropriate for regulated utilities, and that these entities should be exempted from these provisions.

ISSUE 13: Paragraphs 38 and 51 of the proposed SOP state that when existing PP&E is replaced or otherwise removed from service and the replacement is capitalized, the net book value of the replaced PP&E should be charged to depreciation expense in the period of replacement.

NARUC does not agree with this provision's application

to regulated
utilities, and believes that the AcSEC should amend these provisions to
exempt regulated utilities. For regulated utilities, when a retirement unit
(component) is retired with or without replacement, the original cost of the
unit is credited to plant with a debit to the accumulated depreciation. The
item is assumed to be fully recovered at the time of retirement, with any
shortfall or surplus due to over or under recovery, corrected over the
remaining life of the associated group of assets. Neither depreciation
expense nor accumulated depreciation is maintained for each individual asset
or component.

Under unit or component depreciation, life and salvage is estimated
for individual assets and depreciation is recorded on that basis. Because
of this, the accumulated depreciation and net book value (i.e., cost less
accumulated depreciation) for individual assets can be determined at any
time. When an asset is retired, therefore, the net book value is compared
to the net salvage received. If net salvage exceeds net book value, the
retirement results in a gain, and if net salvage is less that net book
value, the retirement results in a loss. Gains and losses for retirement of
assets are recorded in the period that the retirement occurs.

Under group depreciation, no gain or loss is recognized for
retirement of individual assets. Upon retirement of an asset from the
group, the cost of the asset is debited to the accumulated depreciation
account and credited to the asset account. Any gross salvage received is
debited to the accumulated depreciation account. Under group depreciation,
since the accumulated depreciation relates to the entire group rather than
to specific assets within the group, no gain or loss is recognized. This
assumes that the group depreciation rate is accurate for the group as a
whole and that the cost of the retired asset, net of

gross salvage and cost
of removal, is being fully provided for in the accumulated depreciation
account.

Under group depreciation, the accumulated depreciation is maintained
for the entire group of assets. The proposed SOP would require an
allocation of the group accumulated depreciation to the individual assets
within the group.

ISSUE 14: The proposed SOP requires the use of component accounting to
depreciate identified components over their respective useful lives. As
noted in paragraph A48 of the proposed SOP, entities have developed and
utilized various conventions to depreciate assets, including group
depreciation or use of composite lives. Those conventions are acceptable
only if they result in approximately the same gross PP&E, depreciation
expense, accumulated depreciation, and gains or losses on disposals of PP&E
as the component accounting method required by this proposed SOP.

NARUC does not agree with the provision of the proposed SOP requiring
separate depreciation accounting for all individual components. Regulated
utilities have historically relied upon group depreciation accounting and
composite depreciation procedures in accounting for utility property. These
methods were perfected and employed in the industry because of the large
number of assets, the high dollar amount of the total depreciation recovery,
and the need for a fair, accurate, and objective recovery. Component
accounting would be impracticable and costly, and would not improve
financial reporting for a regulated utility.
The Interstate Commerce Commission defines depreciation as:

Depreciation is the loss in service value not restored by
current maintenance and incurred in connection with the consumption or
prospective retirement of property in the course of service from causes

against which the carrier is not protected by insurance, which are known to
be in current operation, and whose effect can be forecast with a reasonable
approach of accuracy. (Emphasis added)

The FCC USOA (CFR 47, Part 32) requires use of group depreciation accounting
and defines depreciation recognizing that the causes of depreciation "can be
forecast with a reasonable approach to accuracy." Also, group depreciation
is required for all railroads (49 CFR Part 1201, 4-1(a) and is the
accounting procedure utilized by the FERC for electric and gas utilities.
NARUC asserts that the FCC, the FERC, and the Surface Transportation Board,
all federal regulatory agencies, believe through their rules and regulations
that group depreciation accounting provides a reasonable approach to
accuracy in the determination of useful lives of property. In addition, the
Rural Utilities Service, which is a federal lending agency for more than
1,500 rural electric and telecommunications companies, requires group
depreciation for its utility borrowers. Further, these USOAs have generally
been accepted by states in their regulations.
The mortality concept in depreciation has roots in studies of human
mortality experience and efforts to relate the results to a survivor curve
or life table. Such studies date back to 1725. Historically, accounting
and other plant records kept by regulated utilities contain a great deal of
information awaiting statistical interpretation. There are several accepted
techniques for statistical analysis of property retirements. Estimates of
life may range from somewhat arbitrary assumptions of average life by
management to informed judgment based upon highly technical mathematical
models derived from actuarial science. These mathematical models were
developed specifically to apply to groups of property, particularly suited
for mass utility assets, not components. The individual component
depreciation approach will force assets into expected

average life groups,
and will perform a calculation as if each asset in the group will live to
that age, which may or may not be the case. Indeed, there is more
subjectivity in determining the individual life groups than with the life of
the group of assets. The Equal Life Group (ELG) procedure is a refinement
whereby the vintages of a group of assets are subdivided using a survivor
curve into subgroups having equal probable lives. It is not possible to
physically identify the individual units in each group since the groups are
statistically made by the curve shape utilized. The ELG procedure is
designed to charge to depreciation expense the investment in each equal life
group by the time each group is completely retired. However, detailed
vintage plant mortality data must be maintained from which future mortality
dispersions can be estimated. It is doubtful that utilities are currently
maintaining this detail. Without the long-term accumulation of data
involving large numbers of units within each group, such accuracy may not be
obtainable. Additionally, the cost and burden of maintaining the required
separate depreciation rates for each vintage, has made the ELG depreciation
procedure impractical to implement without major compositing techniques to
reduce the number of rates required to be maintained. Similarly, component
depreciation would be impractical for the same reasons.

Transition

ISSUE 17: Under paragraph 71(a) of the proposed SOP, the allocation of
existing net book value to components at transition should be based on (a)
allocation of original accounting records, if available, (b) relative fair
values of components at date of transition, if original accounting records
are not available, or (c) another reasonable method.

NARUC asks that "original accounting records" be clarified. The original
accounting records for mass assets will reflect an

average cost or average
vintage cost of assets placed. There will not be
original work orders for
individual assets of mass property.
Additionally, NARUC does not believe the SOP should
require an allocation of
the existing net book value to individual components
but rather should
address an allocation of gross investment and
accumulated depreciation.
Further, NARUC disagrees with the option of using fair
values as a basis for
allocating existing net book value, if original
accounting records are not
available.
Fair value is the value that exists between a willing
buyer and a willing
seller. The 1934 decision Lindheimer v. Illinois Bell
Telephone Company,
292 U.S. 151, (1934), as well as the 1994 decision
Federal Power Commission
v. Hope Natural Gas Company, 320 U.S. 591, (1944),
affirmed the use of
original cost as the cost basis for depreciation for
regulated utilities.
Additionally, the regulatory guidelines of the FCC,
the FERC, and NARUC
require assets be recorded at original cost, estimated
if not known.
Regulatory agencies require utilities to maintain
continuing property
records from which original cost or average original
cost information for
each asset can be obtained. Original cost may be
determined by analyses of
the construction costs incurred as shown by completion
reports and other
data, accumulated in the respective construction work
orders or
authorizations. For mass property, plant consisting
of a large number of
similar units, units of similar size and type may be
grouped to develop an
average original cost. In cases where the actual
original cost cannot be
determined, an estimate consistent with the accounting
practices in effect
at the time the property was constructed should be
made.

CONCLUSION

Public utilities may be heavily impacted
by this SOP due to the

capital-intensive nature of the industry. System of accounts have been developed over the years for this industry to take into account the needs of the utilities, utility shareholders, customers, and regulators. This SOP will force public utilities that already have extensive accounting and reporting requirements, to increase those requirements. NARUC supports the continued use of the current system of accounts for public utilities. These system of accounts provide for consistent accounting for PP&E among public utilities and meet the current needs of the industry, customers, and regulators.

As stated in the SOP, FASB uses four criteria for clearance of proposed documents. With regard to public utilities:

1. The SOP conflicts with current accounting requirements and the proposal does not adequately justify the departure.
2. The SOP will not improve the current accounting practice.
3. There has not been a demonstrated need for the proposal.
4. The costs of applying the SOP will far exceed the benefits of the SOP.

If the SOP is approved as currently drafted, NARUC requests that regulated utilities be exempted from these provisions. If AcSEC does not believe that utilities should be exempted from the SOP, it should at least make clear if and how SFAS 71 applies and also limit the SOP to the more costly material components.

If you have questions about this submission, please do not hesitate to contact me at 202.898.2207 or jramsay@naruc.org <mailto:jramsay@naruc.org>.

Respectfully Submitted,

James Bradford Ramsay

General Counsel

The National Association of Regulatory Utility
Commissioners
1101 Vermont Avenue, Suite 200
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(202) 898-2207

DATE: November 15, 2001

Resolution Regarding American Institute of Certified
Public Accountants
Proposed Statement of Position for Accounting for
Certain Costs and
Activities Related to Property, Plant, and Equipment

WHEREAS, The Accounting Standards Executive Committee
(AcSEC) of the
American Institute of Certified Public Accountants
(AICPA) is seeking
comment on its June 29, 2001 Proposed Statement of
Position (SOP) regarding
the accounting for certain costs and activities
related to property, plant,
and equipment; and
WHEREAS, The AcSEC proposes two purposes for the SOP:
1) to standardize
capitalization and expensing criteria for Property,
Plant, and Equipment
(PP&E); and 2) to standardize the depreciation
methodology used by all
non-governmental entities, including regulated
utilities, for the recovery
of PP&E assets; and
WHEREAS, The accounting guidance contained in the SOP
has been cleared by
the Financial Accounting Standards Board (FASB); and
WHEREAS, The SOP sets forth criteria to be used in
determining what costs
should be capitalized when incurred during the
acquisition, construction, or
replacement of PP&E based on the kinds of activities
performed rather than
on traditional classification criteria such as repairs
and maintenance,
extraordinary repairs and maintenance, replacements,
betterments, additions,
renovations, retrofits, and refurbishments; and
WHEREAS, The SOP requires that A&G and overhead costs,
gains or losses from
the disposal of assets, and costs associated with
planned major maintenance
projects be expensed as incurred, each of which will
result in increased
earnings volatility and an unfair shift in the burden
of collection from
customers receiving the benefit of the applicable

assets to current
customers during the construction; and
WHEREAS, The SOP requires the use of component
(retirement unit or unit)
depreciation; and
WHEREAS, The SOP requires that when existing PP&E is
replaced, the net book
value of the replaced PP&E should be charged to
depreciation expense in the
period of replacement; and
WHEREAS, The SOP requires that, at transition, the
existing net book value
associated with a group of assets should be allocated
to individual
components based on an allocation of original
accounting records, if
available; relative fair values of components at the
date of transition, if
the original accounting records are not available; or
another reasonable
method, if relative fair value is not practicable; now
therefore be it
RESOLVED, That the National Association of Regulatory
Utility Commissioners
(NARUC) convened in its November 2001 113th Annual
Convention in
Philadelphia, Pennsylvania, appreciates the
opportunity to comment on the
SOP; and be it further
RESOLVED, That uniform accounting systems for
regulated utilities have been
developed over the years through collaborative
processes involving federal
and State regulatory agencies as well as the various
industries, and these
systems take into account the needs of the utilities,
utility shareholders,
customers, and regulators, and provide consistent and
uniform accounting for
PP&E among public utilities; and be it further
RESOLVED, That the SOP conflicts with current
regulatory accounting
requirements for utilities whose accounting procedures
and depreciation
methodology are prescribed by federal or State
regulatory agencies and does
not adequately justify the departure, will not improve
current accounting
practices, and will result in costs far outweighing
the benefits of
application; and be it further
RESOLVED, That the AICPA has not demonstrated a need
for the SOP or its
applicability to public utilities; and be it further

RESOLVED, That the use of component accounting will not improve the accuracy
of depreciation while imposing unwarranted costs on utilities; and be it
further
RESOLVED, That the NARUC General Counsel be directed to file and take any
appropriate actions to further the intent of this resolution.

Sponsored by The Committee on Finance and Technology.
Recommended by the NARUC Board of Directors November 13, 2001.
Adopted in Convention November 14, 2001.

James Bradford Ramsay
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111501 FASB AICPA Comments.

IMC Global Inc.
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Northbrook, Illinois 60062-6146
847.272.9200

November 15, 2001

Marc Simon
Accounting Standards, File 4210.CC
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Mr. Simon:

You have requested comments on the Proposed Statement of Position (SOP), *Accounting for Certain Costs and Activities Related to Property, Plant and Equipment*. At IMC Global Inc. (IMC), we believe that the proposed methodology discussed in the SOP will have an effect on IMC's accounting and reporting of Property, Plant and Equipment (PP&E) costs. We have structured our response to address the SOP's issues that are most applicable to our operations.

Issue 2

IMC disagrees with the new approach of using a timeline framework in order to determine whether to capitalize an expenditure. Although this framework provides very specific guidelines to follow, which will reduce the differences in accounting for these expenditures among entities, few entities will receive benefits to outweigh the costs of implementation and tracking that will arise.

Issue 3

IMC agrees with paragraph 16 that the preliminary stage ends when the acquisition is probable. However, IMC does not agree with paragraph 22 that all costs should be charged to expense when incurred except for the cost of an option to purchase the PP&E because there could be costs incurred during the preliminary stage that meet the definition of directly identifiable costs.

Issue 4

Although IMC disagrees with the components approach, IMC does concur with the following: (i) capitalizable expenses should be directly identifiable to specific PP&E; (ii) the definition of directly identifiable costs; and (iii) the charging to expense of general and administrative costs and overhead costs.

Issue5

IMC agrees with the capitalization of costs incurred while real estate and other property is under development.

Issue 6

IMC agrees with the conclusions reached in paragraph 37 with the exception of the component approach.

Issue 7

IMC disagrees with paragraph 39 because it seems to differ from the concepts of when to record a liability. For example, if a plant is to be demolished, but the demolition will take two years, the estimated cost of demolition should be accrued for when the liability is both estimable and probable.

Issue 8

IMC disagrees with paragraph 44. At IMC, expenditures for repair and maintenance overhauls (Turnarounds) are deferred when incurred and amortized over an 18-month period. Turnarounds are large-scale maintenance projects that are performed regularly every 18 to 24 months. Turnarounds are necessary to maintain the operating capacity and efficiency rates of the production plants. Without these Turnarounds, the assets would not yield the same economic benefit. Therefore, these costs do provide a future economic benefit, which under current and proposed accounting literature constitutes an asset. It would appear to be consistent with other guidance that these costs be capitalized and expensed over their useful life.

Issue 9

IMC disagrees with paragraph 45 based on the discussion in Issue 8.

Issue 12

IMC disagrees with the concept of this section and questions the practicality of it. For IMC as well as for most entities, tracking all of these components could become overly burdensome. Even though paragraph 52 discusses the importance of immateriality in the application of this guidance, at a minimum it should be noted that if the costs of such a change outweigh the potential benefits then application need not be necessary.

Issue 13

IMC agrees with the treatment of net book value for replaced and removed PP&E in paragraphs 38 and 51.

Issue 14

IMC agrees with the proposed SOP that if a depreciation convention is found to be materially consistent with the component accounting method discussed in this proposed SOP then the depreciation convention should be used.

Issue 16

IMC disagrees with component accounting, however, if adopted IMC agrees with the conclusion reached in paragraph 71, which allows the choice of whether or not to apply this standard to previously held PP&E.

Issue 17

IMC disagrees with these allocation methods because of IMC's opposition to the adoption of the component approach.

Issue 18

IMC disagrees with paragraph 72 regarding the expensing of Turnarounds upon adoption of the SOP. Any assets related to planned major maintenance activities that exist prior to adoption should be amortized over their planned useful lives. It is not consistent to allow an entity the choice of whether to retroactively apply this SOP on certain components of PP&E but not on others.

Conclusion

IMC is not in support of this SOP because the SOP is overly burdensome in both its proposed accounting and reporting standards. IMC does not believe that entities or financial statement users gain benefits from the adoption of this SOP.

We appreciate your consideration.

Very truly yours,

/s/ Anne M. Scavone
Anne M. Scavone
Vice President and Controller

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W. P. (Pat) Shannon
Vice President - Finance
and Supply Chain Managment

404 249 5798

November 14, 2001

Mr. Marc Simon
Technical Manager, Accounting Standards
File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

(Also sent via e-mail to: msimon@aicpa.org)

RE: June 29, 2001 Exposure Draft, *Accounting for Certain Costs and Activities related to Property, Plant, and Equipment*

Dear Mr. Simon,

BellSouth Corporation ("BellSouth") is pleased to comment on the June 29, 2001 exposure draft of the proposed Statement of Position, *Accounting for Certain Costs and Activities related to Property, Plant, and Equipment* ("SOP"). BellSouth is a Fortune 100 communications services company serving more than 46 million customers in the United States and 15 other countries. Through our subsidiary BellSouth Telecommunications, Inc., we have provided local phone service in the southeastern United States for over 100 years. As of September 30, 2001, BellSouth reported total gross property, plant and equipment of over $63 billion. BellSouth engineers and manages its construction program internally with annual construction expenditures of approximately $6 billion.

The AICPA's proposed SOP provides guidance on accounting for certain costs and activities related to property, plant and equipment ("PP&E") in financial statements prepared in conformity with generally accepted accounting principles. PP&E accounting practices are complex and require continuous detailed review of estimates and assumptions – particularly for asset-intensive companies like BellSouth. The stated criteria to be applied by the FASB in reviewing proposals such as this SOP include the following:

- The proposal will result in an improvement in practice.
- The benefits of the proposal are expected to exceed the costs of applying it.

Overall Comments on Key Concepts

BellSouth has significant concerns about the SOP in its current form, including:

- We do not believe that all PP&E-related support costs should be expensed. Certain "support" costs are appropriately capitalized due to their direct incremental nature. (See comments on Issue 4.)

- We believe that costs of removal should be considered in determining net salvage and expensed over the life of the asset through periodic depreciation expense. (See comments on Issue 7.)

- In our opinion, the proposed "component" accounting method will not produce a significantly different result than BellSouth's application of the group method. The assumptions in the SOP regarding the group depreciation method do not reflect the level of complexity and detail as applied by BellSouth and other companies in the telecommunications industry. (See comments on Issues 12, 13 & 14 and the detailed description of BellSouth's group accounting in Attachment 2.)

- We do not believe that the FASB's evaluation criteria are met by this exposure draft. We do not believe this standard will result in a noticeable improvement in the application of accounting practices or the accuracy of reported financial results for BellSouth or many other companies in the telecommunications industry. In addition, the preliminary estimates of incremental costs required to build new systems and hire additional employees to fully comply with the proposed rules exceed $300M. The application of the proposed component accounting methodology to BellSouth's 85 million property record units is simply not practical and would be difficult to justify in a cost/benefit analysis.

For the reasons above and the more detailed comments in Attachment 1, BellSouth does not support the proposed SOP in its current form. If the SOP is issued, we believe it must: 1) clarify the definition of support costs, 2) revise its position on cost of removal accounting, and 3) recognize that the group method of accounting for PP&E, when appropriately applied, is a legitimate alternative for asset-intensive companies.

We appreciate the opportunity to comment on the proposed Statement of Position. Representatives of my staff are available to discuss these comments with you and your staff. We would also be willing to meet with AcSEC to further explain our application of the group depreciation method. Please feel free to call or email Guy Cochran (404-927-7154; Guy.Cochran@BellSouth.com) to discuss further.

Sincerely,

W. P. Shannon
Vice President – Finance and Supply Chain Services

Attachments

Attachment 1

Comments on Specific Issues

Issue 4: The proposed SOP states that PP&E-related costs incurred during the preacquisition, acquisition-or-construction, and in-service stages should be charged to expense unless the costs are directly identifiable with the specific PP&E. Directly identifiable costs include only (a) incremental direct costs incurred with independent third parties for the specific PP&E, (b) employee payroll and payroll benefit-related costs related to time spent on specified activities performed by the entity during those stages, (c) depreciation of machinery and equipment used directly in the construction or installation of PP&E and incremental costs directly associated with the utilization of that machinery and equipment during the acquisition-or-construction stage, and (d) inventory (including spare parts) used directly in the construction or installation of PP&E. All general and administrative and overhead costs incurred, including all costs of support functions, should be charged to expense. See paragraphs 24, 25, 29, and 30. Do you agree with those conclusions? If not, what alternatives would you propose and why?

BellSouth agrees that general and administrative ("G&A") costs should be expensed as incurred, but we do not agree that "all costs of support functions" should be charged to expense. BellSouth constructs its own assets and incurs plant and engineering staff costs that are appropriately allocated between expense and capital.

BellSouth believes that the following accounting guidance for indirect and overhead costs in paragraph 7 of FASB Statement 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects*, is appropriate for PP&E:

> *Project costs clearly associated with the acquisition, development, and construction of a real estate project shall be capitalized as a cost of that project. Indirect project costs that relate to several projects shall be capitalized and allocated to the projects to which the costs relate. Indirect costs that do not clearly relate to projects under development or construction, including general and administrative expenses, shall be charged to expense as incurred.*

The SOP's conclusion that all support costs associated with PP&E should be expensed as incurred per the guidance in FASB Statement 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*, and SOP 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*, does not take into consideration the true nature of these costs and their relationship to the investment involved. In an industry with significant internally constructed assets, such as the telecommunications industry, support staffs are required in order to engineer, construct/acquire and oversee installation of assets. These support staffs are a direct incremental cost of construction and would not exist without the construction activities.

Often these staffs reside in centralized environments for the sake of efficiencies of scope and scale.

In deliberations regarding SOP 98-1, AcSEC acknowledged "...that the costs of some activities, such as allocated overhead, may be part of the overall cost of assets, but it excluded such cost because it believes that, as a practical matter, costs of accumulating and assigning overhead to software projects would exceed the benefits that would be derived from a 'full cost' accounting approach. AcSEC considered that costing systems for inventory and plant construction activities, while sometimes complex, were necessary costs given the routine activities that such systems support."

BellSouth has developed and deployed such complex systems to manage and control an annual construction program of $6 billion. Using an allocation methodology based on time reporting by construction forces, these systems allocate the costs of the support staffs to PP&E assets based on a consistent, systematic and cost effective process that is prescribed by the Federal Communications Commission in Uniform System of Accounts (USOA) in Title 47, Part 32.

BellSouth does not suggest that a portion of all support costs be assigned to PP&E and does recognize that the type of cost assigned to PP&E assets should be limited to those support functions that can be directly associated with and are incremental to construction and installation activities. While it may not be feasible to directly report these support salary costs to the PP&E construction projects and activities as they are incurred, the costs are just as much an incremental part of the PP&E assets as the cost of employees or contractors constructing/installing the assets. For example, specific plant and engineering staff functions provide direct support for multiple construction projects. These costs would appear at face value to be of a "general support" nature but are actually an engineering activity that is in direct support of the acquisition/construction projects. As such, a consistent, cost effective, systematic and rational allocation process should be used to associate the cost to the appropriate PP&E assets.

BellSouth constructs its own assets and incurs support costs during construction that would not otherwise exist. A standard that would require companies that construct their own assets to expense these costs, while allowing entities that use independent third parties for their construction activity to capitalize the same costs, would be inherently inconsistent.

Issue 7: Paragraph 39 of the proposed SOP states that costs of removal, except for certain limited situation demolition costs, should be charged to expense as incurred. Do you agree with that conclusion? If not, what alternative would you propose and why?

BellSouth does not agree that cost of removal should be charged to expense as incurred. Rather, we believe the estimated cost of removal should be included in the determination of net salvage value and thus depreciated over the life of the asset. ARB 43 (Chapter 9C,

paragraph 5) indicates that depreciation "... aims to distribute the cost or other basic value of tangible capital assets, less salvage (if any), over the estimated useful life of the unit (which may be a group of assets) in a systematic and rational manner. It is a process of allocation, not of valuation." For the telecommunications industry, this is best accomplished by including both gross salvage and cost of removal in the depreciation of the asset. This is the approach mandated by the Federal Communications Commission (FCC) for use in regulatory filings, and our current systems are designed to handle gross salvage and cost of removal in this manner.

As described in comments on Issue 14, the group depreciation method estimates the useful life of a group of homogeneous asset units; similarly, future net salvage (gross salvage less cost of removal) is estimated for a group of homogeneous assets. Expensing removal costs for each unit is contrary to these fundamental group methodology principles. BellSouth reviews and resets future net salvage estimates as appropriate when new depreciation rates are established each year.

AcSEC states that it bases its conclusion that removal costs should be charged to expense on "the observation that removal costs are the last costs in the life cycle of an asset and should remain associated with the removed asset rather than being capitalized into the cost of the replacement asset." Our approach ensures that removal costs remain with the removed asset and are not capitalized into the cost of the replacement asset. By including the cost of removal of a given group of assets in depreciation calculations, we ratably recognize the entire costs associated with these assets over their useful lives. As a result, the liability for future costs of removal is embedded in accumulated depreciation. When the assets are actually retired and removal costs are incurred, these costs are recorded as a reduction to accumulated depreciation.

This position is further supported in the National Association of Regulatory Utility Commissioners' (NARUC) "Public Utility Depreciation Practices" (page 18), dated August 1996: "The goal of accounting for net salvage is to allocate the net cost of an asset to accounting periods, making due allowance for the net salvage, positive or negative, that will be obtained when the asset is retired....This treatment of net salvage is in harmony with generally accepted accounting principles...."

Including cost of removal in the depreciation calculations, as the telecommunications industry generally does today, ensures that journalization of asset-related costs correspond to the asset's useful life. As supported above, this conceptually sound method accrues removal costs over the lives of the related assets. To allow a "cash-basis" expensing of removal costs is acceptable, but to require a change from a preferable accrual method does not seem reasonable.

Issue 12: Paragraphs 49 through 56 of the proposed SOP discuss component accounting and state that if a component has an expected useful life that differs from the expected useful life of the PP&E asset to which it relates, the component should be accounted for separately and depreciated or amortized over its separate

expected useful life. Do you agree with this approach to accounting for PP&E? If not, what alternative would you propose and why?

BellSouth does not agree with the SOP's requirement for component accounting for the following reasons:

- Implementing component accounting would be both impractical and very costly.
- Requiring component accounting for financial reporting would result in an inconsistency with regulatory accounting.
- As previously stated, we do not believe the component accounting methodology is a significant improvement over the group method when applied with the appropriate detail.

Impractical and Costly

BellSouth uses the group depreciation method because the tremendous size of its asset base makes it impractical to do otherwise, and because the group method produces a reasonable accounting result. BellSouth currently has approximately 85 million property record units with a gross investment of more than $58 billion in its wireline telecommunications operations. We estimate that the costs to modify our systems to the component approach would exceed $300M. In addition, ongoing record keeping and administration would be significantly impacted.

For example, implementation of component accounting to a level of detail described in the SOP for one asset group, such as Buildings, would be an immensely involved and costly task for BellSouth. In BellSouth's nine-state region, there are more than 7,000 building locations with approximately 51 million square feet of space. BellSouth estimates that a staff addition of four people trained in construction estimating methods would be required for two years to survey and format existing property records into the recommended form. An additional dozen employees would be needed to assimilate and develop component building data for this effort. Systems changes at implementation would cost at least $4 million, with additional costs for ongoing systems requirements. Since several asset groups have even larger investment amounts and more units than Buildings (e.g., the metallic cable asset groups), the task of implementing component accounting as proposed is impractical at best. BellSouth does not foresee benefits in financial reporting derived from this change that could justify the costs.

Inconsistency with Regulatory Accounting

The Federal Communications Commission has mandated group depreciation in Part 32 of its Uniform System of Accounts, and BellSouth believes that it is unlikely the FCC would make changes to align with this proposed SOP, thus requiring companies regulated by the FCC to continue to use group depreciation for FCC reporting purposes. In addition, the FCC has defined depreciation rate asset groupings that BellSouth must use

for journalization and reporting purposes. If component accounting were implemented, components would have to be composited to these groups for FCC purposes. Implementing component depreciation for financial reporting purposes would necessitate creation of a completely separate set of books, while maintaining the current set. This would obviously add considerably to the cost of adopting this proposal.

Implementing Component Accounting Would Yield Minimal Benefits

Under BellSouth's application of the group depreciation method, assets are already separated into "components"-- groups of homogeneous assets that are similar in character, used in the same manner in a limited service territory, operated under the same general conditions, and having similar lives. BellSouth's chief asset is its network, which is made up of switches, transmission equipment, cables, etc. BellSouth records depreciation expense based on average remaining lives that are developed separately for each of its nine states (i.e., AL, FL, GA, KY, LA, MS, NC, SC, TN) for logical asset groupings, or "components", of the network. More specifically, a separate remaining life and depreciation rate is determined in each of BellSouth's nine states for Digital Switching Equipment, Analog Switching Equipment; Digital Circuit Equipment, Analog Circuit Equipment, Digital Data Service Circuit Equipment; Aerial Metallic Cable, Underground Metallic Cable, Buried Metallic Cable, Aerial Fiber Cable, Underground Fiber Cable, Buried Fiber Cable, Submarine Cable, Intrabuilding Cable, and various supporting asset groups. A detailed description of how these lives are determined can be found in Attachment 2.

BellSouth develops separate lives and depreciation rates for each of the asset groups described above, because that is a reasonable, practical, effective and appropriate grouping of homogenous assets with similar use and similar lives. Attempting to assign an individual life and depreciation rate beyond this level (e.g., to each span of aerial cable) would be impractical.

Determination of the lives that BellSouth uses to develop depreciation rates for each of its asset groups is a very detailed, methodical, and thorough process. BellSouth continually compiles information related to the lives of its assets. Many years of mortality data for the various asset groups has been collected and analyzed -- similar to actuarial analysis in other disciplines. Subject matter experts responsible for the various asset groups furnish data and future plans for these assets. These company plans, including network deployment planning data, are of considerable value in assessing the near term impact for most asset groups.

Numerous methods have been utilized in the telecommunications industry to process this data and to assess the lives of network technologies. These methods are described in detail in Attachment 2. A review of these details is essential to understanding the appropriateness of BellSouth's group method.

BellSouth finds the component method described in the proposed SOP impractical to implement and does not believe that it adds desired precision to the depreciation process. It appears that component accounting relies on many more estimates than the present method. For example, under the current approach, BellSouth analyzes data as described above to determine an appropriate life for the Poles asset group. BellSouth has approximately 3 million poles in service in its nine-state region. Of course, not all these poles will have a life equal to the estimated average life. However, determining exactly which pole will be knocked over by a car, or removed due to road construction, is beyond reasonable expectations. In fact, if it were known which particular poles would live only a very short time, those poles likely would not be placed there, and service would be provided in another way. Under BellSouth's group approach, however, history indicates that a certain number of poles will remain in service only a very short time, while others will remain somewhat longer, and still others will remain for many years. The equal life group refinement of the group method, described in BellSouth's comments on Issue 14 and in Attachment 2, considers all the different life expectations of individual items in the Poles asset group in determining the average life. Based on this example, one could argue that the average remaining life approach yields at least as accurate, if not a more accurate, estimate of overall life as attempting to estimate the life of each individual item. While the estimated life of each pole would likely be wrong in every case, the group approach yields an average remaining life that would be reasonably accurate overall. The added detail and administrative effort involved with depreciating on a component basis would not improve the results of BellSouth's current group approach

In addition, BellSouth believes that implementation of component accounting will lead to many more inconsistencies than are present with the current approach. Historical investment and accumulated depreciation information for each identified component would not necessarily be available, making further estimates inevitable. Further, while telecommunications companies generally group assets today in a relatively similar way, companies' determination of what constitutes a component seems subjective and arbitrary. Paragraph A46 of the proposed SOP describes confusion that could result from accounting for replacement of an item that was not originally accounted for as a separate component. BellSouth believes that the confusion described here would be commonplace under component accounting. Clearly, inconsistencies would exist among companies as to the designation of components, due to intended use of the asset, local practices, as well as judgment. Admonitions to exercise reasonable judgment ensures that there will be inconsistencies among companies in determining what comprises a component.

The SOP Uses Faulty Reasoning in Supporting Component Accounting

Paragraph A44 of the proposed SOP contains a list of reasons why "AcSEC chose component accounting rather than the composite method". Following is an attempt to address each of those concerns.

(a) "Component accounting more precisely allocates the cost of PP&E to the periods benefited by that PP&E."

The precision of component accounting is dependent on the accuracy of the life estimates for each individual component. Inaccurate estimates would result in imprecise allocations of costs to periods. The component method is a more precise allocation of cost to periods only if individual component life estimates are more accurate than the composite estimate. As illustrated earlier in the example involving poles, BellSouth has no way of reasonably determining the life of each individual pole, but there are reliable tools to determine the life expectancy of the asset group of poles with a reasonable degree of accuracy. Thus, practically, component accounting would give no more precise an allocation than the refined group approach used by BellSouth.

(b) "A composite life may not be determined with a high degree of precision and may not reflect the weighted average useful lives of the PP&E asset's principal components."

While this concern may be valid for assets that are dissimilar in character and usage, for homogeneous assets with similar usage and life expectations, grouping results in a reasonable life estimate and expense allocation, as demonstrated in the same poles example.

It should be recognized that even lives developed for components of units are estimates. However, BellSouth's "remaining life" and "equal life group" approaches lend as much precision as can reasonably be expected.

(c) "The composite approach may conceal inaccurate estimates of expected useful life for long periods."

Under BellSouth's group approach, depreciation rates are adjusted each year for any changes in life and salvage estimates due to changes in company plans, technology changes, market conditions, etc. BellSouth continually compiles information related to the lives of its assets, including technology forecasting, mortality data, company plans, subject matter expert input, and benchmarking. Each year, lives are assessed and adjusted as needed, and depreciation rates are adjusted to reflect these changes. Thus, any new information that would impact asset lives is incorporated into the depreciation rates.

(d) "By not recognizing gains or losses, the approach may not correct for changes in asset usage or other factors affecting actual useful lives as compared to expected useful lives."

Gains and losses are simply missed estimates of depreciable lives. Clearly, when a company uses an average life for similar assets, some live for a longer period, and some live for a shorter period. However, BellSouth's approach recognizes the economic reality of the assets' mortality by recalculating average remaining lives at the beginning of each year and setting new depreciation rates reflecting those lives. The new lives take into account changes in asset usage over the prior year, as well as

company plans for upcoming changes. Further, new annual depreciation rates reflect changes to accumulated depreciation, so that rates are set to recognize net book investment (that is, amounts remaining to be depreciated) over appropriate average remaining lives. This provides a self-correcting mechanism to adjust the accrual rate to accommodate changes between actual and expected useful lives.

Although BellSouth does not expect the need to arise, there are procedures in place under current methods to handle any extraordinary event that has not been considered in the normal process described above. It is important to note, however, that events that might be extraordinary to many entities (e.g., hurricanes, ice storms, flooding, etc.) are "business as usual" to BellSouth's southeastern region and are considered in the determination of the average remaining lives of the categories of assets deployed in our network.

(e) "Control over PP&E may be reduced because detailed records may not be used."

The use of group accounting does not relieve a company from the responsibility of maintaining a reasonable level of accounting detail. BellSouth maintains a level of detailed records necessary to meet its various business needs. Also, BellSouth maintains a level of detailed records that meets the very specific and detailed requirements set out by the Federal Communications Commission. It should be noted that the FCC's Uniform System of Accounts requires detailed accounting records much more rigorous than other accounting requirements. Further, the determination of depreciation lives for book purposes is much more detailed than that for tax purposes.

(f) "If individual property units become idle, depreciation on those idle units may not be determined with the same precision as if those units were depreciated individually."

BellSouth follows the mandates of the Federal Communications Commission's very detailed Part 32 (of its Uniform System of Accounts) when accounting for its assets. If individual property units (pre-defined retirement units) are no longer used or useful, they are retired. Use of retirement units in the current depreciation process ensures that separately identified parts of an asset are retired and their replacements capitalized when that part of the asset is no longer used or useful. The retirement is reflected in the depreciation rate calculated for the next year, as well as in the investment base to which it is applied.

Some assets, when removed from service, are retained in appropriate accounts on BellSouth's books. In accordance with Part 32, BellSouth accounts for property not currently in service, but owned and held for no longer than two years with a definite plan for use in telecommunications service, as "Property held for Future Telecommunications Use." Also, property not includable in plant accounts as operating telecommunications plant is recorded in the "Non-operating Plant" account.

Both of these accounts carry the same depreciation rates as the associated in-service plant, and the characteristics of these assets are considered in the depreciation rates for these items. The investment in these two accounts added together is less than one-tenth of one percent of BellSouth's investment in telecommunications plant in service. Implementing a change to component accounting for BellSouth's approximately 85 million property record units because of concerns about these few assets does not seem justified.

Issue 13: Paragraphs 38 and 51 of the proposed SOP state that when existing PP&E is replaced or otherwise removed from service and the replacement is capitalized, the net book value of the replaced PP&E should be charged to depreciation expense in the period of replacement. Do you agree with this approach? If not, what alternative would you propose and why?

BellSouth does not agree with this approach, since it is inconsistent with the group accounting approach that BellSouth currently uses and believes to be the most appropriate for its telecommunications assets. BellSouth's determination of average life takes into consideration that some assets will retire earlier than the projected average life, and some will retire later. Under this approach, these assets are fully depreciated upon retirement, and thus the approach described in Issue 13 is not appropriate.

When assets that constitute a pre-determined retirement unit are no longer in service, BellSouth retires them from its accounting records. The assets do not remain capitalized on the books, a concern AcSEC expressed in paragraph A34 of the proposed SOP. Under provisions of the remaining life depreciation method, as detailed in response to Issue 14, the impact of retirements on BellSouth's accumulated depreciation and on life estimates is reflected in the determination of the following year's depreciation rates. Therefore, depreciation rates and depreciation expense are adjusted to appropriately recognize any undepreciated values.

Issue 14: The proposed SOP requires the use of component accounting to depreciate identified components over their respective expected useful lives. As noted in paragraph A48 of the proposed SOP, entities have developed and utilized various conventions to depreciate assets, including group depreciation or use of composite lives. Those conventions are acceptable only if they result in approximately the same gross PP&E, depreciation expense, accumulated depreciation, and gains or losses on disposals of PP&E as the component accounting method required by this proposed SOP. Do you agree with this approach? If not, what alternative would you propose and why?

BellSouth feels strongly that group depreciation, when properly applied, is a valid and appropriate method. The purpose of group depreciation is the same as the purpose of component, or any other, book depreciation method -- to provide for a reasonable,

consistent matching of the cost of an asset and its consumption by allocating the cost of the depreciable asset systematically over its estimated useful life.

It should be noted that group depreciation has been an accepted practice for many years in many industries (for example, electric, gas, and railroad). In the telecommunications industry, there is a long-standing practice of using group accounting to depreciate property, plant and equipment. According to Ernst & Ernst's 1977 "Study of Common Carrier Depreciation Rate Practices and Policies" (page 72), "Between 1912 and 1913, the Bell System began to account for property on a 'group' basis. Telephone plant was divided into homogeneous categories or major groupings for depreciation accounting purposes. Average service lives and depreciation rates were calculated for each of these groups." Pages 76 and 77 of that document further state, "Of the time related depreciation methods, it would appear that unit depreciation would be the most accurate; and therefore, the most theoretically ideal method of depreciation. But, unit depreciation has historically been rejected for telecommunications common carriers because of the impossibility of estimating service lives for individual units and the millions of property units which would have to be individually depreciated....Due to the problems associated with unit depreciation, group depreciation practices have traditionally been employed by the telecommunications common carriers as well as other utilities." In addition, federal and state regulators have long mandated that the telecommunications industry use group depreciation, and have examined in great detail the appropriateness of its application.

This proposed SOP states that conventions such as group depreciation are acceptable only if they result in approximately the same dollar impact as the component accounting method proposed here. The fundamental differences in the group approach and the component approach make an exact numerical comparison of results impossible. However, the depreciation process is clearly designed to fully recognize the company's asset investment. Total depreciation expense, using the group or the component approach, would be the same, that is, the total investment associated with the asset. Similarly, the accumulated depreciation would reflect ongoing accruals, and ultimately the retirement of the asset using either approach. Using group depreciation, particularly with the remaining life and equal life group refinements described in Attachment 2, BellSouth seeks to recognize its invested capital at a rate consistent with the rate at which the associated asset's services are consumed. If component lives can be estimated with enough accuracy to match recognition of an asset component with its consumption, then component accounting should give results acceptably comparable with the results of BellSouth's refined group approach. It is clear that over time, the nature of the depreciation process ensures that both approaches fully recognize the asset's investment.

Paragraph A48 of the proposed SOP describes the group depreciation method as depreciating "the cost of a large group of homogeneous assets over an average useful life." Although this is generally what the group approach does, BellSouth's approach to group depreciation actually represents a significant refinement of the group method. This refinement minimizes the administrative burden of unit accounting, yet provides a high degree of matching expense recognition and useful life. Any depreciation method that BellSouth uses must take into account the reality of dealing with the tremendous

size of its asset base. BellSouth believes that the approach it takes to group depreciation, that is, the remaining life method and the Equal Life Group (ELG) procedure, appropriately takes into account the life characteristics of its various asset groups, while providing an approach that can reasonably accommodate its huge number of assets. Separate annual depreciation rates are calculated for approximately 30 different groups of homogeneous assets with similar use and similar lives for each of BellSouth's nine states (that is, a total of approximately 270 separate depreciation rates). Depreciation rates are then applied to gross investment to calculate appropriate depreciation expense for each of these 270 groups of assets. More information about the remaining life method and the ELG procedure is found in Attachment 2.

Issue 16: Paragraph 71 of the proposed SOP states that the prescribed component accounting guidance should be initially adopted for existing PP&E using one of two alternatives, the election and disclosure of which should be made when the SOP is adopted. Do you agree with that approach and, if so, do you agree with the choice of the two alternatives from which the election is to be made? If you do not agree with that approach for existing PP&E, what approach would you propose and why?

BellSouth does not agree that component accounting should be the only alternative for PP&E and believes companies should have the choice to select the method that allocates the cost of PP&E to the periods benefited in the most cost effective manner in accordance with GAAP. As such, BellSouth does not agree with either alternative for component accounting adoption.

Issue 17: Under paragraph 71(a) of the proposed SOP, the allocation of existing net book value to components at transition should be based on (a) allocation of original accounting records, if available, (b) relative fair values of components at date of transition, if original accounting records are not available, or (c) another reasonable method, if relative fair value is not practicable. Do you agree that that ordering of allocation methods is appropriate? If you believe that a different order would be appropriate, what order would you propose and why? Should the proposed SOP provide additional examples to illustrate what constitutes "another reasonable method"?

For large, asset-intensive companies like BellSouth, allocation of net book value over the more than 85 million property record items would be exceptionally costly and time consuming - on a cost basis or on any other basis. In fact, it is unlikely that a practical method exists for such an allocation. BellSouth feels strongly that the time and cost necessary to comply with the SOP far exceed any proposed benefit from its adoption.

Issue 18: Paragraph 72 of the proposed SOP states that the SOP should be applied prospectively for all costs incurred after the adoption of the SOP. It also states that costs incurred prior to the adoption of the proposed SOP should not be re-

characterized (as capital or expense items) to conform to the guidance in the SOP, with the exception of certain costs of planned major maintenance activities. Do you agree with that approach? If you do not agree with that approach, what approach would you propose and why?

Other than component accounting, which BellSouth does not support, any changes should be applied prospectively, and costs incurred prior to the effective date of the SOP should not be re-characterized. This approach would be consistent with the policy in prior SOPs (e.g., SOP 98-1).

Issue 19: Under paragraph 71(a) of the proposed SOP, and as illustrated in Example 3 in appendix C, an entity applying component accounting retroactively at date of adoption may calculate a difference between the pre-adoption balance of accumulated depreciation and the balance recalculated based on the estimated useful lives of components that previously were not accounted for as separate components. Under that paragraph, the difference is allocated back to the accumulated depreciation of each component based on the net book values of the components. Two alternatives considered were recording the difference as a cumulative effect type adjustment at adoption and recording the difference as additional depreciation expense at adoption. Do you agree with the proposed approach or either of the alternatives, and why?

Again, BellSouth believes that group depreciation should be recognized as an appropriate method of accounting. If, despite all the reasons given in these comments for not mandating component accounting for the telecommunications industry, BellSouth is forced to do so, then implementation should be done prospectively. A retroactive application would likely be impossible. Further, if BellSouth is forced to implement component accounting, a significant extension of the effective date would be required as the date in the proposed SOP is not realistic.

BellSouth's Group Depreciation Accounting

Methods for Determining Lives

Numerous methods have been utilized in the telecommunications industry to assess the lives of network technologies. All methods determine the life by first estimating the remaining life cycle and then calculating the life from the life cycle. One method of life determination is historical mortality analysis, more commonly referred to as actuarial analysis in other disciplines. Huge databases are maintained that contain mortality information for each of BellSouth's twenty-six asset groups in each of BellSouth's nine states. This vintage data reflects investment levels within an asset group for each year in which that investment was placed. Vintage information is updated every year to reflect retirement activity during the previous year. This data provides historical information as to life patterns of assets placed in the past, much as actuarial information does for human life. Historical mortality analysis is particularly useful in assessing the life of asset groups that are not impacted by a competing newer technology, as well as providing insight into displacements of older technologies with newer technologies in the initial deployment stages.

For asset groups in which life estimates are sensitive to technology changes, BellSouth performs technology substitution analyses to determine the rate at which its older technologies (such as analog and metallic) become obsolete and are displaced by newer technologies (such as digital and fiber optics). BellSouth uses an established and accepted approach known as the Fisher-Pry model, developed by John Fisher and Robert Pry of the General Electric Company in 1971, to estimate the period of time in which the new technology substitutes for the old technology. This substitution analysis has been shown to describe accurately the life for technologies in the telecommunications industry, as well as many other industries (such as airlines, railroad, and fuel production). To adequately reflect the impact of mortality and technological substitution, BellSouth uses an approach that combines these two impacts through the use of probability techniques. The probabilities of mortality and technological substitution are statistically combined to determine the aggregate impact. This approach has been found to model accurately actual equipment displacements that have been observed. From these detailed technology substitution analyses come life estimates for BellSouth's technology-sensitive asset groups.

Lives for the technology-sensitive assets are developed on a very detailed level using the substitution analysis approach described above. When analyzing the life characteristics of Digital Switching Equipment, lives are developed for each of its six modular categories: Digital Line Equipment, Analog Line Equipment, Trunk Interface Equipment, Switching Fabric, Central Processor/Memory, and Common Systems Equipment. Separate average remaining lives are calculated for each of these categories

and composited for the digital switching asset group. For Digital Circuit Equipment, lives are developed for each of four categories: Analog/Digital Conversion Equipment, Other Digital Equipment, Asynchronous Optical Equipment, and Synchronous Optical Network (SONET) Equipment. Separate average remaining lives are calculated for each of these categories and composited for the digital circuit asset group. For Cable, lives are developed for each of three categories: Interoffice, Feeder and Distribution. Separate average remaining lives are calculated for each of these categories and composited for the Aerial Metallic Cable, Underground Metallic Cable and Buried Metallic Cable asset groups.

Once lives have been determined by the methods explained above, BellSouth further assesses the reasonableness of its asset life determination by benchmarking with other companies providing telecommunications services. Information is gathered from publicly disclosed documents from numerous companies and ranges of lives used by other companies are noted. The relationship of BellSouth's lives to that range adds a reasonableness check to the analysis process.

This data collection and analysis is continuous. However, data is generally compiled on an annual basis into a Depreciation Study that presents a summary of life data, study methods, planning information, technology substitution findings, and resulting life estimates and depreciation rates. At the beginning of each year, updated depreciation rates for each asset group in each of BellSouth's nine states are put into effect for journalization purposes.

Remaining Life Depreciation Method

BellSouth develops its depreciation rates using the remaining life method, a long-standing, proven approach which first surfaced in 1953. Remaining life is a straight-line depreciation method that determines the unrecognized investment and sets rates to depreciate that amount, less expected net salvage, over the average remaining life of the equipment. Average remaining life is the projection of how many more years on average the embedded assets will continue to live.

BellSouth continually reviews the appropriateness of its depreciation parameters, and generally makes necessary changes to these parameters once a year. Accrual activity during a given year, as well as retirements and other factors, cause the accumulated depreciation amount to change from year to year. This amount is updated each year for each asset group in each state to determine a new net book, that is, amount remaining to be depreciated. Including the net book amount in the depreciation process provides an inherent adjustment mechanism that helps insure full and timely recognition of investment. A change in the estimate of either life or salvage characteristics automatically triggers an adjustment to the accumulated provision for depreciation, and the adjustment is spread over the remaining life of the asset.

Equal Life Group Depreciation Procedure

BellSouth employs the Equal Life Group (ELG) procedure in determining the average remaining lives of its asset groups. ELG has a long history of application and development; as early as the 1930's, this method was being contemplated. In 1942 engineer Robley Winfrey, of what is now Iowa State University, discussed the ELG procedure in "Depreciation of Group Properties" (Bulletin 155), referring to the concept as "the unit summation procedure". In 1973, AT&T petitioned the FCC to allow ELG. Subsequently, regulatory agencies, such as the FCC, the Interstate Commerce Commission, and various state public service commissions, have approved this approach for use by companies they regulate. BellSouth began using ELG in 1982.

The ELG procedure most closely matches the recognition of investment with consumption of the capital assets used to provide service. It accomplishes the same goal as that envisioned by component and other methods of book depreciation -- allocating depreciation expense appropriately over the life of the asset. As discussed earlier, BellSouth depreciates investment over the asset's remaining life, and the ELG procedure is used in calculating that remaining life. Using a curve shape developed from historical data and an economic life, estimated vintage survivors, retirements, and average lives can be determined. (A curve shape is determined that best fits historical mortality data, or retirements. The curve shape is described by parameters used in the Gompertz-Makeham equation. The Gompertz-Makeham equation dates back to the early 1800's when it was used to model life characteristics for actuarial studies. It has been successfully used in asset life analysis and forecasting since the 1920's. More details on the Gompertz-Makeham model can be found in "Depreciation Systems" by Wolf and Fitch, dated 1994.) However, not all investment in a vintage retires at the same time. The ELG procedure statistically calculates when retirements in a vintage can be expected to occur based on prior experience, or historical mortality data. Using ELG, investment within a vintage is segmented into groups having the same, or equal, life. This gives proper consideration to all forecasted retirements, including those expected to occur early in an account's life cycle (sometimes called "infant mortality" of the assets). Each equal life group is treated as a unit of property. The investment in each group of assets within a vintage with the same expected life is allocated over that group's respective life, rather than over the average life of all assets in a vintage. A composite of the vintage remaining lives for the asset is then calculated for use in determining depreciation rates.

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November 15, 2001

Mr. Marc Simon
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Accounting Standards File Reference No. 4210.CC

Dear Mr. Simon:

We have reviewed AcSEC's proposed Statement of Position (SOP) on **"Accounting for Certain Costs and Activities Related to Property, Plant and Equipment"**. We appreciate the opportunity to offer comments for your consideration.

We understand that current practice with respect to accounting for costs of PP&E is varied; however, certain provisions of this SOP will cause a significant change in current practice and potentially may not improve comparability due to the differences in application of what constitutes a "component". USX Corporation's long standing practice has been to expense refinery turnaround costs in the year the costs are incurred. It is also established practice to capitalize the initial cost to construct such assets and to include the first replacement of critical parts (i.e. motors, exchangers, pumps etc.) as part of the initial capital project. The second replacement of such components is taken directly to expense at the time of the replacement.
USX Corporation does not concur with the requirement to capitalize replacement components in accordance with paragraphs 49 – 51 that merely restore an operating asset to its original condition, as the result of having used the PP&E in the past. However, we do concur with the capitalization of replacement components if they extend the useful life of an asset.

Emphasis on Materiality

USX Corporation incurs significant refinery turnaround expenditures in any given fiscal year. If we are required to capitalize new component replacement parts during a turnaround, including the labor cost to install the part, we believe that the definition of materiality must be clarified. As an example, it is not unusual for our total average refinery turnaround expenditures to approximate $100 million per year. Materiality, if applied subjectively, could be applied individually to each component part or in the aggregate. Each company will apply a different

materiality threshold to each component part and in aggregation. Because of the sizeable expenditures incurred in a typical refinery turnaround, a 5% threshold applied in the aggregate could mean that the first $5 million of qualifying costs could continue to be expensed. On the other hand, a dollar-based threshold applied to individual components would tend to be a much lower amount to coincide with a company's normal capitalization limits which could be as little as $1,000 per component. The application of such materiality-based provisions will ultimately affect the cost/benefit relationship and could easily become an onerous effort to track individual component parts. Practice will still be varied as such expenditures will continue to be expensed by larger entities and smaller entities will be subjected to capitalization of replacement components meeting lower dollar threshold limits.

Application of Replacement Accounting for Components

The definition of a component, as indicated in paragraph 49, will result in the majority of planned major maintenance costs to be capitalized rather than expensed as incurred. Even though example 7 in the appendix portrays expensing of lubricants, inspection costs, and cleaning of processing equipment, the major dollar items in a typical turnaround relate to replacement of worn equipment such as heaters, pumps, motors and the like. Additionally, in a typical refinery turnaround, equipment can be installed in the operating units that qualifies as a capital addition due to technological advances or improved refining processes. It is very common for a refinery turnaround project to cost millions of dollars as the shutdown itself is planned well in advance and generally will entail several refinery operating units at the same time.

Paragraph 45 disallows the accrual method, the defer and amortize method and the built-in overhaul method. However, with the focus on capitalization of replacement equipment that meets the definition of a component per paragraph 49, the end result will add costs to the depreciable base thereby increasing depreciation expense over the useful life of each component part, as compared with recognizing a current P&L charge. The end result of requiring the capitalization of component parts, especially those that are for the replacement of worn parts, is similar to the defer and amortize method.

The interpretation and application of what is a component will vary entity by entity and will result in an inconsistent application of paragraph 49, as discussed above. The lower the level of application the more total expenditures in a planned major maintenance project will be capitalized. If the true application in practice of a refinery turnaround (as depicted in example no. 7 of the appendix) was that the majority of costs incurred were purely for maintenance-type tasks and not replacement of equipment, USX would have no problem applying the provisions established in this proposed SOP. However, our experience has shown that the majority of costs incurred in a turnaround include both the cost of contractor labor charges for removal and reinstallation of worn equipment plus the equipment cost

itself. Literally, if these rules were applied currently in practice, we would be capitalizing nuts and bolts because of the way a component is defined in paragraph 49.

Interrelationship between Issues 6, 8 and 12

Issue 6 addresses normal, recurring, or periodic repair and maintenance activities as discussed in paragraph 37. Issue 8 addresses planned major maintenance activities per paragraph 44. Both paragraphs require the same accounting be applied to the expenditures incurred. If the expenditures pertain to the replacement of existing components of PP&E, such expenditures are to be capitalized. Our interpretation of paragraphs 49–51 is that at the time of replacement, component accounting must be applied if the replacement meets the definition established in paragraph 49. Because this SOP defines a component as a tangible part or portion of PP&E that is separable and has an economic life of greater than one year, most replaced pieces of equipment needed to ensure the continued efficient operations of an operating facility such as a refinery will be capitalized.

The decision to shut down hundred of millions of dollars of refining vessels to do simple painting, cleaning, inspection and bolt tightening does not make economic sense. Rather, the decision to shut down for weeks at a time encompasses the prudent decision to replace worn equipment throughout the refinery operation. Therefore, as discussed above, except for any immateriality threshold applied, the expectation derived from this proposed SOP is that the labor costs incurred along with the cost of purchased equipment that have been expensed in the past will now be capitalized and depreciated going forward.

Costs to restore PP&E

As noted in paragraph A31, AcSEC concluded that costs incurred to restore PP&E to its original operating condition do not provide a future benefit but rather remedy the effects of having used the PP&E in the past and allow the PP&E to continue in use through its full expected useful life. We agree with this completely! However, AcSEC concluded in paragraph A31 that the only appropriate accounting treatment is either to capitalize such expenditures if they meet the capitalization criteria (i.e. paragraph 49) or charge the cost to expense. The requirement to capitalize such expenditures is difficult to accept and is being driven by the requirement to componetize assets.

By analogy, costs incurred to remove and rework/rebuild a piece of component equipment should be expensed. This practice assumes that the replaced parts do not enhance the efficiency or extend the useful life but rather return the asset to its original state. This is the same accounting convention described in paragraph A31. USX believes that the continued expensing of replacement components is

the most appropriate as such expenditures principally return the asset to its original state.

Conclusion

We strongly urge AcSEC to reconsider its proposal with respect to requiring capitalization of replacement equipment that is deemed to be a component per paragraph 49. The end result from a P&L perspective is the same as the prohibited accounting practice described in paragraph 45(b) of the SOP.

Thank you for your consideration.

Sincerely,

Larry G. Schultz

Larry G. Schultz
Vice President - Accounting

November 15, 2001

Mr. Marc Simon
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Dear Mr. Simon,

We have recently completed a review of the Accounting Standards Executive Committee's (AcSEC's) Proposed Statement of Position, *Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment* (June 29, 2001). The purpose of this letter is to comment on several issues.

With some clarification and modification, we generally agree with the project stage framework. Our primary concerns are with the component accounting approach to depreciation and expensing certain overhead and support costs. Additionally, we believe that expensing all costs of removal is inconsistent with Statement of Financial Accounting Standards (SFAS) No. 143 and would like clarification.

Issue 4: The proposed SOP states that PP&E-related costs incurred during the pre-acquisition, acquisition-or-construction, and in-service stages should be charged to expense unless the costs are directly identifiable with the specific PP&E. Directly identifiable costs include only (a) incremental direct costs incurred with independent third parties for the specific PP&E, (b) employee payroll and payroll benefit-related costs related to time spent on specified activities performed by the entity during those stages, (c) depreciation of machinery and equipment used directly in the construction or installation of PP&E and incremental costs directly associated with the utilization of that machinery and equipment during the acquisition-or-construction stage, and (d) inventory (including spare parts) used directly in the construction or installation of PP&E. All general and administrative and overhead costs incurred, including all costs of support functions, should be charged to expense. See paragraphs 24 , 25, 29 , and 30. Do you agree with those conclusions? If not, what alternatives would you propose and why?

We agree that general and administrative costs should be expensed as incurred, but disagree that certain overhead costs as well as "all costs of support functions" should also be charged to expense.

Paragraph 7 of Statement of Financial Accounting Standards (SFAS) No. 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects*, provides guidance that is applicable to this situation:

> *Project costs clearly associated with the acquisition, development and construction of a real estate project shall be capitalized as a cost of that project. Indirect project costs that relate to several projects shall be capitalized and allocated to the projects to which the costs relate. Indirect costs that do not clearly relate to projects under development or construction, including general and administrative expenses, shall be charged to expense as incurred.*

We incur significant overhead and support costs in the construction of our own telecommunications PP&E. These are costs that would not have been incurred absent the construction of the PP&E and, in most cases, can be directly associated with specific PP&E. For example, Qwest maintains a large centralized engineering staff to design and coordinate the construction of network assets. These staff costs are appropriately allocated between capital and expense based on work functions. Similarly, Qwest incurs significant procurement costs related to the purchase of new PP&E. These costs include warehousing and

transportation of PP&E. All of these functions are direct incremental costs of construction that would not be incurred otherwise. These costs are systematically allocated to the assets acquired.

We also believe the AcSEC definition of "directly identifiable costs" should be broadened. Similar to the capitalization of equipment depreciation used in the construction of PP&E, other costs (such as those outlined in the preceding paragraph), which can be directly associated with the construction of specific PP&E, should be capitalizable in our view.

We do not suggest that a portion of all support and overhead costs be assigned to PP&E. We recognize that the type of costs assigned to PP&E assets should be limited to those which can be directly associated and are incremental to construction and installation activities.

Issue 7: Paragraph 39 of the proposed SOP states that costs of removal, except for certain limited situation demolition costs, should be charged to expense as incurred. Do you agree with that conclusion? If not, what alternative would you propose and why?

We believe there needs to be clarification on this issue. AcSEC's proposed SOP conclusions do not appear to be consistent with Statement of Financial Accounting Standard (SFAS) No. 143, "Accounting for Asset Retirement Obligations", issued in June 2001. This proposed SOP suggests that only limited demolition costs be capitalized while SFAS 143 requires only legal liabilities be capitalized.

Issue 12: Paragraphs 49 through 56 of the proposed SOP discuss component accounting and state that if a component has an expected useful life that differs from the expected useful life of the PP&E asset to which it relates, the component should be accounted for separately and depreciated or amortized over its separate expected useful life. Do you agree with this approach to accounting for PP&E? If not, what alternative would you propose and why?

We agree with the approach of accounting for assets at the component level. However, we disagree with the implication that component accounting necessitates component depreciation. There are valid and appropriate alternatives. Qwest and most major companies in the telecommunications industry commonly use component accounting for the acquisition, tracking and disposition of many types of assets but use group depreciation techniques to depreciate the components. Group depreciation aggregates homogeneous assets and depreciates these subgroups over the estimated useful life of the group. These useful lives are determined using comprehensive statistical data. Refer to Issue 14 for a more detailed discussion of group depreciation.

Qwest has thousands of telecommunications switches, buildings, miles of various cable types and computers. In instances where a company has a large population of homogeneous assets, even if the company maintains detailed asset records at the component level, group depreciation is an effective methodology which matches the depreciation expense to the useful life of the asset.

Currently, companies have the flexibility to determine the appropriate level of detail for asset records. Many factors may go into the decision, such as operational needs, tax reporting support, and administrative and system costs. For example, Qwest has approximately 2,000 telecommunications switches. Each year the company acquires over a million switch components needed for growth, technological improvement and repair. For operational and other reasons, the company maintains switch asset records at the component level in most cases. For computers, which from a technology standpoint are similar to switches, the company maintains asset records at the unit level, seeing no need to separate computers into component parts for asset records. When components of switches are replaced, the removed components are retired and the replacement components are capitalized. When components of computers are replaced, the replacement parts are expensed.

We believe that individual companies should be able to determine the appropriate level of asset record detail that should be maintained. Group depreciation should be recognized as a credible depreciation method equally valid to component depreciation. Our response to Issue 14 provides further support for this assertion.

Issue 13: Paragraphs 38 and 51 of the proposed SOP state that when existing PP&E is replaced or otherwise removed from service and the replacement is capitalized, the net book value of the replaced PP&E should be charged to depreciation expense in the period of replacement. Do you agree with this approach? If not, what alternative would you propose and why?

We support the proposal that the net book value of PP&E removed from service be charged to depreciation expense when assets are depreciated using component or unit depreciation. However, this approach is not appropriate for assets depreciated using group depreciation techniques. Companies that use statistical techniques for their group depreciation have anticipated asset retirements and component retirements, when appropriate, and incorporated them into their depreciation expense over the lives of the assets. In such cases, assets can be assumed to be fully depreciated when removed from service. When assets are removed from service, the accumulated depreciation is debited with the amount of the original cost of the asset and there is no charge to depreciation expense.

Issue 14: The proposed SOP requires the use of component accounting to depreciate identified components over their respective expected useful lives. As noted in paragraph A48 of the proposed SOP, entities have developed and utilized various conventions to depreciate assets, including group depreciation or use of composite lives. Those conventions are acceptable only if they result in approximately the same gross PP&E, depreciation expense, accumulated depreciation, and gains or losses on disposals of PP&E as the component accounting method required by this proposed SOP. Do you agree with this approach? If not, what alternative would you propose and why?

We disagree with the assertion that component depreciation provides the most accurate accounting for PP&E. Under component depreciation, expected useful lives are applied to individual components. However, asset lives of individual units can never be determined exactly. Unforeseen events will cause variation in the lives of similar items. Thus, the expected useful life applied to any single asset will likely be inaccurate. Component depreciation deals with this by requiring the immediate recognition of expense for the undepreciated value of items that retire before the end of their estimated depreciable life. However, this is an asymmetric solution because it does not recognize that many assets or components will be utilized longer than their depreciable lives. Thus, component depreciation does not always provide a meaningful reflection of asset usage. The best result component depreciation could achieve would be the matching of expense for those components whose lives are exactly equal to the estimated useful life (a small percentage of the total).

There is a long-standing practice in the telecommunications industry of using group depreciation for PP&E. Group depreciation is a method that depreciates a group of homogeneous units of plant. Because retirement units (or components) may be at a more detailed level than the total asset, the life characteristics of each retirement unit are in fact reflected in the life estimate for the group. Qwest uses statistical data, such as life-expectancy tables, to develop estimates of the useful life for all assets within a homogeneous group. These techniques consider the life characteristics of an entire group of similar assets and components and produce reliable life estimates for the group. Additionally, these techniques consider that the life of a component may be different than the life of the asset. Consideration of retirements due to changes in technology and market forces further refine the life estimate process for the group. Additional refinements of the basic process are also utilized such as Equal Life Group (ELG). The ELG method uses the statistical data to subdivide assets into groups having equal lives within the larger group of homogeneous assets. This information is then used to establish an overall depreciation level for the group. Group depreciation using ELG minimizes the administrative burden and still provides a high degree of expense matching with the useful life.

For example, digital switches are a significant portion of Qwest's PP&E. Using historical data (and applying statistical analyses) of purchases and retirements of switch components, such as processors, Qwest determines annual depreciation rates which are applied to PP&E additions in a given year. The average expected life for the digital switch group is 10 years. The statistical analysis determines rates that will

actually be applied from years 1 to 14 consistent with what has happened historically, while factoring in technology and other market forces. This takes into consideration the fact that, while the average expected useful life is 10 years, some assets will retire sooner than 10 years and some will retire later than 10 years. Once a switch or switch component is retired, accumulated depreciation is charged thereby assuming that the retirement was anticipated in determining the rate. The new switch or switch component is then capitalized and begins being depreciated with the group of switches and switch components purchased in that year. This method provides a meaningful reflection of actual digital switch and switch component usage.

We recognize that the proposed SOP allows other depreciation practices to the extent that it can be demonstrated that such conventions produce results that are not materially different from those obtained under component accounting. However, we believe that requiring an entity to demonstrate that another method approximates the same results as the component depreciation method would require adoption of the component depreciation method. One of the reasons for using group depreciation is to ease the record-keeping burden. By requiring the comparison to component depreciation, that benefit is eliminated.

Component depreciation greatly increases the volume of depreciation records. The following example is intended to demonstrate the record-keeping burden of component depreciation. Qwest owns almost 6,000 buildings. If, as one of the proposed SOP examples suggest, each building would be broken into five (could be many more) components, Qwest could expect to have 25,000 to 30,000 components for which we would need to build estimated lives, salvage, depreciation rates, accumulated depreciation records, etc. This would be an immense task unless very broad asset life assumptions over groups of components were made. If broad estimates were utilized, it would be difficult to argue any benefit to the component approach. It should also be noted that buildings are approximately 5% of Qwest's owned assets. When the component approach is applied to the other 95% of our assets, the multitude of records tracking depreciation at this level would be unmanageable.

Group depreciation applies expense recognition over the life characteristics of an entire group of similar assets in a reliable, systematic and rational manner. Requirements for component depreciation would add significant costs and voluminous records without a comparable benefit. Our group method of depreciation should be permitted.

Presentation and Disclosure:
We would also like to comment on the disclosure requirements outlined in paragraphs 58 and 59 of the proposed SOP. We find these requirements to be excessive. In providing an example of building components, the AcSEC has proposed de facto component groupings for all companies to adopt whether those groupings are applicable to specific companies or not. With the exception of disclosure of transition effects, the AcSEC should not require disclosures above and beyond those outlined in paragraphs 4 and 5 of APB Opinion No. 12, *Omnibus Opinion – 1967*. The proposed additional disclosures will not significantly enhance a financial statement user's understanding of how a company computes depreciation.

The provisions of this statement will significantly affect Qwest and the telecommunications industry as a whole. We hope that the suggestions and recommendations set forth in this letter will be given due consideration. We would be happy to provide additional information or discuss these issues further. Thank you for the opportunity to respond and express our concerns.

Very truly yours,

Mark Schumacher
Vice President and Controller
Qwest Communications International, Inc.

United States Department of Agriculture
Rural Development

Rural Business-Cooperative Service • Rural Housing Service • Rural Utilities Service
Washington, DC 20250

November 15, 2001

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1211 Avenue of the Americas
New York, New York 10036-8775

Re: Exposure Draft – Proposed Statement of Position
Accounting for Certain Costs and Activities related to Property, Plant and Equipment

Dear Mr. Simon:

The Rural Utilities Service (RUS) appreciates the opportunity to submit written comments regarding the proposed Statement of Position (SOP), Accounting for Certain Costs and Activities related to Property, Plant, and Equipment. RUS is an Agency of the United States Department of Agriculture, empowered by the Rural Electrification Act of 1936 (RE Act), as amended, to provide financing to Rural America for the purpose of furnishing and improving electric, telecommunications, and water and sewer services. RUS provides financing for the construction of plant to approximately 700 electric cooperatives and municipalities and to approximately 800 telecommunications companies and cooperatives.

RUS, as a Federal lender and mortgagee, and in furthering the objectives of the RE Act has a legitimate programmatic interest and a substantial financial interest in requiring adequate records be maintained by entities borrowing from RUS. For this reason RUS requires, through its standard security instrument, that borrowers in the electric and telecommunications loan programs maintain their books, records and accounts in accordance with methods and principles of accounting prescribed by RUS in the RUS Uniform System of Accounts (USoA). For electric borrowers, this USoA incorporates the USoA prescribed by the Federal Energy Regulatory Commission with modifications, and for telecommunications borrowers, the USoA incorporates the USoA prescribed by the Federal Communication Commission with modifications. These systems of accounts represent a considerable reliance on Generally Accepted Accounting Principles (GAAP). RUS requires each of our 1500 telecommunications and electric program borrowers to have an annual audit prepared by an independent certified public accountant.

RUS comments will focus on four major areas of concern; (1) inconsistencies with currently recognized GAAP, (2) lack of improvement over current practices, (3) no demonstrated need for the proposal, and (4) excessive costs with no realizable benefits.

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1. Inconsistencies with currently recognized GAAP

- Paragraph 39 of the draft SOP calls for expensing all costs of removal, except for certain demolition costs, as they are incurred. In allocation of costs using the accrual method of accounting in any industry, but particularly in the utility industry, cost of removal is an integral part of the costs associated with providing service. Historically, in order to match this revenue and expense, the utility recognizes the cost of removal expense through the depreciation rate. This cost has been incorporated into the depreciation rates used by the utility and is charged to expense over the useful life of the asset. At the end of the useful life of the asset, the cost to remove the asset has been accumulated in the depreciation reserve. The costs of removal have been charged in a systematic and rational manner to expense and the costs have, in turn, been recovered from those customers benefiting from the use of the asset. A utility recovers anticipated cost of removal expenditures as a part of its revenue rate structure. This allocates costs to the period consumed in the same manner as traditional manufacturing companies would determine costs of goods sold.

  The draft SOP guidance appears to be in conflict with existing guidance in Statement of Financial Accounting Standards No. 143, Accounting for Asset Retirement Obligations (SFAS No. 143). SFAS No. 143 reached the conclusion that reasonably estimable removal costs should be recovered over the useful life of the asset when there is a legal liability for the removal cost. It is our understanding that the intention of SFAS No. 143 was directed more toward recognition of the liability associated with the cost of removal. FASB could have directed that the cost of removal be written off in the year of recognition of the liability but did not. FASB called for the establishment of an asset in the amount of the cost of removal and amortization of this over the life of the asset. We concur with this accounting treatment and believe that the cost of removal for which there is no legal liability should be handled consistently with the method described above.

  There are many reasons to remove plant at the end of its useful life besides having a contractual liability to a third party requiring the removal. For electrical utilities, for instance, reasons would be current safety practice, good social practice, and even the simple and most apparent fact that old plant must come down before the replacement plant can be constructed. Since these entities are operating as going concerns, these costs should be recognized along with the depreciation of the asset. The draft SOP itself in paragraph A32 states, "AcSEC's conclusion on removal costs is based on the observation that removal costs are the last costs in the life cycle of an asset and should remain associated with the removed asset rather than being capitalized into the cost of the replacement." Since AcSEC believes removal costs are a cost of the asset, the removal costs should clearly be amortized with the asset.

- Under current RUS and GAAP guidelines, capital expenditures, which benefit future periods, add fixed asset units, or have the effect of increasing capacity, efficiency,

life span, or economy of operation of existing fixed assets, are capitalized. According to the project stage or timeline framework, these expenditures, if they occur in the preliminary stage as defined in the draft SOP, would be expensed although they benefit future periods. This timeline approach will increase inconsistencies between entities. The draft SOP criteria provides for different accounting of similar items simply because management has not determined to go forward with a project. This approach focuses more on the timing of a decision process than on the nature of the expenditure, which will lead to capitalization inconsistencies.

Under current utility guidelines, all expenditures for preliminary surveys, plans, and investigations made for the purpose of determining the feasibility of utility projects under review, and the costs of studies and analyses mandated by regulatory bodies are deferred and capitalized if construction results. If the project is abandoned, the deferred amount is charged to the appropriate operating expense account. The draft SOP also requires that internally occurring general and administrative (G&A) expenditures are to be expensed, but allows for the capitalization of the same expenditures if they are provided by a third party and billed to the entity. The SOP does not take into account that there are legitimate G&A expenses not directly related to a given project that should be capitalized as overhead. We believe any cost associated with the construction of plant assets should be capitalized.

- This draft SOP indicates that items constructed for resale would be allocated the additional G&A costs, whereas items constructed for internal use would not be allocated similar costs. We believe all costs of constructing an item should be allocated to the item regardless of whether the item will be sold or used internally. There is no reason to account for units constructed for different purposes differently.

- Financial Accounting Standards Board Statement of Concept No. 5, Fundamental Recognition Criteria, (Con 5) indicates that if an item meets the four fundamental recognition criteria (Definition, Measurability, Relevance, Reliability) it should be shown in the financial statements. Con 5 goes on to state that the recognition of expenses and losses is intended to recognize consumption (using up) of economic benefits on occurrence or discovery of loss of future economic benefits during a period. Expenses and losses are generally recognized when an entity's economic benefits are used up in delivering or producing goods, rendering services, or other activities that constitute its ongoing major or central operations or when previously recognized assets are expected to provide reduced or no further benefits. Since, as stated above, the costs of removal are associated with the life cycle of the asset, then these costs should be handled in accordance with Con 5 and allocated by a systematic and rational procedure to the periods during which the related assets are expected to provide benefits.

- Financial Accounting Standards Board Statement of Concept No. 6, Elements of Financial Statements, (Con 6) indicates in paragraph 144 that a major difference between accrual accounting and cash basis accounting is the timing of the

recognition of revenues, expenses, gains & losses. Con 6 goes on to state that the matching of costs and revenues through allocation and amortization is the essence of using accrual accounting to measure the performance of entities. Expenses resulting from the use of assets that provide a benefit over several periods, such as property, plant, & equipment, are generally allocated to those periods in which the benefits are expected to be realized. This is the basis of "systematic and rational" allocation procedures such as amortization and depreciation. To expense legitimate costs of acquiring or constructing property plant, & equipment based on the timeline framework of this draft SOP will not provide a true representation of the cost of acquisition/construction of these assets. Nor will it permit these costs to be matched against the use of these assets. For electric and telecommunications utilities, in the absence of significant accounting adjustments and regulatory adjustments as indicated by Statement of Financial Accounting Standards Board No. 71, Accounting for the Effects of Certain Types of Regulation, (SFAS No. 71), the draft SOP will also require that future consumers pay for benefits being provided to today's consumers for costs of removal. For timeline framework changes that require expensing of early costs of construction, today's consumers will pay for costs that benefit future customers.

- In general, the draft SOP raises significant ratemaking, operational, and accounting concerns for utilities. We understand that this project was originally conceived to address issues within the real estate industry. The accounting provisions proposed in this draft SOP may be very appropriate and beneficial to that target industry, however for utility enterprises, the accounting provisions should not be implemented unless and until significant changes that give due consideration to the utility operating environment are included.

2. <u>No identifiable improvement over current practices</u>

- Much of the utility industry continues to establish rates based on a specific cost of service that has been approved or established by the utility's regulator. The cost elements included in these cost-of-service studies are based on defined cost elements as contained in a prescribed UsoA. As stated previously, both the Telecommunications and Electric USoAs generally follow GAAP. However, general ratemaking procedures of utilities provide that a utility, at the direction or approval of its regulator, defer or accelerate the rate recognition of certain costs or revenues. When such adjustments are required to accommodate rates, SFAS No. 71 takes effect and regulatory assets or liabilities are recognized to show the differences between typical GAAP and GAAP under a regulatory structure. It is not clear from the draft SOP what is intended in relation to the application of SFAS No. 71. Would SFAS No. 71 be precluded from being utilized for Property Plant and Equipment items specifically addressed in the draft SOP? Clearly this would be a substantial burden on utilities that we believe would be unacceptable.

- The draft SOP does not allow the group method of accounting for plant. Accounting Research Bulletin No. 43 gives the definition of depreciation for GAAP. It states that

the costs of a productive facility are one of the costs of the services it renders during its economic useful life. Generally accepted accounting principles require that this cost be spread over the expected useful life of the facility in such a way as to be allocated as equitably as possible to the periods during which services are obtained from the use of the facility. This procedure is known as depreciation accounting, a system of accounting which aims to distribute the cost or other basic value of tangible capital assets, less salvage (if any), over the estimated useful life of the unit (which may be a group of assets) in a systematic and rational manner. It is a process of allocation, not valuation.

The parenthetical reference clearly gives authority to utilizing group method of accounting for assets. For utilities that have considerable investment in mass items of property plant and equipment, group accounting for assets is a necessity. The costs of accounting for individual units of property from cradle to grave would be prohibitive. For example, in a typical electric cooperative with $60 million in total assets there is an investment in net utility plant of $46.5 million. This plant consists of approximately 40,000 poles and 29,600,000 feet of wire alone. The total number of retirement units (which meet the definition of components under this draft SOP) is 313,524 excluding wire which is generally accounted for by the foot. Adding in wire, there would be 30 million property units to account for individually. We do not believe accounting for these items on an individual basis would be feasible. It would be cost prohibitive for our borrowers to label each unit of property so that it could be identified at retirement and removed from the accounting records.

- Component depreciation also would not be equitable for mass items of property plant and equipment. Group depreciation is the preferred method of depreciation. In order to determine the lives of individual units of mass property it is necessary to perform a statistical analysis of the units. Such a method of statistical analysis widely used by utilities and regulators is the Iowa curves model. This model has been extensively tested and is widely accepted. This model analyzes the placement and retirement history of the mass items along with developing estimates for cost of removal and salvage and changing technology and construction techniques to develop an average service life for units of property. Even with the knowledge of the average service live of a type of plant it would not be beneficial to account for each individual unit separately and establish a separate depreciation reserve. Very few individual units will have exactly the "average life". To require establishing a separate reserve to determine a gain or loss for each individual item of mass property and then charging that gain or loss to depreciation expense would be an academic exercise that would provide no benefit to the company or to the user of the financial statements.

- Further, the draft SOP proposes that composite depreciation is not an acceptable method of depreciation. Composite depreciation rates for assets, if calculated properly, are an acceptable tool. With proper monitoring of the depreciation rates for the components of the group, composite rates should yield materially the same results as component depreciation.

3. <u>No demonstrated need for proposal</u>

- The draft SOP indicates that a significant diversity in accounting for cost related to property, plant, and equipment has been widely observed. While RUS cannot address all industries, we can assure you that RUS electric and telecommunications borrowers have sufficient guidance provided in the RUS UsoAs. We further believe that all other entities within the electric and telecommunications industry also have sufficient guidance in accounting for costs related to property, plant, and equipment in the USoAs maintained by the Federal Energy Regulatory Commission and the Federal Communication Commission. These systems provide uniform, comprehensive capitalization and expense recognition guidelines for accounting for cost elements associated with property, plant and equipment. These guidelines have been in effect for decades and are widely disseminated. We believe that current guidance and industry practice are adequate in this area.

4. <u>Benefits will not exceed costs</u>

- Although paragraph A48 appears to provide relief from component accounting to those entities currently using another convention, such as group depreciation and the use of composite lives, the only method of developing the information necessary to justify relief is to establish a parallel system using component accounting. Such a parallel system would be extremely expensive for utilities due to the number of property, plant, and equipment components in use in the utility industry. The costs of maintaining dual systems would be prohibitive. Clearly if this test were required to be met on a yearly basis, utilities would have to abandon the group method due to the costs of maintaining dual systems. The cost of identifying individual components and tracking these components through their useful lives would be significant. The costs of course would have to be passed on to the ratepayers. We believe that this draft SOP would yield no benefits for the electric and telecommunications entities and that the cost involved with this transition to component accounting would be excessive.

- If this draft SOP is implemented, utilities will find themselves in the unenviable position to being forced to keep two separate sets of accounting records. One set to satisfy the requirements of utility regulators prepared in accordance with the USoA appropriate to that industry, and a second set of books in accordance with GAAP for the preparation of external financial statements. This would lead to great confusion among users, as well as considerable unnecessary cost.

In conclusion, the draft SOP, due to the capital-intensive nature of the industry, will heavily impact electric and telecommunications utilities. Systems of accounts have been developed over time to take into account the needs of the utilities, customers, and regulators. These systems of accounts are generally under the framework of current GAAP. This draft SOP will force increased requirements on industries that already have extensive accounting and reporting requirements. It is the considered opinion of RUS that this draft SOP conflicts with current accounting guidance, provides no improvement

in current practices, presents no demonstrated need for the proposal, and that the costs of implementing this draft SOP will be excessive with no realizable benefits for utilities.

If the AICPA and FASB elect to proceed with the proposals due to perceived deficiencies within other industries, we recommend that:

- Utilities that follow the FERC, RUS, or FCC uniform systems of accounts or other systems of accounts similar to those, be exempted from implementing the SOP.
- Ability to implement SFAS 71 in relation to property plant and equipment be clarified.
- Methods be explicitly stated for demonstrating that group accounting and composite depreciation systems are not materially different from component accounting and unit depreciation. As written, this proposed SOP will require maintenance of two plant accounting systems.
- FASB Concept Statements Numbers 5 and 6 be revised since the concepts presented in those statements would no longer apply.
- AICPA/FASB study and provide quantitative evidence of the currently accepted depreciation models (life analysis) used by utilities and regulators to determine the average lives for mass industrial property and demonstrate if unit versus composite depreciation is more accurate as asserted in the draft SOP.
- AICPA/FASB study and provide quantitative evidence of currently accepted group method of accounting for mass items utilized by utilities to determine if it is more accurate to account for the mass items on a unit basis than on a group basis as asserted in the draft SOP.

We would again like to express our appreciation at the opportunity to submit these written comments regarding your proposed Statement of Position, Accounting for Certain Costs and Activities related to Property, Plant, and Equipment.

Sincerely,

/S/

Kenneth M. Ackerman
Assistant Administrator
Program Accounting and Regulatory Analysis

Doniphan Electric Cooperative Association Inc
PO Box 699
Troy KS 66087

November 15, 2001

Mr. Marc Simon
Technical Manager, Accounting Standards
File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Exposure Draft - Proposed Statement of Position, "Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment"

Dear Mr. Simon:
Doniphan Electric Cooperative appreciates the opportunity to submit written comments regarding the above-referenced Proposed Statement of Position (PP&E Accounting Proposal) to the Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants (AICPA).

Doniphan Electric Coop is an electric cooperative in the state of Kansas, providing electricity to approximately 1629 consumers-owners in three counties. Since we operate within the capital-intensive electric utility industry, the PP&E Accounting Proposal would significantly and negatively impact Doniphan Electric's accounting policies and administrative costs. Over the past three years, additions to our total utility plant have averaged $206,059 annually. During this same period, yearly reported patronage capital (margins) has averaged $164,572. We conservatively estimate that, if adopted, this PP&E proposal could decrease these margins by at least 50%. Resultant electric rates to our consumers would have to be increased substantially to cover the incremental costs associated with this proposal and to protect our financial integrity and credit rating.

Doniphan Electric Coop is required to follow accounting requirements promulgated by the Rural Utilities Service (RUS). The PP&E Accounting Proposal raises significant ratemaking, operational, and accounting concerns for Doniphan Electric. The most significant of these concerns arise due to accounting inconsistencies between this proposal and the RUS Uniform System of Accounts and attendant RUS regulations and interpretations (collectively, Electric Cooperative Accounting Requirements). The PP&E

Accounting Proposal and the attendant detrimental impacts to Doniphan Electric include the following:

- Electric Cooperative Accounting Requirements specify capitalization of overheads in support of construction projects and permit capitalization of an appropriate portion of administrative and general (A&G) costs. In addition, Electric Cooperative Accounting Requirements specify capitalization of preliminary investigation and survey (PI&S) charges. The PP&E Accounting Proposal would prohibit capitalization of overheads, PI&S charges, and A&G costs.

  Implementation of these provisions would dramatically increase earnings volatility, as these overhead, PI&S charges, and A&G costs would be expensed, rather than capitalized as they are today. We estimate that the annual financial impact of these items would decrease our margins by at least $12,015 annually or more depending upon the extent of the capital restrictions ultimately imposed. Furthermore, from the standpoint of rate-making fairness, failure to capitalize these costs would inequitably shift the burden of collection of these costs from customers using the plant asset over its useful life to existing customers at the time the plant asset is constructed.

- Electric Cooperative Accounting Requirements prescribe the use of the group method of depreciation for plant assets. The PP&E Accounting Proposal would require use of depreciation accounting by component, defined as "a tangible part or portion of [plant] that can be separately identified as an asset and depreciated or amortized over its own separate expected useful life". The PP&E Accounting Proposal generally prohibits the use of a group method of depreciation, unless it can be shown by the entity that the asset balances and operating results under the group method is not materially different from that obtained under the component method. Implementation of this provision would require administrative reorganization to comply with the data collection requirements, as well as expensive new automated accounting systems -- or at a minimum, significant upgrades to existing software. In addition, determination of material differences between the component and group accounting methods would require record keeping for both methods, adding significantly to plant record-keeping costs, as well as audit costs. The estimated costs to upgrade automated systems and provide additional administrative record-keeping and data input is projected to add at least $50,000 in one-time costs and will conservatively exceed $82,137 on an annual basis thereafter. If adopted, our staffing costs are projected to increase by at least $31,604 annually, or more than 25%, to support the extra administrative and reporting burdens of this requirement.

- Electric Cooperative Accounting Requirements, consistent with group depreciation accounting convention, generally prescribe that gains and losses on normal dispositions of mass assets be closed to the accumulated depreciation account, under the theory that over time gains and losses will net out. The PP&E Accounting Proposal would require that gains and losses be reflected in the results of operations in the current accounting period. Implementation of this provision would result in increased earnings volatility, as gains and losses on plant disposition are reflected in

the current results of operations. Annual gains / (losses) closed to the accumulated depreciation account over the past three years have averaged $28,810. Electricity rates would likely require significant upward adjustment to provide for this increased uncertainty of earnings.

- Electric Cooperative Accounting Requirements generally recognize the cost of removal of a plant asset over the useful life of that asset, as a component of the depreciation rate. The PP&E Accounting Proposal would require that cost of removal be reflected in the results of operations in the accounting period in which such cost was incurred. Removal costs we've incurred over the past three years have averaged $9,708 annually. Implementation of this provision would result in increased earnings volatility, as cost of removal would be reflected in a single accounting period. Furthermore, from the standpoint of ratemaking fairness, failure to recognize cost of removal over the asset's life would inequitably shift the burden of collection of these costs from customers using the plant asset to customers during the retirement of the plant asset.

Each of the above accounting inconsistencies pose operational problems and create significant administrative burdens for Doniphan Electric that will dramatically raise the cost of electricity our rural member owners. The detrimental impacts of each item should be carefully considered and weighed against any identifiable benefits before the AICPA AcSEC implements the attendant provision of the PP&E Accounting Proposal for electric utilities. Further, we recommend that any and all decisions and changes impacting PP&E be closely coordinated in advance with RUS and all other federal and state governmental authorities regulating electric cooperatives and the electric industry.

Doniphan Electric appreciates the opportunity to provide comments on the PP&E Accounting Proposal and respectfully urges the AICPA AcSEC to consider its views. If questions arise concerning these comments, please feel free to contact Laura Jeschke, @ 785-985-3523.

Sincerely Yours,

Arlan C. Mitchell, Manager

November 15, 2001

Mr. Marc Simon, Technical Manager
Accounting Standards, File 4210.CC
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

RE: *Exposure Draft on Proposed Statement of Position: Capitalization of Certain Costs Related to Property, Plant and Equipment, dated June 29, 2001.*

Dear Mr. Simon:

Thank you for this opportunity to respond to the proposed statement of position on the capitalization of certain costs related to property, plant and equipment. Host Marriott has always been a strong proponent of well-founded accounting and financial reporting principles and practices that reflect the economic realities of the real estate industry. In this regard certain members of the Company serve on committees and boards of various similarly committed not-for-profit associations such as the National Association of Real Estate Companies ("NAREC") and the National Association of Real Estate Investment Trusts ("NAREIT") so as to better support the development of accounting and reporting standards.

As an owner of real estate, we look to standards that will help us reflect the economic reality of acquiring, developing, owning and operating real estate as an investment property. In this context the accounting standards for capitalizing the costs of these assets are fundamental to producing useful financial reports.

Host Marriott's Background

Host Marriott Corporation is one of the largest owners of hotels and one of the nation's largest real estate investment trusts. Historically Host Marriott has built its portfolio of hotels primarily by acquiring and holding large urban, resort, convention and airport operating hotel properties from partnerships and other owners of real estate. We own 124 hotels located throughout the United States, as well as in Mexico City and parts of Canada. These assets at book value comprise nearly $7.1 billion in value or an average book basis of $64 million per hotel. It is not uncommon for Host Marriott to purchase or develop a single hotel property at a cost that is in excess of $100 million. These properties consist of many significant components including restaurants, pools, tennis courts, convention and meeting facilities, exercise facilities, business centers, retail outlets, parking garages, world class spas and a wide variety of guest accommodations. The guest rooms themselves provide amenities ranging from in-room mini-bars to internet connections.

In general, Host Marriott's assets are positioned in the luxury and upper upscale sectors of the hotel industry. They are located primarily in major urban markets and resort/convention locations where competition demands that these assets be continually updated and renewed in order to command premium room rates and maintain high occupancies. Accordingly, Host Marriott continually engages in vigorous capital expenditure programs designed to preserve and enhance the long-term value of these assets and drive higher operating results by providing highly attractive properties offering facilities and amenities that guests desire.

In addition to our owned full service hotel portfolio, we hold equity investments in several additional full service and numerous limited service and extended-stay hotel properties through various partnerships.

Overview

In addition to adding additional emphasis to the comments included in the letters submitted by NAREC and NAREIT, Host Marriott wishes to comment on several unique impacts of the proposed SOP on our business. In particular, we are concerned with the following:

- The cost of implementing and operating under the proposed SOP seems to greatly outweigh any benefits that might be derived. Our hotel properties consist of a wide variety of assets designed to meet our guests' needs. When acquired, generally these assets are recorded in groupings and depreciated under the composite method of accounting. While it would be possible to record each of these individual assets and assign it a unique life, this process would be very expensive to implement and maintain. To implement this methodology would require us to conduct detailed cost segregation studies. At a conservative estimate of $25 thousand per property, implementation would cost the company $3 million without regard to staffing and system issues. On an ongoing basis, we estimate that the number of assets we would be required to maintain would increase at least ten-fold from our current base of approximately 645,000. This would require additional staffing on our part, as well as additional computer capacity, in addition to forcing the companies that manage our hotel properties to incur additional costs to comply with our detailed record needs.

- While the proposed SOP suggests that great diversity exists in practice, we do not believe that such diversity exists regarding the recording of the acquisition, development and depreciation of real estate. Therefore, we believe that changing a working and well understood accounting model without achieving well understood and accepted benefits for a broad cross-section of business is ill-advised. Specific areas of perceived diversity should be dealt with directly rather than changing a model that is fundamentally sound.

- In several instances, the proposed SOP offers guidance that is inconsistent with the matching principle. In particular, real-estate investment assets from time to time require major maintenance activities, which may arguably extend the life of the asset

or increase the value of the property. In any event, it is indisputable that these activities have a benefit to future periods, whether in improved operating performance or revenue generating capability. Current expense recognition of these costs would produce a result inconsistent with the matching principle.

- The United States accounting profession continues to work toward convergence with international standards. The proposed SOP endorses extremely detailed accounting for individual components of real estate assets, while IAS 40 treats investment properties as integrated operating entities. We believe the proposed SOP creates a needless divergence from international standards that is unlikely to be embraced outside of the United States.

- An item that has not been addressed in the current deliberations of this SOP is the impact the adoption of this statement will have on contracts that were previously negotiated with clauses triggered based on existing generally accepted accounting principles. In particular, as it relates to our portfolio, each of the properties that we own is subject to a management agreement that provides for payments of base and incentive management fees based on a formula that relies on financial statements prepared in accordance with generally accepted accounting principles. Each of the existing management agreements were individually negotiated based on the macro- and microeconomics existing at the time of the negotiations. The fees that are paid to the manager are compensation for services related to the operations and maintenance of each property. The management contracts generally are for 15 to 20 years in length with multiple renewal periods.

  Certain major repairs, alterations, improvements, renewals and replacements to the structure or façade, and mechanical, electrical, heating, ventilating, air conditioning, and plumbing, can be capitalized under the accounting guidance that currently exists, and was in place at the time the contracts were negotiated. Under the guidance of the proposed SOP the manager of our properties, or Host, as owner, would be required to expense these items. This would drastically change the economics of the management agreement and in the end would result in the costly renegotiation, both in terms of time and expense, of each management contract. In the event that it was determined that negotiations could not result in a satisfactory resolution to the manager or the owner of the properties, the parties would be required to establish parallel systems to monitor accounting differences between the current and proposed accounting guidelines.

The following are our comments on specific issues raised by the AICPA.

<u>Issues</u>

Project Stage Framework – Issue 2 & 3

Host Marriott does not object to the guidance proposed of a project stage or timeline framework. However, we do believe that additional guidance should be provided with

respect to common classification categories so that expenditures within various categories can be placed within the appropriate stage.

We are more concerned with the "bright line" approach to classification of a project as preliminary or pre-acquisition stage. Current accounting literature, primarily SFAS 67, clearly indicates that costs related to a property that would otherwise be capitalized should be capitalized until a final determination on the status of the project is made. Given the extended time line for development of real estate projects, the determination of when a project is probable is difficult to define. For Host Marriott, we recognize that the process to develop a typical urban, airport or resort hotel can take from five to seven years. In the case of one of our largest hotels in a major urban market, the process took nearly 14 years. This process may involve some or all of the following activities: acquiring land rights, negotiating with multiple layers of regulatory bodies including state, local, environmental authorities, participating in public hearings, conducting an extensive design and site selection process, obtaining bids and negotiating construction contracts, obtaining financing and constructing the asset. Given such extended timelines, the costs and the benefits to the project can and do change dramatically, thereby impacting the likelihood of completion of any project. Previous literature seems to indicate that these costs should be capitalized and expensed only when it was probable that a project would not be completed. It is clear to Host Marriott that assumptions regarding our probable return and costs associated with a project could change significantly given these timelines and that no bright line exists. We agree with the proposed standard that expenses related to failed or abandoned projects should be expensed, but believe that many of the activities leading up to the "bright line" have significant long-term value to the project and should be capitalized for successful projects.

Accounting for Cost Incurred - Issue 4

Host Marriott generally agrees that general and administrative costs should be expensed as incurred. However, we note that certain costs will vary with the level of activity and therefore should be included in the capitalization of major projects. Frequently our asset managers are directly involved in capital spending projects from the creation of the original architectural designs to approval of vendors in addition to their day-to-day oversight of a project. A particular project may comprise a substantial portion of that asset manager's time. Their involvement would naturally include travel, support staff and related materials and supplies that are a normal part of large capital projects. These costs would be incurred whether by a third party or an outsourced department, are integral to the completion of a project and are incremental. Clearly our staffing in this area would be reduced if not for these projects. We believe that the focus in determining expense/capitalization treatment should remain on the nature the cost and how it adds to the value of the investment and not who provides the value to the investment.

Accounting for Cost Incurred – Issue 5

Currently, paragraph 6 of SFAS 67 provides guidance on accounting for property taxes and insurance. Clearly, the treatment of ground rent has similar characteristics and would be expected to be treated similarly. As SFAS 67 indicates, the treatment should be more analogous to the capitalization of interest expense under SFAS 34, which recognizes that projects are completed in parts and that therefore capitalization should cease on each portion of the project, as it is substantially complete and ready for use.

The proposed SOP requires that capitalization of these costs cease "no later than the date initial operations commence in any portion of the building or structure." We believe this approach is inconsistent with a proper matching of costs and expenses. In a hotel development project, for instance, it would not be uncommon for a portion of the project (that is, rooms) to open while another guestroom wing or tower or other substantial guest amenity such as a conference center or spa is still under construction. In these situations, we suggest that it would be more appropriate to allocate these costs between the capitalizable (that is, still under construction) and expense (that is, construction completed) portions.

Accounting for Cost Incurred – Issue 6, 8 & 9

Investments in real estate require regular major renewal expenditures, which we believe, should be capitalized. These projects effect multiple periods and as such should not be reflected in a single period. Updates in hotel properties often require regularly scheduled maintenance to keep the properties visually appealing, enabling them to earn higher revenues, and operate efficiently and seamlessly in order to remain competitive in markets where customer impressions are a key feature to a properties success. Typically these costs will substantially extend the life of these assets as well as provide increases in efficiency and productivity (for example, higher revenue generating capability, less power consumed, fewer customer service interruptions). These costs will benefit multiple future periods, but under the proposed SOP would be charged to a single period. We believe that the SOP should be amended to include planned major maintenence for real estate investments as an exception to the proposed expense treatment.

Further, under the proposed SOP, the remaining book value of the asset undergoing maintenance would be written off in the period if the parts are not identified separately. In lieu of that, the SOP suggests that companies break the assets into components to further identify the longer-lived parts. This places an unreasonable burden on company's to identify individual components integral to the working of single machine and to estimate a reasonable depreciable life in comparison to the remainder of the individual machine. These estimates by the company would likely vary significantly between companies and between industries leading to less comparability and a decrease in investor understanding. Tracking the significantly increased number of assets would be burdensome both from a volume standpoint as well as increasing administrative costs and would undoubtedly add to the costs of our vendors and managers without adding any benefit as to the accuracy of the actual life of an asset.

Accounting for Cost Incurred – Issue 7

We believe that removal and demolition costs are planned or contemplated in conjunction with the acquisition of an asset and should be capitalized when the expenditure is made. Development of urban and airport hotels frequently involve the demolition or removal of existing structures both above and below ground. These costs are clearly contemplated in the cost of the acquisition and build out of the property whether for environmental concerns or simply to facilitate the construction of a more modern or more profitable facility. We believe that improvements in existing properties, which require demolition, should be treated in a similar manner and therefore capitalized. Almost any installation of machinery or construction of a structure requires modification of existing area for proper installation. As a real estate investor we frequently make modifications and improvements to our properties that in many instances require the demolition or removal of parts of an existing structure. Our determination to perform a renovation or make a new investment in a hotel asset is based on a return on investment analysis that incorporates all costs that are required to complete the project, including any demolition costs. Our decision to go forward with a project based on such an analysis assumes that the incremental revenue generated or expenses saved will justify the expenditures to be made, including demolition costs. As an example, we have on several occasions in recent years created a concierge or club level in a hotel. This required us to remove the walls between three or four hotel rooms to create a restricted access concierge lounge. These demolition expenditures were justified in these cases because they enabled the hotel to sell the remaining rooms on these special access floors at a much higher nightly rate and improve customer repeat business. Obviously the investment decision includes the costs to remove the existing structure and thus these costs should be capitalized as they result in appropriately matching the costs, through subsequent depreciation, with the revenues to be realized from the project. It should also be noted that in certain instances the demolition costs on large-scale projects are not distinguishable from modifications and therefore may result in subjective decisions, and inconsistent in reporting between entities.

Issue 12 through 14: Component Accounting.

Although we agree with the theoretical foundation for the proposed use of component accounting, we are skeptical about the practical ability of companies to obtain and maintain the massive database of detail regarding each component. We also believe that the costs associated with adopting this SOP will far outweigh the benefits to the financial statement user.

The Proposed SOP suggests in paragraph 49 that each tangible part or portion of PP&E that can be separately identified as an asset and depreciated or amortized over its own separate expected useful life. While this is theoretically the best means to identify and track assets, it will be extremely difficult to create a consistent application of this theory between real estate investment companies. We as a company currently track 645,000 individual assets totaling $7.1 billion within fifty asset categories with ten different depreciable lives, while using as many as seven separate methods of book or tax

depreciation (that is, ACRS, MACRS, straight-line and so forth). Each of these assets is maintained in seven different books so that we are able to track information to create corporate and various subsidiary partnership financial statements as well as prepare the related tax returns. As currently written, the SOP proposes that a typical building asset would consist of three basic components: tenant improvements, integral components, and building shell. Based on our familiarity with our portfolio we believe that three component categories significantly under-estimates the number of components that actually exist. As is demonstrated in Attachment 1 we believe that there is a minimum of 25 typical hotel building components that should be considered, but we also note that the total number of components could easily be in the 100's. We believe that adopting a new standard that contemplates only the three classes suggested would not reflect any better the reality of our business environment and thus would not produce information of greater value to the readers of our financial statements.

In the event the Proposed SOP is adopted in its current form, we would envision that the number of assets that would we would be required to individually track would increase tenfold or more. Using the composite method of accounting, we currently maintain one asset for depreciation purposes that, as a result of component accounting, would require the asset to be broken down into a large number of components. For example, each of our hotels has elevators that are being depreciated over their estimated useful life, representing a composite life for all of the parts. Component accounting would require each elevator to be broken down into several different components such as the motor, the elevator car, the electronic switchboard, the wiring, the carpeting, the ventilation, the doors, the shaft, etc. Although it is possible to break the elevator into its many components the number of assets would increase substantially. This same example can be applied to other major items that each of our properties have in common such as the boiler, the HVAC system, the security system, and the kitchen to name a few.

It is our opinion that the composite method of capitalizing and depreciating PP&E, which is both used and accepted in current practice, should continue to be offered as an alternative to the component method. This is supported by a number of sources of authoritative accounting literature, including SEC Staff Accounting Bulletin 1 Topic 5B, the AICPA Audit and Accounting Guide for Audits of Airlines, SFAS No. 19, Appendix B and the AICPA Audit and Accounting Guide for Audits of Oil and Gas Producing Companies. The conclusions reached in the current literature note that the composite method results in a systematic and rational allocation of depreciable cost over the estimated useful life of a group of related assets at reasonable cost. Under the composite method, property items that are similar in nature despite differences in the useful lives of the individual parts are grouped and depreciated over an average useful life. Common groupings include type, classification, location, or a combination of these. Composite depreciation is commonly applied to a group of related assets that are significant in number but have relatively small unit values.

In order to comply with the provisions of the Proposed SOP the volume of data that would be included in our database would result in a large increase in cost in terms of

wages and information systems, as well as the cost of training both our staff and the staff of the management company at each of our hotels that would be required to account for the components. As a result of the volume of information that would be required of each asset (for example, in-service dates, asset name, asset location, cost, net-book-value, and so forth), we estimate that we would need to, at a minimum, double the number of staff that we currently employ in our fixed asset department. Additionally, we would also need to change the job requirements to ensure that we have members of our fixed asset accounting team that have the technical/engineering background and ability to determine the components of an asset. A possible consequence of the change in dynamics of the fixed asset group could result in the traditional background and training of an accountant with a C.P.A. designation becoming less important than having an engineering background to facilitate the accounting required by this exposure draft.

Our enterprise reporting system, PeopleSoft, does not have limitations on the number of records that can be accommodated, but increasing the number of assets we track by nearly a factor of eight will cause more than the asset table to grow. PeopleSoft creates depreciation records for the entire life or each asset. Currently we have 19 million rows in our Depreciation table. The increase being considered would raise that number to approximately 200 million rows depending on asset lives. The additional time to process those records through our period close process will be substantial. Additional technical resources would be needed to tune and support the system. The need to invest in the development of a data archiving scheme for our PeopleSoft applications would also be essential. PeopleSoft does not currently provide an archiving solution. Some additional hardware would be needed especially data storage medium.

Any increase in the number of categories at which we track assets will have a ripple effect on our General Ledger. Additional asset categories means additional accounts, which means additional journal lines each period. The concerns stated address ongoing issues after the existing data has been modified to meet the proposed rules. The data conversion itself would be a major project requiring extensive technical support and system processing.

Since we receive a large portion of our asset and project costing data through electronic feeds from our managers, their processes and data systems would need to be modified to assure that they meet the proposed requirements. The cost of design modifications to large data systems is significant.

A number of real estate companies rely on obtaining the information related to fixed asset expenditures from the property managers. In our particular instance, the managers (that is, another company) of our properties have access to a fixed asset escrow account so that they can facilitate the acquisition of requisite fixed assets and then provide adequate detail on the expenditure. The Proposed SOP would require the property managers to provide substantial additional detail and perform significant additional services that were not contemplated at the time the management agreements were negotiated.

An area of particular concern relates to the volume of information gathering and processing that the proposed SOP would require in conjunction with a large real estate transaction. As an example, in 1998 we acquired twelve hotels in a single transaction for approximately $1.55 billion. Each of the assets acquired were built at different times such that the components of the building are at different stages of their useful lives. In order for the Company to comply with the Proposed SOP the company would be required to incur substantial costs to re-allocate the cost of the acquisition to the components. We believe that this process would be impractical, would result in arbitrary allocations to a substantially increased number of components and would also result in substantial incremental transaction cost.

The SOP also suggests that NBV would be obtained from accounting records, or an estimate of NBV obtained by applying an appropriate factor (such as the producer price index) to the current costs of the replacement component. We feel that broad estimates of NBV by companies will result in inconsistencies. Alternately, the composite depreciation method is designed to reflect the "weighted average lives" of both longer-lived and shorter-lived assets. When assets are retired (both before and after useful life), the resulting gain or loss is offset to accumulated depreciation.

The company believes that the additional current and future costs of managing and tracking the vastly increased number of assets will not provide investors with additional information, but will certainly increase the cost of doing business. Shareholder value will, therefore, be reduced while not increasing the usefulness of the information provided.

Issues 16 – 19 Transition

The proposed SOP suggests two alternative methods of adoption. We believe that this proposal will create greater diversity in practice. We further believe that any implementation should be treated consistent with APB 20.

I appreciate the opportunity to participate in the Board's considerations with respect to the Exposure Draft. If you should have any questions regarding the above comments, please feel freed to contact me (301) 380-7201.

Sincerely,

Donald D. Olinger
Senior Vice President and Corporate Controller

Attachment 1

Capitalization of Certain Costs Related to Property, Plant, and Equipment

For the acquisition of a building, we record one composite cost. To implement this SOP, the possible components and sub-components for acquisition-building costs are:

1. ADA Upgrade
   - Lifts
   - Ramps
   - Railings
2. Architectural & Engineering
   - Steel support structure
   - Drawings/Blueprints
   - Foundation
   - Walls
3. Asbestos Abatement
4. Bathroom Tiles
5. Built-in cabinets
6. Ceilings
   - Acoustic
   - Drywall
   - Decorative (metal, wood, plaster)
7. Closets
8. Doors
   - Revolving
   - Folding
   - Fire Prevention
   - Guestroom
9. Electrical
   - Panels
   - Circuit breakers
   - Conduit
   - Wiring
   - Outlets/Switches
10. Elevators
    - Each elevator is a separate component per the ED's Example 1 in Appendix C and each hotel has a minimum of 10.
    - Motor
    - Lighting
    - Paneling
    - Flooring
    - Panel/wiring
11. Environmental improvements

- Noise and light abatements
- Plantings
- Flood control
- Grading
- Soil Improvements

12. Façade
    - Signage
    - Masonry work
    - Support structure
    - Architectural design
13. Internet/communications
    - Fiber-optic Cable
    - Control panels
    - Modems
    - Hotel room connections
    - TV Cables
    - Satellite Receivers
14. Fire Protection System
    - Alarms
    - Enunciator panels
    - Audio/visual Alarms
    - Wiring
    - Pipes
    - Sprinklers
15. Floors
    - Marble
    - Ceramic
    - Wood
    - Tile
    - Carpet
16. Food & Beverage Facilities
    - Kitchen F&B storage cabinets and shelves
    - Restaurant F&B storage cabinets and shelves
    - Branded Retail outlet configuration
17. HVAC
    - Central Plant
    - Cooling Tower
    - Duct Work
    - Room Units
    - Thermostats
18. Internal Walls
    - Studs (metal, wood)
    - Drywall

- Wall coverings (Paint, wallpaper)
- Soundproofing

19. Landscaping
    - Trees, bushes, plantings
    - Curbing
    - Storm drains
    - Walls
    - Gates
    - Gazebos
    - Walkways
20. Lighting
    - Recess
    - Track
    - Spot-indoor/outdoor
21. Parking
    - Surface
    - Curbing
    - Painting
    - Signage
    - Drainage
    - Attendant booth
    - Gate
    - Fencing
22. Plumbing Systems
    - Pipes
    - Showers
    - Tubs
    - Fixtures
23. Recreational Amenities
    - Pools
        - Deck
        - Tile
        - Filtration system
        - Heating
        - Painting
        - Fencing
        - Lighting
        - Deck house
    - Tennis Courts
        - Surface
        - Nets
        - Fencing
        - Equipment House

- Painting

24. Roof
    - Truss
    - Roofing (Slate, tile)
    - Insulation
    - Drainage
25. Convention/Meeting Rooms
    - Stages
    - Curtains/room dividers
    - Lighting
    - Specialized Walls (sound proof)
    - Food preparation areas
    - Floors

NiSource

Delivering life's essential resources

November 15, 2001

Marc Simon, Technical Manager, Accounting Standards, File 4210.CC
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Response Letter to AcSEC Exposure Draft on Proposed Statement of Position – Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment (Dated June 29, 2001)

Dear Sir:

NiSource Inc. (NiSource) is pleased to submit its comments concerning the Exposure Draft of the Proposed Statement of Position (Proposed SOP), "Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment." NiSource is a holding company with headquarters in Merrillville, Ind., whose operating companies engage in the exploration and production, transmission, storage and distribution of natural gas, as well as the generation, transmission and distribution of electricity. Its operating companies provide service to 3.6 million customers located within the high-demand energy corridor that stretches from the Gulf of Mexico through the Midwest to New England. NiSource has approximately $17 billion of gross property, plant, and equipment. For the nine-month period ending September 30, 2001, total capital expenditures totaled approximately $400 million, which amounts to approximately $500 million on an annualized basis. Due to the capital-intensive nature of the natural gas and electric industries in which NiSource operates, NiSource has a strong interest in the accounting requirements prescribed in the Proposed SOP.

NiSource is a member of the American Gas Association (AGA), Interstate Natural Gas Association of America (INGAA), and the Edison Electric Institute (EEI) and participated in the creation of the Comment Letters drafted by these organizations. NiSource wishes to express its support of the comments and recommendations offered in the respective Comment Letters.

In particular, NiSource believes that the Proposed SOP would directly conflict with regulatory accounting requirements, would not result in improvements in practice, and would result in a situation where the costs to implement would exceed any derived benefits. In the areas regarding component method accounting and the expensing of general and administrative overheads, early-stage project costs, and the net book value of retirements related to replacements, the Proposed SOP is in direct conflict with regulatory accounting and rate-making methodology. NiSource strongly recommends that AcSEC exclude rate-regulated entities from the scope of the Proposed SOP that conflict with regulatory accounting rules.

NiSource urges AcSEC to consider that accounting practices in the natural gas and electric industries are thoughtful, consistent, and have withstood the test of time. The practices in these industries are subjected to regulatory scrutiny before being approved for implementation.
Applying the Proposed SOP without adoption by regulatory commissions results in duplicative and non-productive effort without value.

NiSource appreciates the opportunity to respond to the Proposed SOP and urges AcSEC to consider the views and recommendations expressed in the AGA, INGAA, and EEI Comment Letters.

Very truly yours,

Jeffrey W. Grossman
Vice President and Controller

November 15, 2001

Mr. Marc Simon
Technical Manager, Accounting Standards
File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of the Americans
New York, New York 10036-8775

Dear Mr. Simon,

Progress Energy (PGN) welcomes the opportunity to comment on the proposed Statement of Position (SOP), "Accounting for Certain Costs and Activities Related to Property, Plant and Equipment", as prepared by the Accounting Standards Executive Committee (AcSEC). PGN thanks the AICPA for providing the opportunity to respond and hopes the comments enclosed are useful to the AcSEC in its deliberations.

If you have any questions with respect to PGN's comments, please feel free to contact me directly at (919) 546-2723, or through email at andy.krebs@pgnmail.com.

Regards,

Andy Krebs
Progress Energy Service Company
Manager, Management Reporting

Progress Energy's Response to "SOP – PP&E" Dated 11/15/01

PGN is a leading integrated energy provider with our primary base of operations in the southeastern United States. We have over $20 billion in assets, annual depreciation expense in excess of $750 million and accumulated depreciation of over $9 billion. These assets include 20,000 megawatts of electric generating capacity and electricity and natural gas transmission and distribution assets serving 2.8 million customers. We operate through both regulated utility businesses and non-regulated diversified businesses. Of our consolidated operating revenues of $4.2 billion for the six months ended June 30, 2001, our regulated utility businesses accounted for 81% and our non-regulated diversified businesses accounted for 19%.

Our regulated utilities are:

- Carolina Power & Light Company, or CP&L, a regulated public utility, is engaged in the generation, transmission, distribution and sale of electricity in portions of North Carolina and South Carolina;

- Florida Power Corporation, or Florida Power, a regulated public utility, is engaged in the generation, transmission, distribution and sale of electricity in portions of Florida; and

- North Carolina Natural Gas Corporation, or NCNG, a regulated public utility, which provides natural gas and related services in portions of North Carolina.

Our non-regulated diversified businesses:

- Engage in non-regulated power generation; energy marketing and trading; and extraction, manufacturing and delivery of fuels, including coal, synthetic fuel and natural gas;

- Own and operate a voice and data fiber network that extends from Washington, D.C. to Miami, Florida;

- Provide facility management software and energy management solutions; and

- Provide railroad and transit system maintenance and reconditioning services.

Summary of Progress Energy Issues

PGN believes in setting a final SOP, the AcSEC needs to consider:

The use of group accounting and depreciation methods needs to be continued for assets that are homogenous in nature and the SOP must allow for some flexibility in setting component levels. PGN believes the SOP in its current state is neither feasible to implement nor cost beneficial considering the large volume of transactions currently accounted for under group accounting methods.

The SOP conflicts with currently acceptable regulatory accounting requirements as outlined by the Federal Energy Regulatory Commission (FERC) in the Code of Federal Regulations and those allowed by the state commissions. PGN would apply SFAS No. 71 and defer the differences between current regulatory requirements and the SOP. Therefore, the SOP will not impact operating results for its regulated businesses, but will require excessive costs to maintain the two sets of books required to meet the reporting requirements for GAAP and regulatory reporting.

With respect to costs incurred, PGN believes the SOP's definition of incremental costs needs to be expanded to include the capitalization of internally incurred overheads and allow for the allocation of supervisory overhead costs. PGN believes the capitalization of these costs allows for a better matching of these costs with the benefit to be derived.

Costs Outweigh the Benefits

As further discussed, PGN believes the costs of implementing and maintaining the records of its regulated entities in accordance with the SOP would be cost prohibitive. PGN's regulated entities currently apply group accounting and depreciation methods to groups of similar assets with approximately the same useful lives, such as poles, transformers, overhead lines and meters. As noted below, the SEC and regulatory agencies recognize group accounting concepts, as an appropriate method of accounting for homogenous assets. The group method approximates a single unit cost procedure since the dispersion from the average is not significant. Mandating component accounting to these types of assets is neither cost efficient nor feasible. The SOP, in paragraph 48A, allows for methods such as group and composite, to continue if similar results can be achieved. As explained in Issue #14, assessing the SOP against current regulatory requirements is not feasible, given the number of process and system changes and the volume of transactions to review in order to make this assessment.

Conflicts with Current Accounting Requirements

PGN believes for its regulated businesses the SOP conflicts with current industry accounting requirements as outlined by the Federal Energy Regulatory Commission (FERC) and those allowed by the state commissions. These businesses generally follow the FERC Uniform System of Accounts, which allows for the capitalization of indirect overheads, general and administrative costs and the use of group property accounting (See 18 CFR Part I Electric Plant Instructions). Application of the SOP criteria would require each PGN regulated entity to develop and maintain processes to support GAAP and regulatory reporting requirements. In essence, two sets of books would need to be established and maintained. Due to the number of differences between the SOP and current regulatory requirements, PGN believes the implementation and maintenance of systems and processes to support both regulatory and GAAP reporting are cost prohibitive. PGN also believes the reporting differences caused by the SOP would result in excessive communication and change management not only within each of these entities, but also to external parties. This will not necessarily improve the quality of reporting or impact the results of operations because of the requirement to defer differences under SFAS No. 71.

Below are PGN's comments to the specific issues on which the AcSEC requested comment.

Issue # 1 – Lessee and lessor accounting for reimbursements

No comment

Issue # 2 – Project Stage Framework

PGN conceptually believes the project stage framework makes sense, but the kinds of activities being performed also need to be considered when determining whether the cost is capital or expense. This is inferred in paragraph A8 of the SOP where it states, "the guidance in the SOP would be more operational if capitalization criteria were based on the kinds of activities performed and kinds of costs incurred rather than on whether a particular expenditure fits into one of a large number of classification categories".

Additionally, PGN requests the AcSEC for reconsideration and clarification on two examples of costs incurred during the in-service stage, as defined by the SOP.

PGN disagrees with the treatment described in footnote 7 of paragraph 28b, where an asset is considered in-service when the first unit of production is generated and sold in

test. PGN and others in the electricity generation business typically consider the in-service date to be the official commercial operation date.

PGN also asks the AcSEC for clarification of footnote 7 to paragraph 28b, where the footnote indicates "costs subsequently incurred by the entity to enhance the production efficiency of the PP&E — for example, to increase a machine's hourly output — should be charged to expense as incurred". PGN currently has a Power Uprate project underway, where significant dollars are being spent to increase the capacity at a generating plant. PGN believes this project would be treated as capital under the SOP, paragraph 37 (item a) as the additions represent the acquisition of "components", but asks that the AcSEC clarify the relationship between paragraph 28 footnote 7 and paragraph 37 (item a). PGN believes capital treatment is appropriate given the definition of components and that the depreciation of these costs better matches the revenues with the associated expense.

Issue # 3 – Preliminary Stage

PGN generally agrees with the SOP and the criteria for accounting for costs incurred in the preliminary stage. However, as noted in Issue # 2, PGN does not believe that the timing of when costs are incurred should be the sole determination in whether costs are capitalized. Additionally during this stage, there currently exist differences between the SOP and current regulatory requirements. PGN's regulated entities would be required to incur the added burden of capturing and tracking these transactions to meet the reporting requirements for both GAAP and regulatory reporting. This requires the development and maintenance of two sets of books. PGN believes the costs of changing and maintaining two sets of books far outweigh the benefits gained. Additionally, for PGN's regulated business, any differences between the SOP and regulatory accounting requirements would be accounted for under the provisions of SFAS No. 71. See 18 CFR Part I – "Electric Plant Instructions" for the many differences between the SOP and currently acceptable utility practice.

Issue # 4 – Accounting for Costs Incurred

PGN believes the AcSEC needs to clarify the SOP's definition of incremental costs and the relationship between incremental costs incurred by a third party and similar costs incurred internally. As an alternative, the AcSEC should expand the scope of how it defines "avoidable" costs in paragraph A20, to address some of the inconsistencies in the SOP. For example, at a construction site, a trailer is placed on site where project engineers and a project cost accountant work. If costs for the trailer were incurred in a transaction with an independent third party, the costs would be capitalized under paragraph 23a. If incurred internally, PGN interprets that the SOP would require the costs to be expensed under paragraph 23b. Additionally, the SOP would allow the

project accountant to be capitalized under paragraph 26 if incurred by an independent third party, but the same cost would be expensed if incurred internally under paragraph 24. PGN believes, in this example, both the costs for the trailer and the project cost accountant are incremental or "avoidable" costs, as they would not be incurred if it were not for the construction project. Accordingly, these costs should be treated similarly regardless of whether the costs are incurred internally or by an independent third party. Since these costs are "avoidable", PGN believes there is a direct correlation between these costs and the project they support. The SOP seems to ignore the relationship of the incremental value these costs add to a project and appears to be more focused on who incurs them. PGN also disagrees with the SOP allowing independent 3rd party administrative overhead to be capitalized while internal overheads are expensed. PGN believes internally incurred overhead costs should be treated the same as the 3rd party costs in paragraph 26 and 31. PGN also believes capitalizing and depreciating these incremental overheads better matches the costs with the future benefit to be derived. PGN believes the AcSEC should provide specific examples to illustrate its intent for incremental costs.

PGN's business is capital-intensive and many times engineering supervision and other overhead costs are rationally allocated to many projects rather than directly charged. Doing so facilitates the charging of this labor to the projects to which these individuals contribute. PGN asks that the SOP allow entities to continue with the practice of allocating these types of costs rather than directly charging these costs. PGN believes similar results are achieved whether the costs are directly charged or allocated, and that the AcSEC should be concerned more with the results presented in the financial statements than the mechanism of getting supervisory and other overhead costs assigned directly to particular projects or components.

As an order of magnitude, PGN's two electric utilities, CP&L and Florida Power, currently capitalize approximately $75 million annually for overhead costs as allowed by the FERC and the state commissions. These costs consist of thousands of transactions. To comply with the SOP, processes would need to be put in place to either (1) begin to direct charge these costs to projects or (2) to develop processes to account for these costs in a manner that meets both GAAP and regulatory reporting requirements. PGN questions the benefits gained versus the costs incurred to evaluate and implement either alternative.

PGN would also like to highlight the differences between the SOP and the guidance as outlined in ARB No. 43 (Statement 3) – "Inventory Pricing". ARB No. 43 states "costs means in principle the sum of the applicable expenditures and charges directly or indirectly incurred in bringing an article to its existing condition and location". It further states that "the exclusion of all overheads from inventory costs does not constitute an accepted accounting procedure". PGN believes the SOP needs to reconsider the value of incurring certain "avoidable" overhead costs today to the value of the assets involved, as well as the matching of expense with revenues in the future.

Again, PGN's regulated entities would capitalize many of these overhead type costs as permitted by accepted utility practice and would apply SFAS 71 to the differences. This would result in a large number of transactions that would need to be accounted for and significant costs to develop processes to enable reporting in accordance with regulatory and GAAP guidelines.

Issue # 5 – Property Taxes

PGN agrees with the guidance as currently outlined in the SOP.

Issue # 6 – Normal Maintenance and Costs after the In-Service Date

PGN generally agrees with the SOP that normal maintenance should be charged to expense and that all costs incurred after the in-service date be expensed unless the costs relate to additional components or the replacement of existing components. PGN suggests that the SOP also allow for costs incurred shortly after the in-service date that relate to construction, but that were not necessary for the asset to be placed in-service to be capitalized. Examples of these types of costs include painting, landscaping and punchlist items.

Issue # 7 – Cost of Removal

For its non-regulated business, PGN agrees with the guidance in the SOP. Cost of removal for PGN's regulated business would need to be accounted for separately to meet both GAAP and regulatory reporting requirements. To do so, processes would need to be developed to track these charges separately, adding to the cost of implementing the SOP.

Issue # 8 – Planned Major Maintenance

PGN agrees with the guidance as currently outlined in the SOP.

Issue # 9 – Major Maintenance and the Built – In Overhaul Method

No comment

Issue # 10 – Inventory Used in Internal Production

No comment

Issue # 11 – Assets produced for Sale or Operating Lease

No comment

Issue # 12 – Component Accounting

PGN believes the SOP needs to reconsider the use of composite and group accounting methods for industries where these methods are accepted and widely used. These methods call for a retirement unit, which sets the level that assets are accounted for. PGN believes the retirement unit meets the spirit of the SOP's intent of requiring component accounting. PGN believes the real intent of the AcSEC in requiring component accounting was to address those industries where a certain level of component accounting did not exist. PGN believes the SOP needs to further incorporate specifications to allow for an entity, or a particular industry, to have some flexibility in setting the appropriate level of a component. While in the case of PGN, it may be possible to further refine the level of a retirement unit, we do not believe the result, when compared to the cost of performing this exercise, provides significantly more useful reporting than the currently acceptable industry practice. PGN asks the AcSEC for confirmation as to whether this is reasonable judgement, as stated in paragraph 52 of the SOP, in applying the guidance in paragraphs 49-51. PGN is concerned the SOP would eliminate an accepted industry practice without providing added benefit. We believe the AcSEC has grossly underestimated the level of effort and cost that would be incurred to implement and maintain a component accounting process for a regulated entity such as PGN.

Issue # 13 – Component Accounting – Gain or Loss on Replacement

Currently for those assets where PGN uses group accounting methods to account for assets, gain or loss on replacement is recorded to accumulated depreciation. This accounting treatment is consistent with SEC Staff Accounting Bulletin 5b – "Gain or Loss on Disposition of Equipment" and current utility industry practice. To be required to individually calculate gain or loss on assets currently accounted for using group accounting methods is cost prohibitive. PGN believes its current method of charging gain or loss to accumulated depreciation is appropriate for these items and believes group accounting practices should be an acceptable alternative under the SOP.

Issue # 14 – Component Accounting – Depreciating Components

PGN currently uses composite and group depreciation methods, which are acceptable industry practice to record depreciation. As noted in the example that follows, changing methods for PGN's regulated business would be an extreme undertaking in terms of time and cost given the necessary process and system changes. When weighing the costs against the benefits derived, PGN believes little value is gained. Absent the cost of the changes to be made, PGN also believes there would be little impact to the results of operations given the ability to treat most differences under SFAS No. 71. In paragraph A48, the SOP offers the opportunity to continue with current composite and group depreciation methods if it can be demonstrated the current methods would yield similar results to component accounting. PGN does not believe this is an acceptable alternative for the regulated businesses. As described in the example that follows, due to the drastic differences with regulatory requirements, the amount of detail component accounting would entail and the expected system modifications needed to compute the comparison, PGN believes this is not an acceptable alternative. PGN believes AcSEC should provide specific guidance of how to perform this comparison without utilities incurring unnecessary costs.

Example of Implementing Component Accounting for Group Assets

Below is an example of the issues PGN would encounter in implementing the SOP's guidance for poles for one of its regulated entities.

PGN's subsidiary, CP&L, currently has approximately 1.4 million poles in service that are accounted for using group accounting and depreciation methods. These poles are classified using 14 different retirement units and currently do not have any unique identification. For book purposes, within each pole classification, the assets are further segregated by the vintage year or the year installed. Quantities and depreciation are tracked and computed for each vintage year. Due to the high volume of poles, retirements are recorded on a FIFO basis on the premise that some assets will have longer or shorter lives than others, but on average, the actual life is consistent. Gains and losses on replacements are charged to accumulated depreciation.

In order to comply with component accounting for just this one type of asset that is currently accounted for using group accounting concepts, PGN believes some of the steps necessary to convert to component accounting are:

- An individual record would need to be established for each pole that would include original cost, installed date, estimated life and salvage value, at a minimum.

- System modifications would be necessary to revise depreciation computations from group to component methodologies, such as extensive program logic changes to

compute depreciation and altering the current database to capture the additional details required by a change to component accounting. A move to component accounting would vastly expand the currently defined property units, which in turn would trigger a multiple explosion of the number of records processed. These volume increases would need to be assessed against the system limitations and logic configuration, thus adding to the cost to implement and maintain the assets according to the guidance in the SOP.

- Accounting operations and field personnel would be required to develop new processes to identify locations for both existing and new pole installations, as well as modify the process to identify retirements by specific pole. This would create a significant change management effort.

- Additional field and accounting operations personnel would be required to account for the increase in the volume of transactions.

- For tax purposes, IRS approval would be necessary for the change in retirement methodology, from FIFO to specific identification.

While this is not a comprehensive list, PGN wants to emphasize that requiring a regulated utility to do away with composite and group accounting concepts would be a significant undertaking and needs to be evaluated based upon the results to be achieved. PGN believes for assets such as poles, the group method of depreciation properly balances the level of effort and cost with the results achieved and should continue to be permitted.

PGN would account for all differences between the SOP and regulatory reporting using the provisions of SFAS No. 71. However due to the large number of differences between the GAAP and regulatory guidance, the cost and effort to create and maintain two sets of books, far outweighs the benefit to be gained for financial reporting.

In summary, there are a number of differences between the SOP and currently acceptable industry practice, which will result in excessive costs to utilities to maintain reporting for GAAP and regulatory purposes. PGN believes the SOP should be expanded to include the use of group accounting methods and provide for flexibility in establishing component levels. If expanded, utilities would not be required to make what is believed to be a costly undertaking to comply with the SOP while providing minimal improvements in reporting and results of operations.

Issue # 15 - Amendments to Other Accounting Guidance

No comment

Issue # 16 – #19 – Transition and Adoption Requirements

PGN believes the transition and adoption requirements in the SOP are reasonable for those industries that have a manageable number of asset components. As noted throughout, PGN does not believe this to be true for its regulated businesses. Additionally, PGN believes due to the complexity of implementing the SOP and the changes required from a systems and process standpoint, implementation would require a period of at least 18 months from the issuance date. The implementation of the SOP is also complicated by the adoption of SFAS No. 143, which for the utility industry, appears to be just as complex as the SOP. Since both deal with fixed assets, the same resources (system support and functional) would be required to assist with the implementation of both pronouncements.

Conclusion

In summary, PGN urges the AcSEC to consider the following in its future deliberations in defining the scope of the SOP:

- Utility accounting standards apply a form of component accounting through the use of the retirement unit
- The use of group accounting and depreciation methods are acceptable alternatives to component accounting for homogenous items
- Applying the proposed SOP standards to regulated entities results in an unnecessary and costly bookkeeping effort, without impacting the results of operations

PGN again thanks the AICPA for providing the opportunity to respond and hopes the comments enclosed are useful to the AcSEC in its deliberations.

**Jewell-Mitchell Cooperative
Electric Co., Inc.
PO Box 307
Mankato, KS 66956**

November 15, 2001

Mr. Marc Simon
Technical Manager, Accounting Standards
File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Exposure Draft - Proposed Statement of Position, "Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment"

Dear Mr. Simon:

Jewell-Mitchell Cooperative Electric Co., Inc. appreciates the opportunity to submit written comments regarding the above-referenced Proposed Statement of Position (PP&E Accounting Proposal) to the Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants (AICPA).

Jewell-Mitchell Cooperative Electric Co., Inc is an electric cooperative in the state of Kansas, providing electricity to approximately 2926 consumers-owners in 10 counties. Since we operate within the capital-intensive electric utility industry, the PP&E Accounting Proposal would significantly and negatively impact Jewell-Mitchell Cooperative Electric Co., Inc accounting policies and administrative costs. Over the past three years, additions to our total utility plant have averaged $790,396 annually. During this same period, yearly reported patronage capital (margins) has averaged $249,265. We conservatively estimate that, if adopted, this PP&E proposal could decrease these margins by at least 88.9%. Resultant electric rates to our consumers would have to be increased substantially to cover the incremental costs associated with this proposal and to protect our financial integrity and credit rating.

Jewell-Mitchell Cooperative Electric Co., Inc is required to follow accounting requirements promulgated by the Rural Utilities Service (RUS). The PP&E Accounting Proposal raises significant ratemaking, operational, and accounting concerns for Jewell-Mitchell Cooperative Electric Co., Inc. The most significant of these concerns arise due to accounting inconsistencies between this proposal and the RUS Uniform System of Accounts and attendant RUS regulations and interpretations (collectively, Electric

Cooperative Accounting Requirements). The PP&E Accounting Proposal and the attendant detrimental impacts to Jewell-Mitchell Cooperative Electric Co., Inc include the following:

- Electric Cooperative Accounting Requirements specify capitalization of overheads in support of construction projects and permit capitalization of an appropriate portion of administrative and general (A&G) costs. In addition, Electric Cooperative Accounting Requirements specify capitalization of preliminary investigation and survey (PI&S) charges. The PP&E Accounting Proposal would prohibit capitalization of overheads, PI&S charges, and A&G costs.

  Implementation of these provisions would dramatically increase earnings volatility, as these overhead, PI&S charges, and A&G costs would be expensed, rather than capitalized as they are today. We estimate that the annual financial impact of these items would decrease our margins by at least $37,780 annually or more, depending upon the extent of the capital restrictions ultimately imposed. Furthermore, from the standpoint of rate-making fairness, failure to capitalize these costs would inequitably shift the burden of collection of these costs from customers using the plant asset over its useful life to existing customers at the time the plant asset is constructed.

- Electric Cooperative Accounting Requirements prescribe the use of the group method of depreciation for plant assets. The PP&E Accounting Proposal would require use of depreciation accounting by component, defined as "a tangible part or portion of [plant] that can be separately identified as an asset and depreciated or amortized over its own separate expected useful life". The PP&E Accounting Proposal generally prohibits the use of a group method of depreciation, unless it can be shown by the entity that the asset balances and operating results under the group method is not materially different from that obtained under the component method. Implementation of this provision would require administrative reorganization to comply with the data collection requirements, as well as expensive new automated accounting systems -- or at a minimum, significant upgrades to existing software. In addition, determination of material differences between the component and group accounting methods would require record keeping for both methods, adding significantly to plant record-keeping costs, as well as audit costs. The estimated costs to upgrade automated systems and provide additional administrative record-keeping and data input is projected to add at least $50,000 in one-time costs and will conservatively exceed $221,608 on an annual basis thereafter. If adopted, our staffing costs are projected to increase by at least $68,197 annually, or more than 25%, to support the extra administrative and reporting burdens of this requirement.

- Electric Cooperative Accounting Requirements, consistent with group depreciation accounting convention, generally prescribe that gains and losses on normal dispositions of mass assets be closed to the accumulated depreciation account, under the theory that over time gains and losses will net out. The PP&E Accounting Proposal would require that gains and losses be reflected in the results of operations in the current accounting period. Implementation of this provision would result in

increased earnings volatility, as gains and losses on plant disposition are reflected in the current results of operations. Annual gains / (losses) closed to the accumulated depreciation account over the past three years have averaged (8). Electricity rates would likely require significant upward adjustment to provide for this increased uncertainty of earnings.

- Electric Cooperative Accounting Requirements generally recognize the cost of removal of a plant asset over the useful life of that asset, as a component of the depreciation rate. The PP&E Accounting Proposal would require that cost of removal be reflected in the results of operations in the accounting period in which such cost was incurred. Removal costs we've incurred over the past three years have averaged (9) annually. Implementation of this provision would result in increased earnings volatility, as cost of removal would be reflected in a single accounting period. Furthermore, from the standpoint of ratemaking fairness, failure to recognize cost of removal over the asset's life would inequitably shift the burden of collection of these costs from customers using the plant asset to customers during the retirement of the plant asset.

Each of the above accounting inconsistencies pose operational problems and create significant administrative burdens for Jewell-Mitchell Cooperative Electric Co., Inc that will dramatically raise the cost of electricity our rural member owners. The detrimental impacts of each item should be carefully considered and weighed against any identifiable benefits before the AICPA AcSEC implements the attendant provision of the PP&E Accounting Proposal for electric utilities. Further, we recommend that any and all decisions and changes impacting PP&E be closely coordinated in advance with RUS and all other federal and state governmental authorities regulating electric cooperatives and the electric industry.

Jewell-Mitchell Cooperative Electric Co., Inc appreciates the opportunity to provide comments on the PP&E Accounting Proposal and respectfully urges the AICPA AcSEC to consider its views. If questions arise concerning these comments, please feel free to contact Sherrilynn F. Boley at (785)378-3151.

Sincerely Yours,

Sherrilynn F. Boley
Office Manager

Marc Simon

11/16/2001 12:00 PM

To: agadkins@uss.com, bdrake@kpmg.com, cdaugherty@dttus.com, james_ross@csx.com, jbrant@deloitte.com, leonard.gatti@us.pwcglobal.com, lmayshak@dttus.com, msimon@aicpa.org, richard.h.moseley@aexp.com, rrendino@pgrt.com, Sharon Macey/NY/AICPA@AICPA
cc:
Subject: cl #287

cl #287
----- Forwarded by Marc Simon/NY/AICPA on 11/16/01 12:05 PM -----

bsteen@mtemc.com

11/15/01 05:43 PM

To: msimon@aicpa.org
cc:
Subject: Proposed Statement of Position, "Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment"

Dear Mr. Simon:
The Middle Tennessee Electric Membership Corporation (MTEMC) is a rural
electric distribution cooperative that provides electric service to
approximately 142,000 member-owners in a five-county area in the State of
Tennessee. MTEMC is a member of the national trade organization called
National Rural Electric Cooperative Association (NRECA). Also, MTEMC is a
Rural Utilities Service (RUS) borrower and derives its power supply from the
Tennessee Valley Authority (TVA).
MTEMC hereby respectively submits written comments regarding the above
referenced Proposed Statement of Position (PP&E Accounting Proposal) to the
Accounting Standards Executive Committee (AcSEC) of the American Institute
of Certified Public Accountants (AICPA).
The electric distribution cooperative utility business is a
capital-intensive, rate-based, member-owned, and regulated industry. With
that in mind, the PP&E Accounting Proposal would significantly impact the
operational and accounting policies of this organization and potentially
cause harm to our member- owners through increased cost with little or no

evidence of benefits derived from the accounting change. Considerable discussion should take place with utility regulators, such as the Federal Energy Regulatory Commission (FERC), RUS, and TVA before any standing practices are overturned by the proposed accounting change.

MTEMC follows the Uniform System of Accounts of FERC and RUS and is regulated by TVA in its cost-of-service studies, accounting, and rate-making process. This Uniform System of Accounts for utilities along with FASB #71 reflects best the rates required and the most consistent matching of revenues with expenses and presents the fairest representation of financial position and results of operations to its financial statement users, the member-owners and regulatory bodies.

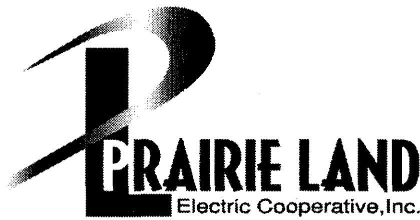
MTEMC believes that uniformity and standardization exists in its industry and any attempt to unite with other dissimilar industries is not desirable due to increased costs and is not necessary.

Implementation of the PP&E Accounting Proposal by electric distribution systems raises specific concerns.

First, strictly limiting the types of costs that could be capitalized as part of PP&E would ultimately result in rate volatility and inequitably shift the burden of collection of these costs from members using the plant asset over its useful life to members during the construction of the plant asset. Second, requiring component depreciation accounting instead of grouping similar assets together (group/composite method of depreciation) in a large volume capital-intensive industry would require a great deal of time and resources to comply with the data collection requirements. Automated plant accounting systems would require major changes resulting in increased costs to the member-owners. Finally, requiring the recognition of gains and losses on plant disposition and costs of removal to be reflected in the current results of operations as incurred rather than written off over the

plant's life (as a component of the depreciation rate) would result in
increased earnings volatility and inequitably shift the burden of collection
of these costs from the members using the plant asset to members during the
retirement of the plant asset.
The above comments are concerns raised not only because of the impacts it
would have on the cooperative's internal procedures and policies but the
detrimental impact it would have on the electric rates charged to our
member-owners. Each item should be discussed with the appropriate utility
entities and a cost-benefit review carefully contemplated before moving
forward with implementation of the PP&E Accounting Proposal provisions for
rural electric distribution cooperatives.
MTEMC urges the AICPA AcSEC committee to consider its comments and views
before making a final recommendation, and we appreciate the opportunity
presented for making such comments. If the committee would like to discuss
further, please contact me at 615-494-1552.

Bernie L Steen, Jr., CPA
Controller
Middle Tennessee EMC
bsteen@mtemc.com
Voice (615) 494-1552
Fax (615) 494-1559



1101 W Hwy 36
PO Box 360
Norton, KS 67654
(785) 877-3323

November 15, 2001

Mr. Marc Simon
Technical Manager, Accounting Standards
File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Exposure Draft - Proposed Statement of Position, "Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment"

Dear Mr. Simon:

Prairie Land appreciates the opportunity to submit written comments regarding the above-referenced Proposed Statement of Position (PP&E Accounting Proposal) to the Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants (AICPA).

Prairie Land is an electric cooperative in the state of Kansas, providing electricity to approximately 4000 consumers-owners in twelve (12) counties. Since we operate within the capital-intensive electric utility industry, the PP&E Accounting Proposal would significantly and negatively impact Prairie Land's accounting policies and administrative costs. Over the past three years, additions to our total utility plant have averaged $1,415,433 annually. During this same period, yearly reported patronage capital (margins) has averaged $880,127. We conservatively estimate that, if adopted, this PP&E proposal could decrease margins by substantial amounts. Resultant electric rates to our consumers would have to be increased substantially to cover the incremental costs associated with this proposal and to protect our financial integrity and credit rating.

Prairie Land is required to follow accounting requirements promulgated by the Rural Utilities Service (RUS). The PP&E Accounting Proposal raises significant ratemaking, operational, and accounting concerns for Prairie Land. The most significant of these concerns arise due to accounting inconsistencies between this proposal and the RUS Uniform System of Accounts and attendant RUS regulations and interpretations (collectively, Electric Cooperative Accounting Requirements). The PP&E Accounting Proposal and the attendant detrimental impacts to Co-op include the following:

- Electric Cooperative Accounting Requirements specify capitalization of overheads in support of construction projects and permit capitalization of an appropriate portion of administrative and general (A&G) costs. In addition, Electric Cooperative Accounting Requirements specify capitalization of preliminary investigation and survey (PI&S) charges. The PP&E Accounting Proposal would prohibit capitalization of overheads, PI&S charges, and A&G costs.

  Implementation of these provisions would dramatically increase earnings volatility, as these overhead, PI&S charges, and A&G costs would be expensed, rather than capitalized as they are today. We estimate that the annual financial impact of these items would decrease our margins by at least $154,000, depending upon the extent of the capital restrictions ultimately imposed. Furthermore, from the standpoint of ratemaking fairness, failure to capitalize these costs would inequitably shift the burden of collection of these costs from customers using the plant asset over its useful life to existing customers at the time the plant asset is constructed.

- Electric Cooperative Accounting Requirements prescribe the use of the group method of depreciation for plant assets. The PP&E Accounting Proposal would require use of depreciation accounting by component, defined as "a tangible part or portion of [plant] that can be separately identified as an asset and depreciated or amortized over its own separate expected useful life". The PP&E Accounting Proposal generally prohibits the use of a group method of depreciation, unless it can be shown by the entity that the asset balances and operating results under the group method is not materially different from that obtained under the component method. Implementation of this provision would require administrative reorganization to comply with the data collection requirements, as well as expensive new automated accounting systems -- or at a minimum, significant upgrades to existing software. In addition, determination of material differences between the component and group accounting methods would require record keeping for both methods, adding significantly to plant record-keeping costs, as well as audit costs. The estimated costs to upgrade automated systems and provide additional administrative record-keeping and data input is projected to add at least $50,000 in one-time costs. If adopted, our staffing costs are projected to increase by at least 25% to support the extra administrative and reporting burdens of this requirement.

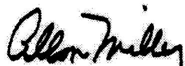
- Electric Cooperative Accounting Requirements, consistent with group depreciation accounting convention, generally prescribe that gains and losses on normal dispositions of mass assets be closed to the accumulated depreciation account, under the theory that over time gains and losses will net out. The PP&E Accounting Proposal would require that gains and losses be reflected in the results of operations in the current accounting period. Implementation of this provision would result in increased earnings volatility, as gains and losses on plant disposition are reflected in the current results of operations. Annual gains / (losses) closed to the accumulated depreciation account over the past three years have averaged $171,893. Electricity rates would likely require significant upward adjustment to provide for this increased uncertainty of earnings.

- Electric Cooperative Accounting Requirements generally recognize the cost of removal of a plant asset over the useful life of that asset, as a component of the depreciation rate. The PP&E Accounting Proposal would require that cost of removal be reflected in the results of operations in the accounting period in which such cost was incurred. Removal costs we've incurred over the past three years have averaged $167,718 annually. Implementation of this provision would result in increased earnings volatility, as cost of removal would be reflected in a single accounting period. Furthermore, from the standpoint of ratemaking fairness, failure to recognize cost of removal over the asset's life would inequitably shift the burden of collection of these costs from customers using the plant asset to customers during the retirement of the plant asset.

Each of the above accounting inconsistencies pose operational problems and create significant administrative burdens for Prairie Land that will dramatically raise the cost of electricity our rural member owners. The detrimental impacts of each item should be carefully considered and weighed against any identifiable benefits before the AICPA AcSEC implements the attendant provision of the PP&E Accounting Proposal for electric utilities. Further, we recommend that any and all decisions and changes impacting PP&E be closely coordinated in advance with RUS and all other federal and state governmental authorities regulating electric cooperatives and the electric industry.

Prairie Land appreciates the opportunity to provide comments on the PP&E Accounting Proposal and respectfully urges the AICPA AcSEC to consider its views. If questions arise concerning these comments, please feel free to contact our office at (785) 877-3323.

Sincerely Yours,



Allan Miller
Manager

November 15, 2001

Marc Simon
Technical Manager, Accounting Standards
File 4210
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, N.Y. 10036-8775

Dear Marc,

Equity Office Properties Trust is a Real Estate Investment Trust and is the largest publicly traded owner and manager of office properties. As of September 30, 2001, Equity Office had a national portfolio of 669 office buildings comprising 124.7 million square feet in 24 states in the District of Columbia. In addition, we own a portfolio of 84 industrial properties with 8.9 million square feet located in California, Oregon and Washington. As of September 30, 2001, we also have an ownership interest in approximately 3.4 million square feet of development projects with an estimated total cost in excess of $1 billion.

Equity Office is an active member of the National Association of Real Estate Investment Trust (NAREIT). We are aware that NAREIT has or will respond to the proposed SOP and we support the views presented in NAREIT's letter.

In addition to expressing or support for the views expressed by NAREIT, below are my comments on the SOP:

Issue 1:

I agree that the SOP should not provide specific guidance on lessor or lessee accounting for reimbursement of costs incurred by a lessor that are directly recoverable from lessees under the terms of one or more lessees. I believe FASB Statement No. 13 provides sufficient guidance. I am not aware of any other areas of the SOP that would conflict with existing lease accounting standards.

Issue 2:

I do not have a problem with the project stage framework with the exception of requiring that all preliminary stage costs (except for the cost of options) be expensed as incurred, as discussed in issue 3 below.

Issue 3:

I disagree that all-preliminary stage costs should be expenses as incurred except for options. The nature of the costs should determine whether or not they are capitalized in the preliminary and pre-acquisition stage. If costs are incurred in a preliminary stage and

capitalized, and later it is determined that the project will not be acquired or constructed, then the previously capitalized costs should be written off at that point. To me this is consistent with the definition of what costs are to be included as part of acquiring an asset. Also, I think that the probability of acquiring an asset, being a subjective determination, will lead more inconsistency in its application than saying certain types of costs can be capitalized and certain types of costs must be expensed regardless of whether they occur in the preliminary or pre-acquisition stage.

Issue 4:

I do not agree with the conclusions that the SOP reaches with regards to disallowing any indirect costs to be allocated and capitalized. While I understand and agree that there may be some inconsistency between companies with regards to what indirect costs they capitalize, I do not believe the right answer is to disallow the capitalization of all but incremental direct costs. Clearly the concepts of cost accounting which apply to the creation of products for sale and include an allocation of indirect costs, are analogous. The requirements should be that the allocation of indirect costs must be calculated and documented with a supportable methodology. Also, if I am interpreting the parenthetical in the second sentence paragraph 28(b) correctly, you are indicating that if any employee spent 50% of his time on development project A, 50% of his time on project B, and takes 4 weeks paid vacation, that I could only allocate 92% of his compensation to these two projects. To me this defies logic since clearly his vacation time is just another payroll benefit related cost, and the SOP indicates that payroll benefit related costs can be capitalized. It seems to me that the fear of people misusing a standard that would provide a more accurate accounting for the cost of an asset (i.e. including some allocation of indirect costs) is being given up for a less accurate but more restrictive methodology.

Issue 5:

I agree that taxes, insurance and ground rent should be capitalized to the extent of the portion of the property that is under development during the time that activities that are necessary to get the asset ready for its intended use are in progress. I disagree, however, with the last sentence of paragraph 32, which seems to carve out our exception to this rule for a building by requiring these costs stop being capitalized as soon as any portion of the building commences operations. A building which is 5% occupied while the remaining 95% is still in a stage of partial completion, and not ready for its intended use, should continue to capitalize these costs relating to the 95% that is not complete as long as activity is taking place to get that portion of the building ready for its intended use. I do not understand why the SOP provides for this inconsistency in the treatment of different types of assets.

Issue 6:

I agree that normal recurring and periodic costs should be expensed as incurred, however, I do not agree that removal or demolition costs should be expensed in cases where the removal cost are necessary and directly related to the replacement of existing components or necessary for the installation of new PP&E. The cost basis of an asset should include all of the cost associated with getting that asset ready for its intended use including any demolition or removal costs that are required before the asset can be put in service.

Issue 7:

I disagree for the reasons stated in issue 6 above

Equity Office Properties Trust
Two North Riverside Plaza - Suite 2200 –Chicago - Illinois 60606, Phone 312.466.- 3300 -Fax: 312.464.0332-http://www.equityoffice.com

Issue 8:

I agree with the SOP on this issue.

Issue 9:

I disagree that only cost of replacement of components should be capitalized. Improvements, which extended the useful life of an asset beyond one year, should be allowed to be capitalized and amortized over an appropriate period, consistent with the matching principle which is one of the conceptual foundations of GAAP Accounting.

Issue 10:

I have no comment on this issue.

Issue 11:

I think a consistent model should be applied to all assets regardless of whether the asset is leased under an operating lease, sales type lease, sold or held for internal use. At the end of the day the asset produced is the same asset, why should the historical cost of that asset be different based on the ultimate way the asset is used? The manner in which the asset is leased does not have an impact on the true costs to produce the asset and the amount of costs capitalized to the asset should be the same in all cases. This amount should include all direct costs required to produce or acquire the asset plus and allocation of indirect costs that are required to produce or acquire the asset. The allocation of indirect costs should be done based on a reasonable and supportable methodology that is consistently applied.

Issues 12-14:

I disagree (at least with respect to investments in real property), with moving from the current widely accepted, and I believe consistently applied, method of viewing building as a single asset which is depreciated over a composite useful life to a method which requires componentization. I do not believe that componentization would result in an improvement in practice, and strongly disagree that it would be cost beneficial with respect to investments in income producing real property. Our real property investment decisions are made based on our estimate of a future cash flow stream that we expect a given property to produce. We view that property as a whole, not an aggregate of separate components. We will typically do an allocation of the purchase price to land and land improvements, building and building improvements and personal property. We use a component life of 40 years for the building component, which we believe, is very consistent with other companies in our industry. I believe that the SOP, which requires that any component that can be separately identified, must be accounted for separately, will result in a much broader diversity in practice and less comparability between companies than exist today. Without detailed guidelines as to what specific components should be broken out and what the appropriate useful lives should be, a wide array of practices will result. In any event, I believe that detailed cost segregation studies would be required to comply with the componentization requirement. In our case assuming a conservative figure of $20,000 to $40,000 per property, this project would cost us from $15 to $30 million just for the cost segregation studies, before including any additional in-house cost for administering this much more complex asset base. Further, I do not believe the resulting disclosure would enhance the end users and understanding of the economics of our business. As mentioned above we buy properties based on an anticipated cash flow stream. In estimating this cash flow we estimate the

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cost of repairs and improvements that will be required to maintain the physical asset. We also estimate a residual value of the property at the end of projected holding period which is almost always higher than our original historical cost to purchase or develop the assets plus the cost of improvements which extend the useful life of the assets.

The point I am trying to make is that I don't feel that providing more detailed depreciation requirement will result in the financial statement more closely reflecting the economic reality, and they will almost surely result in a wider diversity of practice and less comparability.

The real estate industry as well as other industries has recently been criticized for using proforma measures rather than GAAP earnings when disclosing their results of operations. While, I will agree that in certain cases companies may do this to try to shed a more favorable light on their operations, I also believe that the proforma figures arise and are accepted, because GAAP numbers do not adequately portray the economic realities. Thus users of the financial statements must make modifications outside of GAAP to both more accurately reflect the economics and to facilitate a better comparison between companies. I think the componentization method outlined in the SOP takes a step in the wrong direction on both counts.

Issue 15:

No comment on this issue

Issue 16:

I do not agree that there should be two alternative approaches for implementation as this will just further reduce the comparability between companies as discussed regarding componentization in issues 12-14 above. I also think that it will be very costly to implement componentization. For real estate companies it will require cost segregation studies. If the final SOP contains the componentization requirement I think that the implementation should be 100% prospective. All existing assets should continue to be depreciated over their existing remaining lives. If an asset is abandoned or impaired it should be written off. The componentization will only be required for assets placed in several after the effective date of the SOP.

Issue 17:

I do not think that companies should be required to estimate the portion existing book value attributable to a component of an asset which is being amortized over a composite useful life and write-off that amount when a company incurs capitalizable costs for a new component. As mentioned above, I disagree with the componentization requirement. If it were to remain, a totally prospective adoption requirement would make more sense to me. Doing an allocation of a net book value based on a composite methodology where the asset had already been depreciated over a number of years would result in a write-off of an arbitrary amount. If I originally booked an asset as a 40 year asset under a composite life method, I would continue to depreciate that asset over whatever portion of the 40 years is remaining. If I purchase a new component, I would depreciate that component over its useful life. The asset and new component are still subject to the impairment rules. Therefore, I do not believe that my assets will be overstated. My point is that if neither the SOP's proposed method or the simpler method of providing that componentization be adopted only prospectively (with no write-off) provide an

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accurate measurement, why pick the more complicated and costly alternative? You are protected from an overstatement of the carrying value of assets by the rules regarding impairment.

Issue 18:

I agree

Issue 19:

I disagree for reasons outlined in issues 16 and 17 above. However, given the two alternatives listed I think the cumulative change in accounting principle would make more sense because that would be what caused the additional depreciation expense.

I appreciate the opportunity to comment on the proposed SOP and I am very concerned about the impact it may have on Equity Office and the rest of the Real Estate Industry.

Please feel free to contact me if you have any questions concerning the comments above at 312.466.3398.

Sincerely,

Stephen M. Briggs
Senior Vice President
Chief Accounting Officer
Equity Office Properties Trust

Equity Office Properties Trust
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November 15, 2001

Mr. Marc Simon
Technical Manager, Accounting Standards
File 4210.CC
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Proposed Statement of Position: *Accounting for Certain Costs and Activities Related to Property, Plant and Equipment*

Dear Mr. Simon

We are pleased to have the opportunity to submit our comments on the Exposure Draft of the Proposed Statement of Position, *Accounting for Certain Costs and Activities Related to Property, Plant and Equipment*, dated June 29, 2001.

The Principal Financial Group is a member of the Fortune 500 offering a wide range of financial products and services through our diverse family of financial services companies. One of our subsidiaries, Principal Capital Real Estate Investors, LLC (PCREI), manages over $19 billion of real estate investment assets on behalf of several institutional investors. Approximately $5 billion of these assets relate to private equity real estate investments that would be impacted by the proposed SOP.

We support the development of accounting and reporting standards that improve the quality of financial reporting and consistency across organizations. However, we have two major concerns with component accounting as prescribed by the SOP and, thus, are opposed to its adoption. Our concerns, described further below, are that the SOP does not improve the usability and comparability of financial statements, and that the SOP is extremely costly to implement and maintain.

Usability and Comparability of Financial Statements

We feel the SOP will not improve the usability and comparability of financial statements and, instead, may actually impair it. We base this conclusion on the following:

- There will be a high degree of subjectivity establishing the initial value of components at the time a property is acquired, thus leading to inconsistency among properties and among organizations. Valuing private market investments such as real estate is extremely subjective, as evidenced by bid-ask spreads and the lengthy due

diligence and negotiation process involved with a typical purchase of a property. Taking that process a step further and asking purchasers to assign values to hundreds of components within the applicable property will inevitably lead to a wide array of results.

- After acquiring a property, the inconsistency among organizations will be compounded further due to the administrative complexity in applying this SOP to subsequent expenditures. As an example, it's likely that companies able to allocate the resources to fully implement componentization would have less volatility in earnings than a company forced to immediately expense capital expenditures because of its inability to separately identify detailed components.

For these reasons, financial statement users would not have the benefit of receiving consistent financial information. Compared to existing practice, the usability and comparability of financial statements would be impaired.

Administrative Burden

The component accounting prescribed by the SOP results in undue administrative burden. As defined by the SOP, there can literally be hundreds of components in a building. Our company would bear additional costs to identify the applicable components, assign an initial value and useful life, as well as the additional costs to track the depreciation of the components on an ongoing basis. Our estimate of the increased cost is $50,000 for each of the approximate 400 properties our subsidiary manages.

In paragraph 52 of the exposure draft you encourage entities to "exercise reasonable judgment in applying this guidance" and to use reasonable thresholds to determine what should be a component. The definition of "component" and "reasonable" are still subject to interpretation and judgment by each company. Those companies that interpret the new guidance conservatively will be penalized for incurring the additional costs while companies that chose to interpret the guidance more broadly will not incur such a penalty.

We appreciate the AcSEC's interest in mitigating the impact on organizations by allowing for the group and composite methods of depreciation to continue as long as it can "produce results related to gross PP&E, accumulated depreciation, depreciation expense, and gains or losses on replacements or disposals of PP&E that are not materially different from those obtained under the accounting prescribed in paragraph 49 through 56 of this SOP…". However, as a practical matter, in order to make the determination the entity would have to make both calculations.

We appreciate the desire to get more accurate asset book values and periodic depreciation, however; in this case we feel the costs outweigh the benefits.

Conclusion

As stated above, we support the AcSEC's objectives to improve the reporting of financial information. However, we do not support the SOP as we feel the financial statement users would not benefit from its adoption and the costs of implementation are far greater than the benefits to be achieved.

We thank you for the opportunity to comment on the Exposure Draft.

Sincerely,

Hank Anderson
Principal Capital Real Estate Investors, LLC
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(515) 248-8258

Angie Sanders
Principal Financial Group
Des Moines, IA 50392
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(904) 366-3087 (Fax)

CSX CORPORATION

James L. Ross
Vice President and Controller

November 15, 2001

Mr. Marc Simon, Technical Manager
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY. 10036-8775

Re: Accounting Standards, File 4210.CC
Proposed Statement of Position – Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment

Dear Mr. Simon:

CSX Corporation (CSX), headquartered in Richmond, Va., operates the largest rail network in the eastern United States and also provides intermodal transportation services across the United States and into key markets in Canada and Mexico. CSX Transportation, Inc. (CSXT) is the primary operating company within the CSX family, providing rail freight transportation over a network consisting of more than 23,400 mainline route miles in 23 states, the District of Columbia and two Canadian provinces. In addition to rail-related transportation services, CSX operates a container ocean-liner service, marine container- freight terminal and warehouse facilities and resort and other real estate holdings.

The following summarizes the opinion of CSX on the Exposure Draft of the Proposed Statement of Position – ***Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment***. We fully support the underlying concerns of AcSEC and the AICPA and agree that consistent application of accounting standards is essential to maintaining the integrity of financial statements for the investing community. However, we believe that the proposed SOP offers no real improvement to the financial data currently provided to stockholders and investors. The proposed concepts are theoretically sound, but for capital intensive industries that consist of end-to-end, continuous networks, the proposed concepts are impractical to implement and result in little or no improvement to financial information provided to the public.

A Brief Overview

To effectively illustrate our view, a brief understanding of railroad property, plant and equipment accounting is in order. All railroads adhere to generally accepted accounting principles, and are also subject to the guidelines prescribed by the Surface Transportation Board (STB). The STB requires railroad property, plant and equipment to be categorized as either road (land, bridges, tunnels, buildings, track structure, etc.) or equipment (locomotives, freights cars, work equipment, etc.).

The rail industry is the most capital-intensive industry in North America. The net book value of CSXT's property, plant and equipment is in excess of $11 billion compared to CSXT's total assets of $13 billion. Of the $11 billion, $8 billion relate solely to the network infrastructure of the railroad. The total network infrastructure, which covers over 40 thousand miles of track, consists of more than 125 million crossties and over 81 thousand miles of rail.

CSXT utilizes mass asset accounting and the group method of depreciation for all railroad network assets. Periodically, the STB requires depreciation life studies to ensure the remaining useful lives of property, plant and equipment are appropriate and that estimated depreciation rates appropriately reflect those remaining useful lives. As additions and improvements are made to the network, similar quantities of assets are retired. Retirements under mass asset accounting require the historical cost to be removed from the investment account and charged to accumulated depreciation. The underlying theory is that little or no net book value remains; therefore no gain or loss recognition is required. Any cumulative differences found in the life studies between the remaining useful life of these assets and the depreciation recognized to date, is adjusted over the remaining useful life. These life studies are required every 6 years for road assets and every 3 years for equipment assets.

Individual track structure components such as rail, ties, ballast and other miscellaneous material are captured in like groups by number of units and year installed. These individual component groups are depreciated over their respective average lives derived through the aforementioned life studies. In addition, the depreciation studies for rail and ties also incorporate anticipated salvage proceeds and cost of removal, which are recognized during the life of the respective asset groups as a component of the depreciation expense and are reflected in accumulated depreciation on the balance sheet.

As locomotives, freight cars and other equipment are acquired, the individual units are captured within their homogeneous group. As with track structure components, the individual homogeneous groups are depreciated over their respective average lives as derived through life studies, with the anticipated salvage proceeds built into the respective depreciation rates. For all other road and equipment categories, each homogeneous group is depreciated over its respective average life as indicated by the depreciation life studies.

The Relative SOP Issues and Questions

The AcSEC committee requested comments on certain areas of the ED/SOP. Reproduced below are the SOP Issues and Questions with comments by CSX on relative areas of concern:

Scope

Issue 1: Paragraph 10 of the proposed SOP states that the SOP does not provide specific guidance on lessor or lessee accounting for reimbursements of costs incurred by a lessor that are directly recoverable from lessees under the terms of one or more leases, and that the lessor and lessee should refer to FASB Statement No. 13, *Accounting for Leases*, and related lease accounting literature for guidance on accounting for such reimbursements. In many instances, depending on the terms of the lease, those reimbursements may constitute minimum lease payments or contingent rentals under FASB Statement No. 13.

As discussed in paragraph A2 of the proposed SOP, AcSEC elected not to address the accounting for such transactions in this SOP because AcSEC did not want to create conflicts with existing lease accounting guidance and AcSEC did not believe it was appropriate to address the accounting under all of the various reimbursement scenarios and arrangement structures within the scope of this SOP. Are their significant practice issues or concerns related to the accounting for contractually recoverable expenditures that should be addressed in the proposed SOP? Do you believe that there are other areas addressed in the proposed SOP that, with respect to their application to lessors and lessees of PP&E, could create conflicts with existing lease accounting standards?

Issue 1 Comment: No comment.

Project Stage Framework

Issue 2: The guidance in this proposed SOP is presented in terms of a project stage or time line framework and on the basis of the kinds of activities performed during the stages defined in the proposed SOP rather than on whether an expenditure fits into certain classification categories such as ordinary repairs and maintenance, "extraordinary" repairs and maintenance, replacements, betterments, additions, redevelopments, renovations, rehabilitations, retrofits, rearrangements, refurbishments, and reinstallations. Do you agree with that approach? If not, what alternative would you propose and why?

Issue 2 Comment: In capital intensive industries, where capital construction is a continuous process (railroads, pipelines, electric utility networks, etc.), the timeline framework may not be relevant. For industries with infrequent capital projects, the timeline framework *may* be relevant,

although we believe that either approach will yield relatively the same results. The proposed framework would still involve a great deal of subjectivity whether based on time-line or on classification categories. The determination of which current expenditures provide future benefits is still the underlying concept of capitalization, and we see no material improvement provided with this proposed guidance.

Issue 3: Paragraph 16 of the proposed SOP states that the preliminary stage ends and the preacquisition stage begins when the acquisition of specific property, plant, and equipment (PP&E) is considered probable. Paragraph 22 of the proposed SOP states that, other than the costs of options to acquire PP&E, all costs incurred during the preliminary stage should be charged to expense as incurred. Do you agree with that conclusion? If not, how would you propose to modify the guidance and why?

Issue 3 Comment: From preliminary stage (the time an idea or concept is proposed) through the preacquisition stage (an actual project has been formally approved by management) could easily be characterized as one stage. The subjectivity of the costs incurred during these timeframes is the same in nature. Delineating between preliminary and preacquisition provides no benefit. We feel that for industries that self-construct assets, the timeline approach is not relevant. However, if the timeline approach is retained and is deemed to be appropriate for relevant projects, we would propose that there only be three stages in the process: preacquisition, acquisition and in-service.

Accounting for Costs Incurred

Issue 4: The proposed SOP states that PP&E-related costs incurred during the preacquisition, acquisition-or-construction, and in-service stages should be charged to expense unless the costs are directly identifiable with the specific PP&E. Directly identifiable costs include only (a) incremental direct costs incurred with independent third parties for the specific PP&E, (b) employee payroll and payroll benefit-related costs related to time spent on specified activities performed by the entity during those stages, (c) depreciation of machinery and equipment used directly in the construction or installation of PP&E and incremental costs directly associated with the utilization of that machinery and equipment during the acquisition-or-construction stage, and (d) inventory (including spare parts) used directly in the construction or installation of PP&E. All general and administrative and overhead costs incurred, including all costs of support functions, should be charged to expense. See paragraphs 24, 25, 29, and 30. Do you agree with those conclusions? If not, what alternatives would you propose and why?

Issue 4 Comment: We generally agree with the concept that directly identifiable assets should be capitalized as part of an overall capital asset. We do not agree that the Project Stage Framework is appropriate for industries that are self-constructing in nature. Within the railroad industry, as with other network intensive industries, capital investment is an ongoing process to

accommodate growth and to continuously replenish the network. Industries that self-construct their networks have internal organizations in place specifically established to facilitate self-construction of the infrastructure.

As currently proposed, PP&E related costs incurred during the pre-acquisition, acquisition or construction, and in-service stages should be charged to expense unless the costs are directly identifiable with the specific PP&E. Given the capital-intensive nature of the railroad industry, costs related to procurement activities, engineering design costs and limited general and administrative costs are necessary activities that should be included with capital project costs.

Issue 5: Paragraph 32 of the proposed SOP states that for real estate that is not being used in operations, costs of property taxes, insurance, and ground rentals should be capitalized, to the extent of the portion of the property that is under development, during the time that activities that are necessary to get the asset ready for its intended use are in progress. Do you agree with that conclusion? If not, what alternative would you propose and why?

Issue 5 Comment: No comment.

Issue 6: Paragraph 37 of the proposed SOP states that the costs of normal, recurring, or periodic repairs and maintenance activities should be charged to expense as incurred. It also states that all other costs related to PP&E that are incurred during the in-service stage should be charged to expense as incurred unless the costs are incurred for (a) the acquisition of additional PP&E or components or (b) the replacement of existing PP&E or components of PP&E. Do you agree with those conclusions? If not, what alternatives would you propose and why?

Issue 6 Comment: We primarily adhere to policies that follow the guidance proposed in paragraph 37. Locomotive and freight car repairs and overhauls are charged to expense as incurred. Track structure construction is capitalized, with like numbers of units systematically retired. The primary difference in our process from the process described in the SOP is the treatment of retirements under mass asset accounting.

Issue 7: Paragraph 39 of the proposed SOP states that costs of removal, except for certain limited situation demolition costs, should be charged to expense as incurred. Do you agree with that conclusion? If not, what alternative would you propose and why?

Issue 7 Comment: We disagree with the SOP proposal of expensing cost of removal. The railroad industry consistently accrues for cost of removal of track structure components (rail, ties, and other track material) over the life the operating asset through depreciation expense. This accrual is based on engineering studies and is incorporated into the depreciation rates derived from life studies. There are three specific items contained within depreciation expense: first is the cost of the asset amortized over its useful operating life; second is the anticipated

salvage to be recovered at the end of the assets useful life; and third is the anticipated cost to harvest the salvageable assets. In practice, depreciation expense is the amortization of the useable portion of the asset, with the salvage, net of any harvest cost, remaining at the end of the life cycle. Under this concept, the useable/recoverable net book value is reflected in our property records at any given point in the life cycle of our assets and depreciation expense reflects the used portion of the relative asset within any given period. We believe that our current systematic approach to depreciation and the related cost of removal accounting is consistent with ARB 43 and Statement of Financial Accounting Concepts No. 5.

Issue 8: Paragraph 44 of the proposed SOP states that the total of costs incurred for planned major maintenance activities does not represent a separate PP&E asset or component. It states that certain of those costs should be capitalized if they represent acquisitions or replacements and that all other costs should be charged to expense as incurred. Paragraph 45 prohibits alternative accounting treatments including—(a) the accrual of a liability for the estimated costs of a planned major maintenance activity prior to their being incurred, and (b) the deferral and amortization of the entire cost of the activity. Do you agree with those conclusions? If not, what alternatives would you propose and why?

Issue 8 Comment: We believe the accrue-in-advance method yields more consistent, less volatile financial results than the expense when incurred method. If scheduled maintenance activities are evenly distributed across a pool of assets being maintained, there is virtually no difference in expense. However, if the maintenance activities are not evenly distributed among the pool of assets, the expense when incurred method can cause inconsistency and volatility in financial statement comparability, thus confusing the users of financial statements. We believe that planned major maintenance activities, specifically when required by contractual, regulatory or other legal drivers, cause us to have a duty or obligation, which by definition directly translates into the need to record a liability.

Issue 9: Paragraph 45 of the proposed SOP further prohibits, as an alternative accounting treatment, the "built-in overhaul" method for costs incurred for planned major maintenance activities. Under that method, additional depreciation expense is recognized currently to give effect to the decline in service potential that is subsequently restored once the major maintenance activity occurs. When the major maintenance activity occurs, its cost is considered capitalizable. In lieu of the built-in overhaul method, AcSEC concluded that better cost allocation would result from the use of component accounting and limiting the major maintenance activities that would be capitalizable to costs that represent replacements of components of PP&E. Should the costs of restoring PP&E's service potential, in addition to the cost of replacements that would be capitalizable under this proposed SOP, be eligible for capitalization? Do you believe that prohibiting the built-in overhaul method is appropriate, or should it be allowed as an alternative method? If you believe that the built-in overhaul method should continue to be allowed, what industries or entities should be allowed to use it, and why?

Issue 9 Comment: No comment.

Use of Inventory in Production of Internal-Use PP&E

Issue 10: Paragraphs 47, 48, and A41 of the proposed SOP discuss the situation in which an entity owns an asset that it intended to sell as inventory but subsequently decided to retain for use in its own internal operations. Those paragraphs state that the entity should evaluate for impairment amounts included in PP&E that were previously capitalized as inventory but should not redetermine their carrying amount as PP&E using the guidance in the proposed SOP, unless the entity has a pattern of changing the intended use of assets from inventory to PP&E. Do you believe that guidance is appropriate, or should an entity be required to redetermine the carrying amount of PP&E assets previously capitalized as inventory, and why? Should AcSEC provide additional guidance on what kinds of changes in intended use constitute a "pattern," and why?

Issue 10 Comment: No comment.

PP&E-Type Assets Produced for Sale or Operating Lease

Issue 11: The proposed SOP requires assets that are produced by an entity to be leased to a lessee under an operating lease to be accounted for under the provisions of this SOP. As discussed in paragraph A43 of the proposed SOP, AcSEC recognizes that some entities routinely construct or manufacture products, some of which are sold directly and some of which are leased to lessees under sales-type leases whereas others are leased to lessees under operating leases. In some situations, the entity does not know the form the transaction will take until it occurs, and the customer decides whether its acquisition of product will be accomplished through purchase or lease. The proposed SOP requires an entity to accumulate costs differently for similar assets depending on whether the asset is sold outright or leased to a lessee under a sales-type lease (in either case, inventory cost accumulation rules would apply) or leased to a lessee under an operating lease (in which case, the cost accumulation provisions of the proposed SOP would apply). Do you agree with that conclusion and, if so, do you believe the proposed SOP should provide additional guidance on such cost accumulation? Or would it be preferable for a single cost accumulation model to apply during the production process and that there should be a presumption that the assets should be accounted for all as inventory or all as PP&E? If so, which presumption should be applied and why?

Issue 11 Comment: No comment.

Component Accounting

Issues 12-14 are collectively responded to below.

Issue 12: Paragraphs 49 through 56 of the proposed SOP discuss component accounting and state that if a component has an expected useful life that differs from the expected useful life of the PP&E asset to which it relates, the component should be accounted for separately and depreciated or amortized over its separate expected useful life. Do you agree with this approach to accounting for PP&E? If not, what alternative would you propose and why?

Issue 13: Paragraphs 38 and 51 of the proposed SOP state that when existing PP&E is replaced or otherwise removed from service and the replacement is capitalized, the net book value of the replaced PP&E should be charged to depreciation expense in the period of replacement. Do you agree with this approach? If not, what alternative would you propose and why?

Issue 14: The proposed SOP requires the use of component accounting to depreciate identified components over their respective expected useful lives. As noted in paragraph A48 of the proposed SOP, entities have developed and utilized various conventions to depreciate assets, including group depreciation or use of composite lives. Those conventions are acceptable only if they result in approximately the same gross PP&E, depreciation expense, accumulated depreciation, and gains or losses on disposals of PP&E as the component accounting method required by this proposed SOP. Do you agree with this approach? If not, what alternative would you propose and why?

Issues 12-14 Comment: We do not support the use of component accounting to the extent the SOP appears to require. The rail industry utilizes some component accounting today. The major components of the track structure (i.e. rail, ballast, crossties, signals, etc.) are currently accounted for as separate individual homogenous groups of assets. Each group of assets is then systematically depreciated based on its respective average life as determined through life studies. The costs for additional staff, new systems and/or system modifications to perform component accounting at the level of detail required by the SOP would far exceed any benefit achieved.

We also do not believe that component accounting will achieve consistency in accounting for PP&E, which was a primary goal of the draft SOP. Today, all railroads utilize the same groupings of homogenous assets and utilize similar methods for systematic allocation of those costs across periods. Within the rail industry, if the SOP is enacted as currently proposed, considerable latitude would be available in defining components, which would contribute to less comparability within the industry than exists under our current methodology.

In specifically addressing Issue 13, we do not agree with this approach. The rail industry utilizes the group method of depreciation for its PP&E as required by the STB. This method is well understood within the rail industry and is accepted as being the most efficient/systematic method for allocating the cost of large network assets. The group method, which is recognized by GAAP as an accepted method of depreciation, requires the historical cost of the replaced PP&E

to be charged against accumulated depreciation. In addition, this method requires that any proceeds from the sale of such replaced PP&E also be applied to the depreciation reserve. The theory supporting the group life method is based on the assumption that each asset being retired has been fully depreciated to net salvage value. The requirement for frequent life studies ensures that these assumptions are constantly being fine tuned; thus, we believe the current practice of group depreciation yields an equally satisfactory result as that discussed in Issue 13.

Amendments to Other Guidance

Issue 15: Paragraphs 61 and 63 of the proposed SOP list amendments to SOP 85-3, *Accounting by Agricultural Producers and Agricultural Cooperatives*, and the AICPA Audit and Accounting Guide *Audits of Agricultural Producers and Agricultural Cooperatives*, respectively. Do you agree with the proposed amendments? Do you believe that there are unique aspects of agricultural accounting, such as the accounting for breeding and production animals and the accounting for plants and vines, that should not be amended by the proposed SOP, and why?

Issue 15 Comment: No comment.

Transition

Issues 16-19 are collectively responded to below.

Issue 16: Paragraph 71 of the proposed SOP states that the prescribed component accounting guidance should be initially adopted for existing PP&E using one of two alternatives, the election and disclosure of which should be made when the SOP is adopted. Do you agree with that approach and, if so, do you agree with the choice of the two alternatives from which the election is to be made? If you do not agree with that approach for existing PP&E, what approach would you propose and why?

Issue 17: Under paragraph 71(a) of the proposed SOP, the allocation of existing net book value to components at transition should be based on (a) allocation of original accounting records, if available, (b) relative fair values of components at date of transition, if original accounting records are not available, or (c) another reasonable method, if relative fair value is not practicable. Do you agree that that ordering of allocation methods is appropriate? If you believe that a different order would be appropriate, what order would you propose and why? Should the proposed SOP provide additional examples to illustrate what constitutes "another reasonable method"?

Issue 18: Paragraph 72 of the proposed SOP states that the SOP should be applied prospectively for all costs incurred after the adoption of the SOP. It also states that costs incurred prior to the adoption of the proposed SOP should not be re-characterized (as capital or expense items) to

conform to the guidance in the SOP, with the exception of certain costs of planned major maintenance activities. Do you agree with that approach? If you do not agree with that approach, what approach would you propose and why?

***Issue 19*:** Under paragraph 71(a) of the proposed SOP, and as illustrated in Example 3 in appendix C, an entity applying component accounting retroactively at date of adoption may calculate a difference between the pre-adoption balance of accumulated depreciation and the balance recalculated based on the estimated useful lives of components that previously were not accounted for as separate components. Under that paragraph, the difference is allocated back to the accumulated depreciation of each component based on the net book values of the components. Two alternatives considered were recording the difference as a cumulative effect type adjustment at adoption and recording the difference as additional depreciation expense at adoption. Do you agree with the proposed approach or either of the alternatives, and why?

Issues 16-19 Comment: We believe that only one alternative should be allowed in implementing this standard if it is issued as proposed or with some modifications and that is retroactive restatement with a cumulative effect of accounting adjustment. Allowing more than one alternative would create inconsistency in financial reporting between entities and the railroad industry, specifically. This inconsistency would exist for an extended period due to the life of self-constructed assets in the railroad industry.

We also believe that due to the requirements of this proposed SOP, a substantial amount of time would be necessary in order for us to adapt our fixed asset systems, revise our current accounting policies and to change current practices. Thus, we recommend that the minimum time allowed for adoption be two years from the date of issuance of this proposed SOP.

Conclusion

CSX appreciates the opportunity to provide comments on the Proposed Statement of Position – Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment. CSX, as well as the rail industry as a whole, believes that our current methods and practices yield accurate representations of our financial results. We have attempted to provide you with an understanding of those methods and our concerns with the proposal. We trust that you will give consideration to our views and recommendations and we welcome the opportunity to provide you with any additional information you may require in your review.

Sincerely yours,

James L Ross
Vice President and Controller
CSX Corporation

BOWATER INCORPORATED

55 East Camperdown Way
Post Office Box 1028
Greenville, SC 29602-1028
864/271-7733

via electronic mail to msimon@aicpa.org

November 15, 2001

Mr. Marc Simon, Technical Manager, Accounting Standards
American Institute of Certified Public Accountants
File 4210.CC
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Mr. Simon,

Bowater Incorporated is writing to provide its views on the Exposure Draft (ED) of the Proposed Statement of Position (SOP) on Accounting for Certain Costs and Activities Related to Property, Plant and Equipment (PP&E) issued by the Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants (AICPA)

We appreciate the opportunity to provide our comments on issues addressed by the ED.

Component Accounting - Issue 12, 13 and 14

We are strongly opposed to the AcSEC's proposed component accounting approach as discussed in paragraphs 49 through 56 of the ED. We believe that the significant cost and effort required to adopt component accounting and maintain PP&E on a component level would be substantial and burdensome and would far outweigh any benefits from a more precise depreciation accounting.

The forest products industry is a capital-intensive industry. Our major constructed assets are paper machines. Paper machines are comprised of thousands of component parts that make up a single production asset. Depreciation expense is determined based on the estimated useful life of the paper machine, which is periodically reassessed based on current and historical information. The component parts of a constructed paper machine provide benefit only as a completed and constructed asset and not as an individual component. Maintenance is performed regularly on these assets and this amount is expensed.

We do not believe that asset classification and depreciation on a composite methodology is flawed or provides inaccurate reporting of depreciation that would require such a dramatic change to component accounting. We believe that the AcSEC should focus on eliminating the diversity in practice by providing guidance and clarification on the types of costs that should and should not be capitalized as part of PP&E. If the AcSEC continues with this PP&E project, we

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recommend that the AcSEC consider in its ED PP&E accounting and depreciation methodologies currently in practice (such as composite methodology) before making a dramatic change to component accounting that would not differentiate between companies and industries.

Project Stage Approach – Issue 2 and 3

We do not believe that a project stage approach is necessary. We believe that the AcSEC should focus on eliminating the diversity in practice by providing guidance and clarification on the types of costs that should and should not be capitalized.

We believe that by segregating costs into project stages, specifically preliminary and preacquisition stages and the strict adherence to a probability consideration, numerous costs that were previously capitalized by companies would be expensed under the ED's current project stage approach. Specifically for companies that construct their own assets versus those that acquire assets, which would have these type costs embedded in the overall cost of the acquired asset. We believe that costs incurred in the preliminary and preacquisition stages are analogous to due diligence costs incurred in connection with a business combination. Companies typically defer due diligence costs incurred on a business combination and then either capitalize as part of purchase price or expense if the deal is not consummated. We believe that costs as described in the preliminary and preacquisition stages should be deferred and either expensed or capitalized if the company moves forward with the construction project.

Presentation and Disclosures – Paragraph 58

We are opposed to the proposed presentation and disclosure requirements as discussed in paragraph 58 of the ED. To subcategorize main categories of PP&E appears to be excessive and in our opinion would not provide users of the financial statements with any beneficial financial information.

Sincerely,

/s/ Joseph B. Johnson
Joseph B. Johnson
Director, Accounting and Financial Reporting

cc: D. Maffucci
M. Nocito

Marc Simon

11/16/2001 12:11 PM

To: agadkins@uss.com, bdrake@kpmg.com, cdaugherty@dttus.com, james_ross@csx.com, jbrant@deloitte.com, leonard.gatti@us.pwcglobal.com, lmayshak@dttus.com, msimon@aicpa.org, richard.h.moseley@aexp.com, rrendino@pgrt.com, Sharon Macey/NY/AICPA@AICPA
cc:
Subject: cl #293

cl #293

----- Forwarded by Marc Simon/NY/AICPA on 11/16/01 12:17 PM -----

dmcbee@caneyforkec.com

11/15/01 05:21 PM

To: msimon@aicpa.org
cc:
Subject: Exposure Draft - Proposal Statement of Position "Accounting for Certain Cost and Activities Related to Property, Plant, and Equipment

Dear Mr. Simon:

Caney Fork Electric Cooperative, Inc. (CFEC) is a rural electric distribution cooperative that provides electric service to approximately 30,000 member-owners in a four-county area of Tennessee. The cooperative has operations and electric facilities in Warren, White, DeKalb, and Van Buren Counties. CFEC is a member of the National Rural Electric Cooperative Association headquartered in Washington, D.C. Also, CFEC is a Rural Utilities Service (RUS) borrower and derives its power supply from the Tennessee Valley Authority (TVA).

CFEC hereby respectfully submits written comments regarding the Proposed Statement of Position (PP&E Accounting Proposal) to the Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants (AICPA).

The electric distribution cooperative business is a capital-intensive, rate-based, member-owned, regulated industry. With that in mind, the PP&E Accounting Proposal would significantly impact the operations and accounting policies if this organization and potentially cause harm to our member-owners through increased cost with little or no evidence of benefits derived from this proposed accounting change. Considerable discussion should take place with utility regulators, such as the Federal Energy Regulatory Commission (FERC), RUS, and TVA before any standing accounting practices are overturned by this proposed accounting change.

CFEC follows the Uniform System of Accounts of FERC and RUS and is regulated by TVA in its cost-of-service studies, accounting, and

rate-making change. This Uniform System of Accounts for utilities along with FASB #71 reflects the most consistent matching of revenues with expenses and provides the fairest representation of our financial position and results of our operations to our financial statement users, our member-owners, and our regulatory agencies.

CFEC believes that uniformity and standardization already exists in the utility industry. While Imposing these accounting changes on industries other than utilities may be desirable, implementation by electric distribution systems raises some specific concerns.

First, strictly limiting the types of cost that could be capitalized as part of the PP&E would ultimately result in rate volatility and inequitably shift the burden of collecting the cost from the members using the plant asset over its useful life to members during the construction of the plant asset. Second, requiring component depreciation accounting instead of grouping similar assets together (group/composite method of depreciation) in a large volume capital-intensive industry would dramatically increase the amount of time and resources to comply with the data collections requirements. Automated plant accounting systems would require major changes with the cost being passed to our members. Finally, requiring the recognition of gains and losses on plant disposition along with the cost of removals being reflected in current operations rather than written-off over the life of the plant would result in increased earnings volatility and inequitably shift the burden of collecting these cost from members using the plant asset to members during the retirement of the plant asset.

The impact of these proposed accounting changes would have a devastating impact on our cooperative's internal operating procedures and policies with the cost to implement such changes being passed on to our members in higher electric rates.

CFEC urges the AICPA AcSEC committee to carefully consider our comments and views before making a final recommendation and we appreciate the opportunity to comment on these proposed changes.

Respectfully submitted,

Donald L. McBee
Director of Financial Services
Caney Fork Electric Cooperative, Inc.
P.O.Box 272
161 Smithville Highway
McMinnville, TN 37110

November 15, 2001

Mr. Marc Simon
Technical Manager
Accounting Standards
File 4210.CC
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

RE: Exposure Draft, Proposed Statement of Position: Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment

Dear Mr. Simon:

My comments relating to the Exposure Draft are enclosed.

I welcome the opportunity to discuss my comments with the PP&E Task Force. The activities of this Task Force have been of great interest to me.

An earlier draft of the exposure draft, which I appreciate that you forwarded to me, addressed amounts recoverable by landlords from tenants. Landlords and tenants often dispute what should be capitalized, and what should be expensed. Many leases reference GAAP as the determining factor. If the expenditure is expensed, the Landlord usually has the right to recover the majority of the expenditure from Tenants. If the expenditure is capitalized, then the landlord probably does not recover reimbursement of this expenditure from Tenants. There are certain exceptions.

This issue of recoverables is no long addressed by the Exposure Draft. Disparities will thus continue as to landlord classifications for expenditures that may or may not be recoverable by Landlords from Tenants, based on lease language, and relevant GAAP.

Sincerely,

Elaine Roston

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Comments on Exposure Draft

Proposed Statement of Position

Accounting for Certain Costs and Activities Related to Property, Plant and Equipment

Contractually Recoverable Capital Expenditures

Issue 1

Commercial leases in multi-tenanted properties frequently reference generally accepted accounting principles. Leases refer to GAAP for the determination of what should be capitalized, and what should be expensed.

Amounts recoverable by landlords from tenants are defined in the lease, and frequently include amortization of certain (limited) capital expenditures. Amortization on capital expenditures that landlords incur is excluded from Operating Costs recoverable from Tenants. Many leases provide an exception to the exclusions of amortization on capital expenditures from Operating Costs, and provide for amortization for the following expenditures:

a. If required by federal, state, or local ordinance or code.

b. If energy efficient. (Some leases extend this to any expenditure, which reduces Operating Costs.)

c. If related to health, life or safety.

For most leases, amortization of the majority of capital expenditures is not recoverable from Tenants. Leases define Landlord's recoverable amounts due from Tenant as Additional Rent.

After the SOP is promulgated, the additional guidelines regarding capital expenditures, as presented in the Exposure Draft, will relate solely to Landlord accounting for financial statement presentation, and not to Landlord accounting for billings of recoverables to tenants. Thus, additional disparities will exist between Landlord accounting and Landlord billings to Tenants, resulting in continued disputes between Landlords and Tenants. This is why I encourage the Task Force to include recoverables by Landlords from Tenants under its scope. If these guidelines do not relate to Landlord accounting for recoverables, disparities will continue. Landlords may capitalize specific expenditures for financial statement presentation, and classify the same expenditures to expense and recoverable from tenants, because of the lack of relevancy of the new guidelines to recoverables.

Project Stage Framework

Issue 2

The SOP should address both:

a. the project stage, and

b. the classification categories.

A significant disparity exists regarding classification of expenditures during the in-service stage. Examples of the classification categories are shown in the Exposure Draft.

Accounting for Costs Incurred

Issue 4

General and administrative and overhead costs incurred should **not** be charged to expense if the basis of the charge is related to direct expenditures that require capitalization. For example, if the landlord performs certain improvements using employees, or uses an independent third party, the developer may add a percentage "mark-up" as a supervisory fee, in addition to the actual costs. General and administrative and overhead costs should be classified consistently with the underlying project.

Issue 6

I agree that the costs incurred during the in-service stage for the acquisition of additional PP&E or additional components should be capitalized. I do not agree regarding the replacement of existing PP&E or components of existing PP&E. I agree with the proposed SOP, which states that the costs of normal, recurring, or periodic repairs and maintenance activities should be charged to expense as incurred. The replacement of existing components of PP&E, and the replacement of PP&E may constitute normal, recurring, or periodic repairs and maintenance activities. Thus, there needs to be a differentiation between the two. If the replacement is an upgrade, caused by the unavailability of the original component, it should be capitalized. If the replacement is recurring or periodic repairs and maintenance, it may be considered an "overhaul". The issue is how often such building overhauls occur.

Issue 8

I strongly agree with the proposed SOP. Major maintenance activities are frequently amortized, although they do not represent a separate PP&E asset or component.

November 15, 2001

Mr. Marc Simon
Technical Manager
Accounting Standards File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of Americas
New York, NY 10036-8775

RE: Proposed Statement of Position - *Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment*

Dear Mr. Simon:

IBM appreciates the opportunity to comment on the exposure draft on the proposed AICPA Statement of Position, *Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment (ED).* We have serious differences with key changes to generally accepted accounting principles that the document proposes and we cannot support the issuance of a final SOP with the guidance in this document.

We strongly disagree with the 'hidden' dual costing requirement in the basis for conclusions (paragraph A43) relating to manufactured product for sale or lease under a sales-type lease versus product manufactured for an operating lease. We further do not agree with the separate component identification and the subsequent accounting as well as the proposal to select from two related alternative implementation methods. In addition, we have concerns with the requirement in the preliminary stage that all costs except those to purchase an option for a specific item of property, plant and equipment (PP&E) are to be expensed when incurred. Generally, we do not believe that better financial reporting would result from the proposed guidance and that the changes it proposes cannot be justified from a cost/benefit perspective. Our positions on these areas are fully described below. Our primary objections to the draft as well as our positions on many of the specific issues raised in the ED are stated below and therefore we chose not to respond to the individual issues appearing in the ED.

Assets Produced for Sale or Sales-Type Lease Versus Operating Lease

We strongly object to the 'hidden' dual costing requirement in the basis for conclusions (paragraph A43) for entities that manufacture products and either sell directly or lease under sale-type leases versus lease under operating leases. The proposal to accumulate costs differently for such assets based on whether the asset will be sold outright or leased under a sales-type lease (inventory cost accumulation requirement) versus leased under an operating lease (SOP's cost accumulation provisions) cannot be justified on a cost/benefit basis. Generally

we would not know the final disposition of a product at the time it is manufactured and we would have to develop and maintain a dual costing system at a cost that will not produce any benefit to the users of financial statements. Even when we know that a customer will lease the item, that determination is usually made after the item was manufactured and such determination is not further clarified as to whether the lease will be an operating or sales type lease until final negotiations with the customer are complete. Due the fact that we will never know which items will eventually be recorded as a capital asset subject to an operating lease, paragraph 47 would be difficult to apply. The volume of hardware that we lease on an operating basis is far from de-minimis in comparison to the total amount of hardware manufactured. Therefore, paragraph 48 would not apply. Moreover, we do not believe that different costing methods for assets owned and depreciated that are leased to customers on an operating lease basis as compared to assets sold outright or through a sales-type lease enhances investors' and shareholders' understanding of reported results. We support a full costing approach which would include overhead cost in the capitalized amount of PP&E.

General, Administrative and Overhead Costs

We strongly disagree with the requirement that all general and administrative and overhead costs incurred during the pre-acquisition, acquisition-or-construction, and in-service stages be charged to expense as incurred unless they are directly identifiable with specific PP&E. Overhead costs that would not be incurred without a fixed asset acquisition or construction/preparation project should be capitalized as part of the fixed asset. Additionally, the exclusion of overhead costs from capitalization determination, as proposed in the SOP, is inconsistent with the full fair value approach for asset retirement obligations under SFAS 143, *Accounting for Asset Retirement Obligations*.

Component Accounting

We strongly disagree with the proposed requirement to separately identify components of an existing asset that may have separate and different useful lives if such components could be viewed as distinct or on a stand-alone basis. While perhaps being more theoretically pure, the proposed component accounting would create significant work and complexity with no resulting increased value and benefit (internally or externally) to financial reporting. It is not clear from our experience in making expense and capitalization decisions as to why the proposed component accounting would produce better financial reporting conceptually and/or at a cost that could be justified. We believe that current accounting provides quality reporting for fixed assets without requiring additional granularity.

Additionally, we do not support the proposed transition guidance for applying the component accounting method upon adoption of the SOP either retroactively to all PP&E assets or prospectively as portions of PP&E assets are replaced. Although we do not support the component accounting at all, the prospective application method should be the only manner allowed for implementation of this accounting. Alternative methods of adoption would result in inconsistent accounting from entity to entity, thus partially undermining the AcSEC's objective in the ED of eliminating diversity in accounting.

Preliminary Stage Costs

We are concerned that the application of the timeline approach may be applied on a project basis as opposed to an item-by-item basis. For example, consider a company that is planning to build a large manufacturing plant somewhere in the Northeast. We believe that the staged accounting approach should be applied separately to each component of the project. If the plant's buildings are probable of being manufactured and the design of the buildings will not vary even if the company is still considering alternative locations to build the plant, the ED should be clear that the buildings could be in the pre-acquisition stage even though the land and perhaps other assets are in the preliminary stage.

In conclusion, we do not support the issuance of a final SOP and request that you give consideration to the positions expressed in this comment letter.

We appreciate the opportunity to comment on this proposed SOP and are available to discuss our concerns with you at your convenience. You may contact me at 914-766-0850 or through e-mail at Colistra@us.ibm.com.

Yours truly,

David Colistra
Director Accounting Practices and External Financial Reporting
IBM Corporation

November 15, 2001

Mr. Marc Simon
Technical Manager, Accounting Standards
File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

Re: Proposed Statement of Position: *Accounting for Certain Costs and Activities Related to Property, Plant and Equipment*

Dear Mr. Simon:

ProLogis Trust is a Real Estate Investment Trust (REIT) that develops, acquires, owns and operates industrial real estate throughout North America and Europe, with a total portfolio in excess of 180 million square feet. The accounting standards for capitalizing the cost of real estate assets are fundamental to ProLogis producing representative and useful financial reports that are key to its capital market and investor relations.

ProLogis is an active member of the National Association of Real Estate Investment Trusts (NAREIT), which will respond to the above referenced proposed SOP. In addition to supporting the views presented in NAREIT's letter, discussed in detail below are certain points that we would like the AICPA to consider in its comment review process.

Componentization
The proposed SOP's requirement to separately track the cost and accumulated depreciation of thousands of individual property, plant and equipment (PP&E) components would increase considerably ProLogis' administrative costs. We fail to see how the costs related to the detailed componentization requirements of the proposal will be justified compared to the marginal benefit that may accrue to users of financial statements.

To implement the provisions of the proposal would require that we allocate billions of dollars of PP&E book value to thousands of components. Although the proposal provides an option to apply componentization either retroactively or prospectively, the "penalty" associated with prospective adoption effectively means adoption of componentization on a retroactive basis. Implementation of the componentzation provisions of the proposal on a retroactive basis would require that we engage cost study consultants at significant expense to ascertain component costs. Further, we would incur substantial costs for system modifications in order to track the requisite detail.

7777 Market Center Avenue • El Paso, Texas 79912-8412 • Telephone (915) 298-6300 • Facsimile (915) 877-7045

The costs to administer the ongoing provisions of the proposal would be significant. We would be required to track thousands of individual asset components. These requirements pose a significant burden on system resources and ongoing maintenance.

As a real estate company actively doing business in sixteen countries outside the United States, we are particularly opposed to proposed changes that are contrary to that which has been embraced internationally for investment property accounting. International Accounting Standard No. 40 (IAS 40), Investment Property, requires the disclosure of fair value of an investment property in the financial statements or footnotes, and views investment property as an integrated operating entity, not thousands of components. Paradoxically, AcSEC's proposal is offered at a time when representatives of the Financial Accounting Standards Board (FASB) and the Securities and Exchange Commission continually espouse global convergence of accounting standards. In the event the final SOP contains the detailed componentization requirements, we request that investment property be exempted.

Elimination of the Composite/Group Methods of Depreciation
The requirement to componentize all PP&E and to measure the remaining book value of replaced components effectively eliminates the composite and group methods of depreciation. These depreciation methods have been used for many years and are well established in the accounting literature and followed well in practice.

Although the proposal allows the use of the group or composite method of depreciation if an entity can demonstrate that it produces results similar to componentization, past experience shows this option is not realistic because it would force us to use both methods in order to prove that the results are in fact similar. This allowance does not alleviate the detailed componentization required by the proposed SOP – a company would still have to undertake an assessment of its assets "as componentized" to prove that it would be allowed to use the composite or group method.

In the absence of a withdrawal of the componentization requirements of the proposal, we strongly suggest that the Accounting Standards Executive Committee (AcSEC) consider an alternative approach for PP&E cost componentization that would entail a more reasonable level of effort, be more cost effective and provide a demonstrable value to readers of financial statements commensurate with the costs involved.

Deferred Cost Accounting
The proposal's provisions also eliminate the concept of deferred cost accounting with respect to PP&E. ProLogis is especially concerned about the prohibition to defer or capitalize costs that may be incurred during the preliminary stage of a project, as well as long-term or planned major maintenance activities. Clearly, there are costs that provide future economic benefit. These costs should be permitted to be deferred and amortized to properly match the costs with the period of benefit, or expensed when there is a determination of no future economic benefit. This matching of costs with benefits is the essence of accrual accounting and doing away with this concept would selectively convert our reporting on a cash basis for costs that, without question, provide economic benefit for multiple periods.

Accounting for Property Taxes, Insurance and Ground Rents
The proposal would require that the capitalization of property taxes, insurance and ground rentals cease "no later than the date initial operations commence in any portion of the building or structure." As a developer of industrial real estate, this accounting would cause a significant mismatching of costs and related revenues. Charging 100% of these expenses to a partially operational facility distorts economic results and is inconsistent with commonly used financial return metrics. The appropriate accounting would be to allocate the real estate taxes, insurance and ground rents proportionally between space generating revenue and the non-revenue generating space as the property leases up. Limits to the capitalization should be required in terms of the maximum length of time subject to this allocation. Paragraphs 22 and 23 of SFAS 67, as well as paragraph 18 of SFAS 34, provide an appropriate model for the capitalization of these costs.

Limitation on Capitalization of Indirect and Overhead Costs
The proposal would limit the capitalization of costs of internal staff directly associated with specific projects to payroll and payroll-benefit related costs. ProLogis believes that indirect costs and overhead that supports the development, construction or installation of PP&E is inextricably linked to the asset and should be capitalized.

As always, ProLogis appreciates the opportunity to participate in the AICPA's considerations with respect to accounting for PP&E. If you have any questions regarding this response, please contact the undersigned at (915) 298-6300.

Sincerely,

PROLOGIS TRUST

Luke A. Lands
Senior Vice President and Controller

LAL/pa

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November 15, 2001

Mr. Marc Simon, Technical Manager
Accounting Standards
File 4210.CC, American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Reference: Exposure Draft-Proposed Statement of Position Related to Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment.

Dear Mr. Simon:

Columbia Helicopters, Inc. (CHI) is very concerned about the consequences of this exposure draft and feels compelled to comment on the American Institute of Certified Public Accountants Accounting Statement Executive Committee's AcSEC Exposure Draft regarding the Proposed Statement of Position Related to Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment. Columbia Helicopters, Inc. is a world leader in heavy lift helicopter services including logging, petroleum exploration, construction and fire fighting activities.

(All references to Issue Numbers in this letter refer to the related issues in the SOP under the "Areas Requiring Particular Attention by Respondents")

Areas of Concern

Paragraph 44 of this SOP states that the total of costs incurred for planned major maintenance activities does not represent a separate Property, Plant and Equipment asset or component (Issue #8). It states certain of those costs should be capitalized if they represent acquisitions or replacements and that all other costs should be charged to expense as incurred. Further, paragraph 45 prohibits alternative accounting treatments including (a) the accrual of a liability for the estimated costs of a planned major maintenance activity prior to their being incurred, and (b) the deferral and amortization of the entire cost of the activity.

General Comments

With respect to Issue #8 of the proposed SOP, CHI takes the position that the prohibition of an accrual of a liability for the estimated costs of a planned major maintenance activity prior to their being incurred will result in an inappropriate matching of revenue and expense if applied to the aviation industry, as the SOP intends. Most certainly in the Heavy Lift Helicopter business, we know that the net impact of this draft will cause stakeholders in these companies to have far less of an understanding of the actual performance of the organization.

It is our belief that the SOP promulgated by the AcSEC may have application in areas where capital and acquisition costs are extremely high and the recurring maintenance is a less significant element. However, in the aviation industry and more specifically the helicopter industry, overhauls of components and airframes are large issues in terms of the operational costs of a company. They occur sporadically over time and are required to be performed by Federal Aviation Administration (FAA) regulations. Specifically, in the helicopter industry, overhauls of a component can be as high as 90% of the original cost of the asset and these overhauls can be required anywhere from less than one year, to up to seven or eight years. Also, these overhauls can take place over a very long span of time (the life of components can be between 30 and 40 years and overhauls are done routinely over the life of the component). As a result, a large fluctuation in expenses will occur and generate misleading financial statements for years in which major overhauls are completed and the revenue associated with the component was generated in earlier periods resulting in a mismatch of revenue and expenses.

CHI maintains a fleet of 23 aircraft, Boeing Vertol (107), Boeing Vertol (234) and Sikorsky (S-54a). Each of these aircraft contains components that are life-limited in regards to time until inspection, time until overhaul or in some cases the time until the part must be discarded as required by the FAA. Since our fleet of helicopters has been purchased used and then rebuilt, much of the book value is embedded in the components. Current accounting practices at CHI dictate that we capitalize parts when purchased, adding the costs associated with preparing the asset for use and depreciating them over their estimated useful lives. We accrue a liability (Maintenance Reserve) based on the experience of each component type within each aircraft type multiplied times actual flight hours. When components are overhauled, the cost is applied against the accrued liability. At some point in the aircraft's life when the condition of the aircraft is spent, the asset is completely disassembled, inspected, and re-assembled (a one to two year process). These costs are then capitalized and depreciated over the estimated useful life of the refurbished aircraft. (Much of our fleet are 1960's era aircraft which only we fly commercially. These aircraft in appearance look brand new.)

The following example shows what we believe would be the effects of applying this Statement of Position to a company like Columbia Helicopters, Inc.

Example 1
Example 1 illustrates a single component for a period of 15 years. Components are fully interchangeable within the aircraft type and component changes can take place very easily and often if needed. Component changes in an aircraft are done on average several times per month in the evening when the aircraft is not allowed to fly. At the bottom of Example 1, the fluctuation in net expense each year is reflected. As you can see, this example reflects the impact of just one component, and we have hundreds of these types of components. Our stakeholders would only understand the Financial Statements if they had a complete understanding of where each of these hundreds of components were in terms of overhaul status.

Example 2
As another example, we have an engine that was purchased in 1972, and capitalized on our books for $7,267 at that time. For these types of engines we do a major overhaul every 6,000 hours, or about once every five to eight years depending on usage. In addition we perform a light overhaul inspection every 1,000 hours until the 6,000th hour when we do the major overhaul. Assume the major engine overhaul costs in the range of $160,000 and the light overhauls run about $75,000. Since 1972 we have recorded an expense and accrued a Maintenance Reserve liability for every hour flown. When the engine has completed the 6000 hour overhaul, we then reduce the liability reserve account but have proportionately distributed the expense of that overhaul over the period those hours were flown and the revenue was earned. Under the proposed ruling, we understand that CHI would expense the $160,000 in the year the overhaul was completed. So, in essence, we record revenue for five years and in the sixth year record all the expense.

Example 3
It is also our belief that the Statement of Position can lead to the misstatement of financial statements due to manipulation of the proposed guidelines. Using the aviation industry as an example, one only has to look at the current financial crisis facing the airlines to see the mismatching of revenues and expenses if the businesses don't accrue for either the replacement cost or soon to be performed overhaul. The proposal also allows companies to exchange engines, landing gear and other critical components from inactive aircraft to active aircraft as needed in order to defer maintenance costs. In this example, the underlying operating costs would be grossly understated without the proper accrual of the upcoming liability, allowing readers of financial statements to be misled.

In the helicopter industry where maintenance is larger in proportion to the cost of the aircraft, this becomes an even bigger issue. The mission or use of the aircraft can dictate the frequency of needing to perform an overhaul and this is important in allowing for the proper matching of revenues and expenses. For example, some of our operations include moving oil rigs throughout the world on aircraft that might fly between 50 and 75 hours per month. In the case of a forward transmission overhaul, which is performed every 2,400 flight hours, a transmission can go without an overhaul for 48 months (4 years) assuming 50 flight hours per month. Subsequently, and often times, an aircraft can operate an average of 200 hours per month, allowing the transmission to be able to

perform for only one year before requiring an overhaul. Transmissions will need various repairs during use and will be removed periodically between overhauls. As a result, the transmission will most likely work on both aircraft (oil exploration and logging) in the course of its 2,400-hour life between overhauls. Using the Statement of Position, the cost and expenses of these projects and financial statements as a whole will be understated in years where no overhauls are performed and overstate expenses in the year the overhaul is performed.

It is not difficult to illustrate the concept that maintenance costs as a percentage of annual revenue allows companies the ability to manipulate income in any year. Assume a company's annual revenues vary between $180,000,000 and $200,000,000. Annual processed work orders that are debited against the maintenance reserve liability account approach anywhere from $16,000,000 to $30,000,000 per year depending on a number of factors including current economic conditions, weather, etc…

With a profit margin of 10%, deferring certain maintenance costs into future accounting periods can allow the company to alter income by as much as 70%. Assume that a company generates $20,000,000 of profit in a given year (10% profit margin on $200,000,000 of revenue under current GAAP). By performing a minimum amount of maintenance work in the current period or deferring completion of such work, and shifting it into the following year (performing $16,000,000 of work in place of $30,000,000), a company can show an additional $14,000,000 of profit in the current period. Using the proposed standards, such manipulation will be probable and severely affect the integrity of the financial data being presented within our industry.

Summary

While CHI understands the need to reform the accounting of certain aviation companies in order to better inform the users of financial statements, we do not believe that the changes outlined in the current ED would improve the quality or accuracy of our financial statements nor of companies similar to ours. In addition to our direct competitors we would expect that small aviation companies such as charter for hire (e.g. Hillsboro Aviation, Hillsboro, OR) small regional airlines (e.g. ProMech in Ketchikan, AK) and remote freight companies would have similar difficulties presenting their financial statements in a meaningful way. It is our belief that the SOP would have an inappropriate effect (e.g. significant variations in expenses) on smaller, privately held companies when the occurrence of planned major overhauls does not occur evenly over the years because they have few aircraft and the cost of initial purchase is not significantly greater than overhaul costs.

The AcSEC rejected the accrue-in-advance method because they do not believe that estimated future repair and maintenance costs represent a liability as defined in FASB Concepts Statement No. 6. Specifically, prior to the performance of the planned major maintenance activity an entity does not have an unavoidable duty or responsibility to sacrifice assets in the future. In addition, ACSEC does not believe that there has been an obligating event prior to the maintenance activities being performed.

It is our belief that a responsibility to sacrifice assets in the future does exist as FAA regulations will prohibit us from future operations unless the overhauls are performed at specific intervals. This responsibility undoubtedly represents an obligating event prior to the maintenance activities being performed because without them the company will be unable to operate.

As a suggestion, the SOP could contain exclusionary tests such as the following:

Average Life Test. If the average life of your fleet (original date of manufacture) is older than say 15 years.
Purchase Price Test. If the average acquisition cost of your fleet is < 50% of current retail value. If current retail value is not available take original single unit purchase cost and inflate by CPI until the year of purchase.
Component Cost Test. If the value of separable components / purchase price of the aircraft at the time of purchase is > 75%.

These tests would ensure that companies where maintenance is a significant part of operating costs continue to maintain adequate reserves and state net income in a consistent method with expenses incurred, while those who frequently purchase replacement aircraft in lieu of overhauling them do not overstate expenses by accruing liabilities they do not intend to utilize.

As our Example 3 illustrates, we believe if we are prevented from accruing a maintenance reserve liability, we will have the opportunity to fluctuate our net income by 50%-75% each year based on when our overhauls are completed. In periods when we are very busy and unable to complete normally scheduled overhauls, we would have a significant increase in Net Income, whereas, in periods where it is slower and overhauls are completed early, CHI would show a very significant decrease in Net Income. We do not believe this would benefit any of our Stakeholders.

If the accrual in advance method is not deemed appropriate, then we believe all costs incurred in connection with planned major overhauls should be capitalized and amortized over the life of the overhaul.

We appreciate your interest in our comments and look forward to participating in this discussion further with you.

Sincerely,

COLUMBIA HELICOPTERS, INC.

Stan Wilson
Vice President Finance

Aircraft Transmission
200,000.00
01/01/1995
2,400 hours
No Maximum
10 years
Straight Line, 10% Salvage
62.5 per hour
150,000.00
01/01/2000
01/01/2005
01/01/2009
10/31/1999
10/31/2004
10/31/2008

NOTES:

CHI maintains a stock of approximately 90 transmissions. They are either assigned to an aircraft, in stock or in the process of being overhauled.
CHI has a fleet of 23 aircraft. Boeing Vertol (107), Boeing Vertol (234) and Sikorsky (S54a)

Other significant components (Multiply number per aircraft *23 then double to get an estimate of CHI owned components):
Engines - 2 per aircraft.
Mix Box - 1 per aircraft.
Blades - 6 per aircraft.
Pylons - 2 per aircraft.
Swashplates - 2 per aircraft.

All components are interchangeable between their model designations and have life limitations separate from the aircraft.

1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	Total for 15 yrs
500	1,000	100	800	-	400	1,200	100	-	700	-	1,000	1,200	200	100	
500	1,500	1,600	2,400	2,400	2,800	4,000	4,100	4,100	4,800	4,800	5,800	7,000	7,200	7,300	7,300
18,000	18,000	18,000	18,000	18,000	18,000	18,000	18,000	18,000	18,000	-	-	-	-	-	180,000
31,250	62,500	6,250	50,000	-	25,000	75,000	6,250	-	43,750	-	62,500	75,000	12,500	6,250	456,250
-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
49,250	80,500	24,250	68,000	18,000	43,000	93,000	24,250	18,000	61,750	-	62,500	75,000	12,500	6,250	636,250
200,000	200,000	200,000	200,000	200,000	200,000	200,000	200,000	200,000	200,000	200,000	200,000	200,000	200,000	200,000	200,000
(18,000)	(36,000)	(54,000)	(72,000)	(90,000)	(108,000)	(126,000)	(144,000)	(162,000)	(180,000)	(180,000)	(180,000)	(180,000)	(180,000)	(180,000)	(180,000)
(31,250)	(93,750)	(100,000)	(150,000)	(150,000)	(25,000)	(100,000)	(106,250)	(106,250)	(150,000)	-	(62,500)	(137,500)	(150,000)	(6,250)	(6,250)
41,667	83,333	8,333	66,667	-	-	-	-	-	-	-	-	-	-	-	200,000
-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
-	-	-	-	-	150,000	-	-	-	-	150,000	-	-	-	150,000	450,000
41,667	83,333	8,333	66,667	-	150,000	-	-	-	-	150,000	-	-	-	150,000	650,000
200,000	200,000	200,000	200,000	200,000	200,000	200,000	200,000	200,000	200,000	200,000	200,000				200,000
(41,667)	(125,000)	(133,333)	(200,000)	(200,000)	(200,000)	(200,000)	(200,000)	(200,000)	(200,000)	(200,000)	(200,000)				(200,000)
-	-	-	-	-	-	-	-	-	-	-	-				-
(7,583)	**2,833**	**(15,917)**	**(1,333)**	**(18,000)**	**107,000**	**(93,000)**	**(24,250)**	**(18,000)**	**(61,750)**	**150,000**	**(62,500)**	**(75,000)**	**(12,500)**	**143,750**	**13,750**

November 15, 2001

Mr. Marc Simon
Technical Manager, Accounting Standards
File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

RE: Comments of Exelon Corporation on the Proposed Statement of Position, " Accounting For Certain Costs and Activities Related to Property, Plant, and Equipment."

Dear Mr. Simon,

Exelon Corporation appreciates the opportunity to comment on the proposed Statement of Position (SOP), "Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment" as prepared by the Accounting Standards Executive Committee (AcSEC).

Exelon Corporation is one of the nation's largest electric utilities with approximately five million customers and more than $15 billion in annual revenues. The company has one of the industry's largest portfolios of electricity generation capacity, with a nationwide reach and strong positions in the Midwest and Mid-Atlantic. Exelon distributes electricity to approximately five million customers in Illinois and Pennsylvania and gas to 425,000 customers in the Philadelphia area. The company also has holdings in such competitive businesses as energy, infrastructure services and energy services.

Exelon Corporation is a member of the Edison Electric Institute (EEI), and as such, has incorporated or reiterated certain comments from EEI's comment letter in its response regarding the proposed SOP.

General Comments

The AcSEC proposes two purposes for this SOP: 1) to standardize the costs and stages of projects eligible for capitalization as Property, Plant and Equipment (PP&E) assets; and 2) to standardize the depreciation methodology used by all non-governmental entities for PP&E assets. Exelon Corporation acknowledges the Financial Accounting Standards Board's (FASB) criteria for clearance of proposed documents, as stated in the proposed SOP on page 12 that: 1) the proposal should not conflict with current or proposed accounting requirements, unless it is a limited circumstance, usually in specialized industry accounting, and the proposal adequately justifies the departure; 2) the proposal will result in an improvement in practice; 3) the AICPA demonstrates a need for the proposal; and 4) the benefits of the proposal are expected to exceed the costs of applying it.

Exelon Corporation's general comments will focus on concerns that, for electric utilities, the proposed SOP 1) will conflict with current regulatory accounting requirements; 2) will not result in an improvement in practice; and 3) the costs of applying the proposed SOP will outweigh the benefits of its application.

Conflict with Current Accounting Requirements

Electric utilities are regulated by the Federal Energy Regulatory Commission (FERC) and individual state Public Utility Commissions (PUCs). These regulatory bodies generally require utilities to follow the FERC Uniform System of Accounts (USOA). FERC's USOA account structure requires utilities to capitalize costs such as indirect construction overhead and general and administrative costs, and gives the ability to track property using mass property accounting (18 CFR Part 101 Electric Plant Instructions 4.A, 3.A.12, and 10.B.2, respectively). This guidance from FERC is in direct conflict with the guidance provided in the proposed SOP. Significant deviation from capitalization rules already established for electric utilities would be required for compliance. Conforming to both FERC requirements for regulatory reporting and the proposed SOP for reporting to the Securities and Exchange Commission (SEC) will require two "sets of books" with processes to categorize and capture information twice using different rules for reporting and ratemaking. The large number of transactions incurred in the highly capital-intensive electric utility industry will drive significant, expensive changes in automated processes in order to comply with the rules in the proposed SOP. In addition, challenges in the ratemaking process due to the double set of requirements could occur as regulatory commissions would have the ability to review both sets of books. Having two sets of rules would also increase the costs of defending against litigation within the regulatory environment. The increase would result from 1) additional record keeping costs to handle the significant number of regulatory assets/liabilities that would be required; and 2) additional legal costs as a result of the need to examine and defend costs that have been historically included in normal PP&E. .

Negligible Improvements in Practice

The use of component accounting, or a component-based depreciation system will not improve the accuracy of capital recovery, but could significantly put at risk an industry whose financial integrity rests upon recovery of its capital investment. For decades, recovery of investment in the electric utility industry has been accomplished using group depreciation.

The application of group depreciation applied by the industry takes into account both interim retirements of components and the uncertainty or probability inherent in a life estimate. In addition, because an electric utility has significant numbers of items of property, it is neither efficient nor accurate to track them individually. Actuarial studies, university research, and continual revalidation of modeling techniques support group depreciation. Component-based depreciation requires a discrete estimate of life and salvage value for each component. This precludes the use of statistical and empirical analysis in an environment where the only reasonably accurate way of projecting retirements for the large volume of assets within electric utilities is by applying statistical probabilities to groups of assets. Lacking empirical quantification, raw judgment would be applied under component-based depreciation to millions of individual assets to select useful lives and salvage values. Use of judgment of this magnitude is not an improvement in practice, but a step backward in providing accurate capital recovery. Any change in depreciation policy that disallows the ability to use actuarial science to project future conditions and replaces it with a review mandating pure judgment cannot be seen as an improvement in practice.

Costs Outweigh Benefits

The application of this proposed SOP would be extremely expensive for electric utilities. For example, electric utilities have millions of utility poles and cross-arms and hundreds of millions of feet of buried cable and overhead wire. These and similar types of homogeneous assets are currently accounted for using a vintage year group method. As such, a change to component accounting procedures would be neither economically feasible nor physically possible.

The AcSEC seems to realize this, when it offers relief in paragraph 115 of the proposed SOP, which states; "To the extent that an entity can demonstrate that those [group depreciation] conventions can be used and produce the same results—related to gross Property, Plant & Equipment (PP&E), accumulated depreciation, depreciation expense, and gains or losses on replacements or disposals of PP&E—that are not materially different from those obtained under the component accounting prescribed in paragraphs 45 through 51, the AcSEC believes this SOP should not preclude the use of such conventions." Unfortunately, they are not mathematically equivalent. Demonstrating in quantifiable terms that the results obtained using a group depreciation method are not materially different from those obtained under the component accounting prescribed by the proposed SOP would require companies to first calculate the gross PP&E, accumulated depreciation, depreciation expense, and gains or losses on replacements or disposals of PP&E obtained under component accounting. This is not a productive exercise as the group depreciation conventions have been independently examined by the regulators or their consultants and accepted either "as is" or with appropriate modifications.

Also, due to the tremendous number of assets and transactions that occur in this capital-intensive industry, electric utilities would need to make significant programming and operational changes to their processes for capturing, capitalizing, and tracking asset costs. This proposed SOP would necessitate an increased level of staffing in order to track and maintain the additional volume of information created by the proposed change in accounting. The proposed rule would also require the addition of a large number of regulatory assets or liabilities from the application of Statement of Financial Accounting Standards (SFAS) No. 71, "Accounting for the Effects of Certain Types of Regulation" on each company's books to synchronize regulatory reporting (for the purpose of recovering costs under a regulated framework) with reporting as mandated for generally accepted accounting principles (GAAP). Any benefits of this proposed SOP that would be seen for industries not under rate regulation are negated in the electric utility industry by the need for inclusion of significant levels of regulatory assets or liabilities and the inability to model retirements using actuarial methods.

Therefore, Exelon Corporation concludes that for utilities this proposed SOP does not meet the FASB requirement in which the benefits of the proposal should be expected to exceed the costs of applying the proposal. Exelon Corporation cannot overemphasize the cost implications that compliance with this proposed SOP will have on the electric utility industry, both regulated and unregulated. We strongly suggest that AcSEC reconsider the application of this proposed SOP for capital-intensive industries.

Exemption for Regulated Electric Utility Industry

Exelon Corporation strongly believes that regulated electric utilities should be exempted from those provisions of the proposed SOP that contradict regulatory accounting rules. Regulated electric utilities are required to follow the accounting provisions of FERC's USOA. This system of accounts requires that regulated electric utilities use the composite rate method of depreciation. The application of these rules provides independent and scientific review of rates, recognition of interim component retirements supported by actuarial studies, and can include recognition, and losses and gains for events outside of normal statistical variance. Furthermore, state PUCs typically follow FERC's accounting rules and base their ratemaking decisions accordingly. Regulated utilities may not deviate from the FERC rules on computing depreciation. Requiring utilities to capitalize assets or compute depreciation using a methodology contradictory to existing FERC rulemaking would 1) force utilities to maintain two separate sets of accounting books; 2) decrease the accuracy of reporting; 3) unnecessarily add to accounting and administrative costs incurred; and 4) increase - not decrease – public confusion in regards to the financial statements of regulated utilities. For utilities, this proposed SOP will force additional

accounting complexity at a significant cost without any appreciable improvement in either practice or accuracy.

Additional General Comments

Exelon Corporation respectfully suggests that the proposed SOP is much more than a clarification or a simple modification of existing GAAP, but instead, is a significant departure from GAAP as currently practiced by regulated utilities. The result of this proposed SOP will be to require a completely new set of policies and significantly increase record keeping for regulated utilities.

Exelon Corporation's non-regulated operations, with the exception of its generation operations, generally concur with the provisions of the proposed SOP. Exelon Corporation's generation operations, which have only recently become deregulated, continue to utilize the same accounting methods and systems employed when these operations were subject to FERC jurisdiction.

In addition to the general comments above, Exelon Corporation will provide responses to specific issues as put forth by the AcSEC in the letter included with the proposed SOP as follows:

Scope

<u>Issue 1</u>: **Paragraph 10 of the proposed SOP states that the SOP does not provide specific guidance on lessor or lessee accounting for reimbursements of costs incurred by a lessor that are directly recoverable from lessees under the terms of one or more leases, and that the lessor and lessee should refer to Financial Accounting Standards Board (FASB) Statement No. 13, *Accounting for Leases*, and related lease accounting literature for guidance on accounting for such reimbursements. In many instances, depending on the terms of the lease, those reimbursements may constitute minimum lease payments or contingent rentals under FASB Statement No. 13. As discussed in paragraph A2 of the proposed SOP, AcSEC elected not to address the accounting for such transactions in this SOP because AcSEC did not want to create conflicts with existing lease accounting guidance and AcSEC did not believe it was appropriate to address the accounting under all of the various reimbursement scenarios and arrangement structures within the scope of this SOP. Are there significant practice issues or concerns related to the accounting for contractually recoverable expenditures that should be addressed in the proposed SOP? Do you believe that there are other areas addressed in the proposed SOP that, with respect to their application to lessors and lessees of PP&E, could create conflicts with existing lease accounting standards?**

Exelon Corporation agrees with the guidance stated in the proposed SOP.

<u>Issue 2</u>: **The guidance in this proposed SOP is presented in terms of a project stage or time line framework and on the basis of the kinds of activities performed during the stages defined in the proposed SOP rather than on whether an expenditure fits into certain classification categories such as ordinary repairs and maintenance, "extraordinary" repairs and maintenance, replacements, betterments, additions, redevelopments, renovations, rehabilitations, retrofits, rearrangements, refurbishments, and reinstallations. Do you agree with that approach? If not, what alternative would you propose and why?**

Exelon Corporation agrees with the project stage or timeline concept as a general framework for determining capitalization policy; however, Exelon Corporation is concerned that the establishment of a proposed project stage framework as the primary

basis for cost classification could cause the same costs to be treated differently depending upon their timing. Exelon Corporation believes that costs should be capitalized or expensed based on the kind of activity that was performed or the kind of cost incurred and that the beginning and end of each stage should be determined by these criteria and not on a specific time criteria.

Exelon Corporation also believes that an exception should be made for regulated electric utilities that must apply SFAS No. 71 since the types of costs that are capitalizable are already outlined in the regulatory guidance.

***Issue* 3**: **Paragraph 16 of the proposed SOP states that the preliminary stage ends and the preacquisition stage begins when the acquisition of specific property, plant, and equipment (PP&E) is considered probable. Paragraph 22 of the proposed SOP states that, other than the costs of options to acquire PP&E, all costs incurred during the preliminary stage should be charged to expense as incurred. Do you agree with that conclusion? If not, how would you propose to modify the guidance and why?**

Exelon Corporation agrees with the guidance stated in the proposed SOP.

***Issue* 4**: **The proposed SOP states that PP&E-related costs incurred during the preacquisition, acquisition-or-construction, and in-service stages should be charged to expense unless the costs are directly identifiable with the specific PP&E. Directly identifiable costs include only (a) incremental direct costs incurred with independent third parties for the specific PP&E, (b) employee payroll and payroll benefit-related costs related to time spent on specified activities performed by the entity during those stages, (c) depreciation of machinery and equipment used directly in the construction or installation of PP&E and incremental costs directly associated with the utilization of that machinery and equipment during the acquisition-or-construction stage, and (d) inventory (including spare parts) used directly in the construction or installation of PP&E. All general and administrative and overhead costs incurred, including all costs of support functions, should be charged to expense. See paragraphs 24, 25, 29, and 30. Do you agree with those conclusions? If not, what alternatives would you propose and why?**

Exelon Corporation disagrees with the guidance in the proposed SOP with respect to the definition of directly identifiable costs including only incremental direct costs incurred with independent third parties for the specific PP&E asset and the exclusion of certain costs such as general and administrative (G&A) and other overhead costs not specifically identifiable to a capital project. Exelon Corporation believes this guidance is restrictive in nature and contradicts existing electric utility regulatory codes. In addition, an inherent bias appears to exist in this proposed SOP regarding companies with an ability to self-construct assets.

Exelon Corporation does not believe that all G&A and overhead costs should be expensed because many of these costs, in a capital-intensive business, relate directly to construction activities. The direct charging of these costs is not prudent given the large volume of construction projects in progress at one time, but the fact that G&A and overheads are rationally allocated should not exclude those costs from being associated with a capital project. Utilities have strict policies and perform detailed studies to assure that only the "capital portion" of G&A and overheads are applied toward construction work. It is assumed that "direct" costs are those that would not otherwise have been incurred if it were not for the PP&E project as defined in SFAS No. 91, "Accounting for

Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases." Certain G&A and overhead costs fall within this definition within a capital-intensive business and the proposed SOP should be flexible in allowing these costs to be assigned. These costs can be substantial, and in some cases, may actually exceed the direct costs of a small distribution project. Certainly, this practice will affect rate base and the rate of return, thereby creating regulatory issues. For a regulated electric utility, expensing of all G&A overheads is in direct conflict with the Code of Federal Regulations - 18 CFR Part 101, Electric Plant Instruction Nos. 3 and 4. The specific language contained within these electric plant instructions is as follows:

> All overhead construction costs, such as engineering, supervision, general office salaries and expenses, construction engineering and supervision by others than the accounting utility, law expenses, insurance, injuries and damages, relief and pensions, taxes and interest, shall be charged to particular jobs or units on the basis of the amounts of such overheads reasonably applicable thereto, to the end that each job or unit shall bear its equitable proportion of such costs and that the entire cost of the unit, both direct and overhead, shall be deducted from the plant accounts at the time the property is retired.

Issue 5: **Paragraph 32 of the proposed SOP states that for real estate that is not being used in operations, costs of property taxes, insurance, and ground rentals should be capitalized, to the extent of the portion of the property that is under development, during the time that activities that are necessary to get the asset ready for its intended use are in progress. Do you agree with that conclusion? If not, what alternative would you propose and why?**

Exelon Corporation agrees with the guidance stated in the proposed SOP.

Issue 6: **Paragraph 37 of the proposed SOP states that the costs of normal, recurring, or periodic repairs and maintenance activities should be charged to expense as incurred. It also states that all other costs related to PP&E that are incurred during the in-service stage should be charged to expense as incurred unless the costs are incurred for (a) the acquisition of additional PP&E or components or (b) the replacement of existing PP&E or components of PP&E. Do you agree with those conclusions? If not, what alternatives would you propose and why?**

Exelon Corporation agrees, in general, with this conclusion. However, electric utilities place assets in service when they are able to perform their expected function. Costs to complete the asset, in most cases, still occur after the asset is placed in service (*e.g.* final construction not related to primary function). These costs are, in reality, part of the construction costs of the asset and should be capitalized with the asset. Exelon Corporation suggests that paragraph 37 be modified to include criteria 37(c) which would state the following: c) "that are necessary for the completion of the asset, but were not necessary for the asset to be placed into service." Exelon Corporation also repeats here our concern stated in our response to Issue 2 regarding the classification of costs only by timing and not by the "kinds of activities performed and kinds of costs incurred."

Issue 7: **Paragraph 39 of the proposed SOP states that costs of removal, except for certain limited situation demolition costs, should be charged to expense as incurred. Do you agree with that conclusion? If not, what alternative would you propose and why?**

Exelon Corporation disagrees with the guidance that the costs of removal (COR) as

provided in the SOP should be charged to expense as incurred. Code of Federal Regulations - 18 CFR Part 101, Electric Plant Instruction No. 10 provides that COR shall be charged to the accumulated provision for depreciation. COR are reflected in the composite rate of depreciation for the related PP&E. The matching principle of accounting requires the simultaneous recognition of the revenue and expenses that result directly and jointly from the same transaction or event. In this case, the COR, as part of depreciation expense, is being recovered through the utilities rates (revenue) over the useful life of the asset. This treatment is consistent with the regulated ratemaking process.

Additionally, SFAS No. 143, "Accounting for Asset Retirement Obligations," requires that tangible assets with associated liabilities for removal should include the fair market value of the liability as part of the asset cost with an off-setting entry to a liability account. The guidance under SFAS No. 143 has been finalized, therefore, the provisions of the proposed SOP should be reconciled to the provisions of SFAS No. 143.

Issue 8: **Paragraph 44 of the proposed SOP states that the total of costs incurred for planned major maintenance activities does not represent a separate PP&E asset or component. It states that certain of those costs should be capitalized if they represent acquisitions or replacements and that all other costs should be charged to expense as incurred. Paragraph 45 prohibits alternative accounting treatments including—(a) the accrual of a liability for the estimated costs of a planned major maintenance activity prior to their being incurred, and (b) the deferral and amortization of the entire cost of the activity. Do you agree with those conclusions? If not, what alternatives would you propose and why?**

Exelon Corporation agrees with the guidance stated in the proposed SOP.

Issue 9: **Paragraph 45 of the proposed SOP further prohibits, as an alternative accounting treatment, the "built-in overhaul" method for costs incurred for planned major maintenance activities. Under that method, additional depreciation expense is recognized currently to give effect to the decline in service potential that is subsequently restored once the major maintenance activity occurs. When the major maintenance activity occurs, its cost is considered capitalizable. In lieu of the built-in overhaul method, AcSEC concluded that better cost allocation would result from the use of component accounting and limiting the major maintenance activities that would be capitalizable to costs that represent replacements of components of PP&E. Should the costs of restoring PP&E's service potential, in addition to the cost of replacements that would be capitalizable under this proposed SOP, be eligible for capitalization? Do you believe that prohibiting the built-in overhaul method is appropriate, or should it be allowed as an alternative method? If you believe that the built-in overhaul method should continue to be allowed, what industries or entities should be allowed to use it, and why?**

Exelon Corporation agrees with the guidance stated in the proposed SOP.

Issue 10: **Paragraphs 47, 48, and A41 of the proposed SOP discuss the situation in which an entity owns an asset that it intended to sell as inventory but subsequently decided to retain for use in its own internal operations. Those paragraphs state that the entity should evaluate for impairment amounts included in PP&E that were previously capitalized as inventory but should not redetermine their carrying amount as PP&E using the guidance in the proposed SOP, unless the entity has a pattern of changing the intended use of assets**

from inventory to PP&E. Do you believe that guidance is appropriate, or should an entity be required to redetermine the carrying amount of PP&E assets previously capitalized as inventory, and why? Should AcSEC provide additional guidance on what kinds of changes in intended use constitute a "pattern," and why?

Exelon Corporation provides no comment on this guidance stated in the proposed SOP.

***Issue* 11**: **The proposed SOP requires assets that are produced by an entity to be leased to a lessee under an operating lease to be accounted for under the provisions of this SOP. As discussed in paragraph A43 of the proposed SOP, AcSEC recognizes that some entities routinely construct or manufacture products, some of which are sold directly and some of which are leased to lessees under sales-type leases whereas others are leased to lessees under operating leases. In some situations, the entity does not know the form the transaction will take until it occurs, and the customer decides whether its acquisition of product will be accomplished through purchase or lease. The proposed SOP requires an entity to accumulate costs differently for similar assets depending on whether the asset is sold outright or leased to a lessee under a sales-type lease (in either case, inventory cost accumulation rules would apply) or leased to a lessee under an operating lease (in which case, the cost accumulation provisions of the proposed SOP would apply). Do you agree with that conclusion and, if so, do you believe the proposed SOP should provide additional guidance on such cost accumulation? Or would it be preferable for a single cost accumulation model to apply during the production process and that there should be a presumption that the assets should be accounted for all as inventory or all as PP&E? If so, which presumption should be applied and why?**

Exelon Corporation provides no comment on this guidance stated in the proposed SOP.

***Issue* 12**: **Paragraphs 49 through 56 of the proposed SOP discuss component accounting and state that if a component has an expected useful life that differs from the expected useful life of the PP&E asset to which it relates, the component should be accounted for separately and depreciated or amortized over its separate expected useful life. Do you agree with this approach to accounting for PP&E? If not, what alternative would you propose and why?**

Exelon Corporation believes that regulated electric utilities should be granted an exemption from the component accounting guidance outlined in the proposed SOP. Current accounting practices for regulated electric utilities already contain many of the concepts underlying component accounting. The implementation of these new provisions will result in a significant and permanent increase in personnel and systems-related costs for regulated electric utilities that will be borne by ratepayers, without a corresponding improvement in either service to customers or in the quality of financial reporting. The following list contains several reasons why regulated electric utilities should be exempted from the component accounting provisions of the SOP:

- The electric utility industry is one of the most capital-intensive industries in the country, with one of the lowest ratios of revenue to fixed asset investment of any major industry.
- A significant portion of an electric utility's fixed assets are comprised of "mass" property – high volume, low cost assets such as utility poles, line transformers, meters, etc. The implementation of component accounting for these categories of assets would create significant amounts of immaterial transactions.

- Electric utilities continue to be subject to cost-based ratemaking for mass property that remains as a part of regulated utility service even where generation has been deregulated. As an electric utility's largest asset category, PP&E is subject to an extensive and well-developed regulatory framework surrounding accounting for PP&E. The regulatory framework's primary focus is the fair and equitable recovery of its investment in PP&E from ratepayers. Historically, electric utilities have applied these regulatory requirements for PP&E accounting in their external financial statements.

- The regulatory framework for PP&E includes the "retirement unit" accounting concept, which is very similar to the component accounting concept in the proposed SOP.

- Regardless of whether or not regulated electric utilities are required to implement the component accounting provisions of the proposed SOP, these entities will be required, for ratemaking purposes, to continue to account for PP&E in accordance with regulatory guidelines. Accordingly, electric utilities would be faced with the burdensome and expensive requirement to maintain two separate sets of detailed records for their extensive PP&E assets. However, any differences between these detailed records would likely not affect reported results of operations for regulated electric utilities, as the differences would be recorded as regulatory assets or liabilities because of the applicability of SFAS 71. Exelon Corporation believes that this financial reporting result would confuse financial statement users more than it would inform them, and that the costs that would be required in this effort would be non-productive or counter-productive.

  Exelon Corporation believes that the proposed SOP's component accounting approach is not appropriate for utilities, regulated or unregulated, and that these entities should be exempted from these provisions. At a minimum, paragraph 52 of the proposed SOP should be supplemented to specifically exempt items of mass property from component accounting requirements, as the implementation of these requirements for mass property would be impracticable.

***Issue* 13**: **Paragraphs 38 and 51 of the proposed SOP state that when existing PP&E is replaced or otherwise removed from service and the replacement is capitalized, the net book value of the replaced PP&E should be charged to depreciation expense in the period of replacement. Do you agree with this approach? If not, what alternative would you propose and why?**

Exelon Corporation does not agree with this provision's application to regulated electric utilities, and believes that the AcSEC should amend these provisions to exempt regulated electric utilities. As noted in our response to Issue 12, a significant portion of the regulatory ratemaking framework has to do with the fair and equitable recovery of a utility's total investment in PP&E. One feature of this framework is that the net book value of retired PP&E is maintained in an electric utility's accumulated depreciation. This treatment is provided in order to levelize rates and to ensure full recovery of all prudently incurred costs.

As with Issue 12 above, implementation of these proposed accounting techniques for regulated electric utilities would require the costly maintenance of two separate and complete details of PP&E, with any differences recorded as regulatory assets or liabilities. Exelon Corporation does not believe this added cost to be justified in the circumstances. In addition, separate accounting for the retirement of individual items of mass property would be impracticable, and Exelon Corporation believes there should be an exemption

from individual component accounting requirements for those types of PP&E items.

It should also be noted that the proposed SOP's provisions in this regard conflict with the provisions of the SEC Staff Accounting Bulletin Topic 5B. This guidance precludes charging depreciation expense for the net book value of replaced PP&E and recognizes the propriety of group or composite depreciation, including the charging of accumulated depreciation for gains or losses on replaced PP&E.

Issue 14: **The proposed SOP requires the use of component accounting to depreciate identified components over their respective expected useful lives. As noted in paragraph A48 of the proposed SOP, entities have developed and utilized various conventions to depreciate assets, including group depreciation or use of composite lives. Those conventions are acceptable only if they result in approximately the same gross PP&E, depreciation expense, accumulated depreciation, and gains or losses on disposals of PP&E as the component accounting method required by this proposed SOP. Do you agree with this approach? If not, what alternative would you propose and why?**

Exelon Corporation does not agree with the provisions of the proposed SOP requiring separate depreciation accounting for all individual components. Electric utilities have historically relied heavily upon group and composite depreciation methods in accounting for depreciation of utility property. These methods were perfected and employed in the industry because of the large number of assets, the high dollar amount of the total depreciation recovery, and the need for a fair, accurate and objective recovery. As noted in our responses to Issues 12 and 13, individual component accounting would be impracticable and costly, and would not improve financial reporting for a regulated utility.

Exelon Corporation believes that group and composite depreciation methods are superior to individual component accounting in circumstances in which there is a large pool of assets with statistically valid dispersion of actual useful lives. Through standards such as SFAS Nos. 87 "Employers' Accounting for Pensions" and 106 "Employers' Accounting for Postretirement Benefits Other Than Pensions" accounting precedent exists for the recognition in financial statements of estimates made utilizing statistical mortality data. Exelon Corporation believes that there is no better way to project retirement dates for vast quantities of individual assets.

Exelon Corporation is also concerned about the extent of evidence that would be necessary to document that the composite or group method approximates the individual component method. A full comparison of the two methods would be costly, and that cost would not, in our view, be justified, given the lack of impact of this issue on the results of operations ultimately reported by a regulated electric utility. Furthermore, the comparison would be extremely difficult to calculate, if not prohibitive, and for many utilities would require significant computer system modifications and additional support staff to meet this proposed SOP requirement. Exelon Corporation also repeats here our concerns stated in our responses to Issues 12 and 13 regarding the impracticability of individual component accounting for items of mass property. In summary, Exelon Corporation believes that composite and group depreciation methods should continue to be permitted, in recognition of their practical and theoretical superiority in accounting for large pools of similar assets.

Issue 15: **Paragraphs 61 and 63 of the proposed SOP list amendments to SOP 85-3, *Accounting by Agricultural Producers and Agricultural Cooperatives*, and the AICPA Audit and Accounting Guide *Audits of Agricultural Producers and Agricultural Cooperatives*,**

respectively. Do you agree with the proposed amendments? Do you believe that there are unique aspects of agricultural accounting, such as the accounting for breeding and production animals and the accounting for plants and vines, that should not be amended by the proposed SOP, and why?

Exelon Corporation has no comment on this guidance stated in the proposed SOP.

***Issue 16*: Paragraph 71 of the proposed SOP states that the prescribed component accounting guidance should be initially adopted for existing PP&E using one of two alternatives, the election and disclosure of which should be made when the SOP is adopted. Do you agree with that approach and, if so, do you agree with the choice of the two alternatives from which the election is to be made? If you do not agree with that approach for existing PP&E, what approach would you propose and why?**

Exelon Corporation agrees with the guidance stated in the proposed SOP.

***Issue 17*: Under paragraph 71(a) of the proposed SOP, the allocation of existing net book value to components at transition should be based on (a) allocation of original accounting records, if available, (b) relative fair values of components at date of transition, if original accounting records are not available, or (c) another reasonable method, if relative fair value is not practicable. Do you agree that that ordering of allocation methods is appropriate? If you believe that a different order would be appropriate, what order would you propose and why? Should the proposed SOP provide additional examples to illustrate what constitutes "another reasonable method"?**

Exelon Corporation agrees with the guidance stated in the proposed SOP.

***Issue 18*: Paragraph 72 of the proposed SOP states that the SOP should be applied prospectively for all costs incurred after the adoption of the SOP. It also states that costs incurred prior to the adoption of the proposed SOP should not be re-characterized (as capital or expense items) to conform to the guidance in the SOP, with the exception of certain costs of planned major maintenance activities. Do you agree with that approach? If you do not agree with that approach, what approach would you propose and why?**

Exelon Corporation agrees with the guidance stated in the proposed SOP.

***Issue 19*: Under paragraph 71(a) of the proposed SOP, and as illustrated in Example 3 in appendix C, an entity applying component accounting retroactively at date of adoption may calculate a difference between the pre-adoption balance of accumulated depreciation and the balance recalculated based on the estimated useful lives of components that previously were not accounted for as separate components. Under that paragraph, the difference is allocated back to the accumulated depreciation of each component based on the net book values of the components. Two alternatives considered were recording the difference as a cumulative effect type adjustment at adoption and recording the difference as additional depreciation expense at adoption. Do you agree with the proposed approach or either of the alternatives, and why?**

Exelon Corporation agrees with the guidance stated in the proposed SOP.

Liquidated Damages

Exelon Corporation disagrees with the proposed SOP's requirements for accounting for liquidated damages in construction contracts. There are a myriad of these types of provisions in construction contracts. No single, "one size fits all" accounting method can accurately reflect the economic substance of these various provisions, or adequately contemplate the unique facts and circumstances that exist in each contractual arrangement. In fact, the proposed requirements in the SOP might well be completely inconsistent with the economics of certain contractual arrangements.

For example, a fixed-price turnkey construction contract for a generation plant could include liquidated damages provisions for plant capacity, plant efficiency and/or delays in plant completion. The contractual terms and economic substance of these provisions could be entirely different. For instance, a fixed, one-time damage payment for a plant capacity deficiency likely represents a "refund" of plant costs, whereas variable, ongoing damages for completion delays could represent embedded insurance for lost profits. Requiring identical accounting for these very different damage provisions would be a clear violation of representational faithfulness, an important qualitative characteristic of accounting information discussed at length in Statement of Financial Accounting Concepts No. 2 "Qualitative Characteristics of Accounting Information."

Exelon Corporation is not convinced that a need exists for standards in this area, or even that meaningful standards can be set given the many different circumstances and provisions that exist.

Exelon Corporation appreciates the opportunity to respond to the proposed SOP and to provide input into AcSEC's process. We hope that our comments will be helpful in AcSEC's future deliberations.

Sincerely,

Jean H. Gibson
Vice President and Controller
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November 15, 2001

Mr. Marc Simon
Accounting Standards, File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, N.Y. 10036-8775

Dear Mr. Simon:

Eli Lilly and Company appreciates the opportunity to comment on the proposed Statement of Position (SOP), Accounting for the Certain Costs and Activities Related to Property, Plant, and Equipment. Our response includes a summary of our overall concerns and an attachment containing our reply to the specific issues requested by AcSEC.

We are supportive of the effort incurred by the Accounting Standards Executive Committee (AcSEC) to develop Project Stage Framework guidance regarding capitalization of property, plant, and equipment (PP&E). Unfortunately we feel AcSEC's implementation guidance for cost capitalization has taken a very conservative stance to prevent perceived abuses in current practice. The proposed SOP creates several inconsistencies in accumulation of asset values based on the guidance in paragraphs 23-31. Further, financial statement disclosures required by the proposed SOP are unduly burdensome and provide little, if any, incremental benefit to the reader of the financial statements. We highly doubt AcSEC's attempts to bulletproof PP&E accounting from "overly aggressive allocations of such costs" will result in enhanced financial reporting.

Capitalizable Costs

We agree with the guidance in paragraph 23 stating that costs "directly identifiable with the specific PP&E" are eligible for capitalization. However, AcSEC's definition of directly identifiable costs represents our greatest concern with this standard as it leads to inconsistent cost accumulation. Costs incurred via transactions with an independent third party are considered "incremental direct costs" eligible for capitalization per paragraph 23(a). A different standard exists for internal costs incurred by an entity. Specifically per paragraph 23(b), only payroll and payroll-related benefit costs of internal employees who devote time to a PP&E activity are eligible for capitalization. The proposed SOP also prohibits capitalization of any general and administrative (G&A) costs and overhead costs sustained by the company (paragraphs 24 and 25) while allowing administrative overhead incurred by a third party to be capitalized (paragraph 26). Similar guidance is provided in paragraphs 28(b), 29, and 30 for assets in the acquisition-or-construction stage.

To demonstrate these inconsistencies, consider the following example: Lilly maintains a Global Facility Delivery (GFD) group whose primary mission is to deliver capital projects. Members of this team routinely travel to construction sites or out-of-state offices of a general contractor engaged by the company. Travel and other non-payroll related expenditures incurred by our GFD team are directly related to and identifiable with the specific PP&E, but would not be eligible for capitalization under the proposed SOP. However, similar costs paid to an independent third party would be eligible for capitalization as PP&E. From a theoretical perspective, we feel strongly that these costs are capital as they are directly identifiable with PP&E and would not be incurred but for the PP&E project. AcSEC's proposal effectively penalizes an entity for making a sound business decision to incur these costs internally. We find this inconsistency totally unacceptable and we respectfully request that AcSEC consider the revisions proposed below.

Cost accumulation for internally developed PP&E under the proposed SOP is also inconsistent with inventory accounting, which permits an allocation of non-payroll related internal costs to be included in the asset value. AcSEC recognizes this inconsistency in paragraph 48 by allowing entities that manufacture fungible inventory (e.g., computers and automobiles) subsequently used for internal purposes as PP&E to use inventory cost accumulation principles for valuing the PP&E. We see no reason that inconsistencies in cost accumulation should exist and are disappointed AcSEC only acknowledged the matter rather than providing rationale by stating the following in paragraph A1, "different accounting for assets for sale versus internal use is acceptable".

Additional inconsistencies in cost accumulation treatment are noted in paragraph 32: "If a property under construction remains in operation while the construction takes place, costs incurred for property taxes, insurance, and ground rentals should be capitalized only if they are incremental and directly attributable to the construction activities." Special dispensation is granted to these costs based on an analogy to SFAS No. 34, which indicates that interest cost should be capitalized as it is an "avoidable cost" (i.e., a cost the entity could have avoided by using cash to versus debt to construct assets). In paragraph A20, AcSEC states it "does not believe that the "avoidable costs" concept should be extended to costs other than property taxes, insurance, and ground rentals", which seems arbitrary as no additional rationale is provided.

On the surface it appears AcSEC is subjectively revising accounting guidance instead of fairly and objectively determining costs eligible for capitalization. Thus, in an attempt to prevent overly aggressive allocations of expense to internally developed PP&E projects, AcSEC has prohibited many legitimate costs from capitalization. In our opinion the resulting inconsistencies are unacceptable.

We recommend AcSEC delete paragraphs 23(b) and 28(b) and revise paragraphs 23(a) and 28(a) to include all direct internal costs incurred by a company. Our recommendation would result in an entity capitalizing "incremental direct costs" (defined by AcSEC as "costs of a PP&E project that would not be incurred but for that project") regardless of where such costs are incurred (internally or externally), promoting consistency in accumulation of asset values.

Demolition Costs

We are also concerned with AcSEC's proposed treatment of demolition costs outlined in paragraph 33. Specifically, the proposed SOP is very restrictive regarding capitalization of demolition costs. We prefer the theoretical guidance provided by IRS Code Section 280B which requires demolition costs to always be capitalized and added to the basis of the land on which the structure was located. Such costs are similar to site preparation costs that are eligible for capitalization per the proposed SOP. Demolition costs improve the land for future use and effectively add value to the asset.

In our opinion the proposed SOP would discriminate against certain businesses as capitalization of demolition costs would be acceptable only based on intent at the time of property acquisition. For example, a business effectively "land locked" in an urban area decides to demolish an abandoned manufacturing facility to build an office building for its growing base of employees. Since the land was acquired years ago and demolition of the manufacturing building was not contemplated as part of the property's acquisition, the entity will be unable to capitalize demolition costs under the proposed SOP. However, if the entity purchased the land from a neighboring business and removed the building, such demolition costs would be eligible for capitalization.

Presentation and Disclosure

Paragraphs 59 and 60 require an entity to significantly increase financial statement disclosures for PP&E. For example, dividing the "buildings and building improvements" category into subcategories, such as leasehold improvements, integral equipment (HVAC, elevators), and the building shell. Other disclosures include the range of useful lives for each category or subcategory and several disclosures surrounding repair and maintenance expense. Presentation of this information in external financial statements will be time consuming, useful only for a very limited audience, and potentially result in inconsistent presentation among companies in the same industry, effectively undermining the inherent usefulness and value of financial reporting.

We are concerned that AcSEC did not fully consider the cost benefit implications of these disclosure requirements. To adequately meet the requirements of the proposed SOP, the number of accounts in our worldwide trial balance would increase significantly and our business would be burdened accordingly. Unlike certain regulated industries that need to track very detailed asset information for reimbursement or costing purposes, we see no need for such detailed accounting information for the vast majority of businesses.

Summary

We recognize the need for additional guidance concerning accounting for PP&E. The root cause of this concern appears to reside in proper definition of the Project Stage Framework (timeline for capitalization) and clear, <u>consistent</u> definitions of costs eligible for capitalization. Additional financial statement disclosures for PP&E are <u>NOT</u> necessary and those required

by the proposed SOP would burden a corporation with disclosures that are excessive and not meaningful. During my fourteen years of financial reporting experience at Eli Lilly, which includes numerous interactions with our Investor Relations department, I cannot recall a single request from an investment analyst or shareholder desiring additional information about our PP&E. While accounting for PP&E could benefit from additional guidance, it is important to remember that underlying process is not broken, nor are the abuses in practice so great as to necessitate the punitive disclosures required by the proposed SOP. We strongly encourage AcSEC to reassess these important components of the proposed SOP and address the issues identified above and in the attachment.

We appreciate the opportunity to comment on this exposure draft. If you have any questions regarding our response or would like to discuss our comments, please feel free to call me at (317) 276-2024.

Sincerely,

ELI LILLY AND COMPANY

S/Arnold C. Hanish
Executive Director, Finance and Chief Accounting Officer

Attachment

Attachment
Proposed Statement of Position (SOP), Accounting for the Certain Costs and Activities Related to Property, Plant, and Equipment

Scope

Issue 1: The SOP does not provide specific guidance on lessor or lessee accounting for reimbursements of costs incurred by a lessor that are directly recoverable from lessees under the terms of one or more leases, and that the lessor and lessee should refer to FASB Statement No. 13, Accounting for Leases, for guidance on accounting for such reimbursements. Are there significant practice issues or concerns related to the accounting for contractually recoverable expenditures that should be addressed in the proposed SOP? Do you believe that there are other areas addressed in the proposed SOP that, with respect to their application to lessors and lessees of PP&E, could create conflicts with existing lease accounting standards?

Based on our review of the proposed SOP, we do not see any conflicts with existing lease accounting guidance.

Issue 2: Guidance in this proposed SOP is presented in terms of a project stage or time line framework and on the basis of the kinds of activities performed during the stages defined in the proposed SOP rather than on whether an expenditure fits into certain classification categories such as ordinary repairs and maintenance, "extraordinary" repairs and maintenance, replacements, betterments, etc. Do you agree with that approach? If not, what alternative would you propose and why?

We agree with AcSEC's proposed use of a project stage framework to facilitate understanding and consistent application of the relevant concepts of the proposed SOP. The framework proposed should provide a reasonable basis for determination of cost capitalization and lead to greater consistency in financial reporting between entities and industries. It should be noted that no process will be perfect and certain amounts of subjective application in practice are inevitable, though not detrimental to the overall goals of the proposed SOP.

Issue 3: The proposed SOP states that the preliminary stage ends and the preacquisition stage begins when the acquisition of specific property, plant, and equipment (PP&E) is considered probable. Do you agree with that conclusion? If not, how would you propose to modify the guidance and why?

We agree with the proposed SOP that the preliminary stage ends and the pre-acquisition phase begins when acquisition is considered "probable" as defined by SFAS No. 5, *Accounting for Contingencies*. Such treatment also is largely consistent with SOP 98-5, *Reporting on the Costs of Start-up Activities*. As the definition of "probable" can be somewhat subjective, we encourage AcSEC to retain the guidance provided in paragraphs 16 and 17 of the proposed SOP for use in implementation.

Accounting for Costs Incurred

Issue 4: The proposed SOP states that PP&E-related costs incurred during the preacquisition, acquisition-or-construction, and in-service stages should be charged to expense unless the costs are directly identifiable with the specific PP&E. All general and administrative and overhead costs incurred, including all costs of support functions, should be charged to expense. Do you agree with those conclusions? If not, what alternatives would you propose and why?

We agree that directly identifiable costs should be considered capital. We strongly disagree with AcSEC's conclusion regarding non-payroll-related costs for internal costs related to acquisition and construction of PP&E. A thorough explanation of our concerns and alternatives is included in the main body of this letter.

Issue 5: Paragraph 32 of the proposed SOP states that for real estate that is not being used in operations, costs of property taxes, insurance, and ground rentals should be capitalized, to the extent of the portion of the property that is under development, during the time that activities that are necessary to get the asset ready for its intended use are in progress. Do you agree with that conclusion? If not, what alternative would you propose and why?

We agree with AcSEC's proposed treatment of property taxes, insurance, and ground rentals for real estate under development that is not currently used in operations.

Issue 6: Paragraph 37 of the proposed SOP states that the costs of normal, recurring, or periodic repairs and maintenance activities should be charged to expense as incurred. It also states that all other costs related to PP&E that are incurred during the in-service stage should be charged to expense as incurred unless the costs are incurred for (a) the acquisition of additional PP&E or components or (b) the replacement of existing PP&E or components of PP&E. Do you agree with those conclusions? If not, what alternatives would you propose and why?

We are in agreement with AcSEC's recommendations for normal, recurring, or periodic repair and maintenance activities. The guidance provided for costs of replacing PP&E is logical and straightforward. We assume that "the acquisition of additional PP&E or components" as stated in paragraph 37 is intended to represent activities that extend the useful life or provide additional functionality. If not, additional clarity is recommended.

Issue 7: Paragraph 39 of the proposed SOP states that costs of removal, except for certain limited situation demolition costs, should be charged to expense as incurred. Do you agree with that conclusion? If not, what alternative would you propose and why?

We agree that removal costs should generally be expensed, however, we disagree with AcSEC's recommendation for treatment of demolition costs as outlined in the main body of our letter.

Issue 8: Paragraph 44 of the proposed SOP states that the total of costs incurred for planned major maintenance activities does not represent a separate PP&E asset or component. Certain of those costs should be capitalized if they represent acquisitions or replacements and that all other costs should be charged to expense as incurred. Paragraph 45 prohibits alternative accounting treatments. Do you agree with those conclusions? If not, what alternatives would you propose and why?

While our business and industry are not significantly impacted, we disagree with AcSEC's conclusions regarding planned major maintenance activities. Companies that recognize the cost of a planned major maintenance expense over several reporting periods are making a conscious effort to match revenues and expenses in compliance with CON6. This accounting practice arose out of concern that recognizing a major (i.e., significant) maintenance expense only in the period incurred would distort the comparability of financial statements for industries impacted by major maintenance activities. While it is arguable that numerous maintenance activities can provide benefit greater than one year, many companies choose to expense such activities as a matter of convenience and avoid administrative burden. Although AcSEC is concerned that a true liability may not have been incurred during the period leading up to the maintenance activity, business entities maintain a going concern status. As such, the entity fully intends to incur maintenance costs at the proper interval and therefore prefers to match its revenues and expenses accordingly.

One can also analogize that spreading depreciation costs over the useful life of an asset is a similar attempt to match revenue and expense. As several methods exist to recognize depreciation expense (straight line, accelerated, etc.), we feel it would be inappropriate to completely remove current practices of recognizing major maintenance expense. We recommend that AcSEC permit entities to continue accruing planned major maintenance activities as a liability or to defer and amortize the expenditure over the period for which benefit is derived.

Issue 9: Paragraph 45 of the proposed SOP further prohibits, as an alternative accounting treatment, the "built-in overhaul" method for costs incurred for planned major maintenance activities. Should the costs of restoring PP&E's service potential, in addition to the cost of replacements that would be capitalizable under this proposed SOP, be eligible for capitalization? Do you believe that prohibiting the built-in overhaul method is appropriate, or should it be allowed as an alternative method? If you believe that the built-in overhaul method should continue to be allowed, what industries or entities should be allowed to use it, and why?

We do not believe that costs incurred to restore an asset to its original service potential should be capitalized. Regarding the built-in overhaul method, please refer to our response in Issue 8.

Use of Inventory in Production of Internal-Use PP&E

Issue 10: Paragraphs 47, 48, and A41 of the proposed SOP discuss the situation in which an entity owns an asset that it intended to sell as inventory but subsequently decided to retain for use in its own internal operations. Those paragraphs state that the entity should evaluate for impairment amounts included in PP&E that were previously capitalized as inventory but should not redetermine their carrying amount as PP&E using the guidance in the proposed SOP, unless the entity has a pattern of changing the intended use of assets from inventory to PP&E. Do you believe that guidance is appropriate, or should an entity be required to redetermine the carrying amount of PP&E assets previously capitalized as inventory, and why? Should AcSEC provide additional guidance on what kinds of changes in intended use constitute a "pattern," and why?

We diametrically oppose use of different carrying costs for assets held for sale versus used in an entity's operations as indicated in our letter. Permitting different carrying costs for similar assets creates a potential valuation problem that AcSEC attempted to address in paragraphs 47 and 48. We feel that the appropriate strategy is to remove inconsistency from the proposed SOP rather than create rules to prevent potential issues arising from its application.

PP&E-Type Assets Produced for Sale or Operating Lease

Issue 11: The proposed SOP requires an entity to accumulate costs differently for similar assets depending on whether the asset is sold outright or leased to a lessee under a sales-type lease (in either case, inventory cost accumulation rules would apply) or leased to a lessee under an operating lease (in which case, the cost accumulation provisions of the proposed SOP would apply). Do you agree with that conclusion and, if so, do you believe the proposed SOP should provide additional guidance on such cost accumulation? Or would it be preferable for a single cost accumulation model to apply during the production process and that there should be a presumption that the assets should be accounted for all as inventory or all as PP&E? If so, which presumption should be applied and why?

Similar to Issue 10 above, we do not support different cost accumulations for the same assets and prefer that AcSEC remove such inconsistencies from its proposal.

Component Accounting

Issue 12: Paragraphs 49 through 56 of the proposed SOP discuss component accounting and state that if a component has an expected useful life that differs from the expected useful life of the PP&E asset to which it relates, the component should be accounted for separately and depreciated or amortized over its separate expected useful life. Do you agree with this approach to accounting for PP&E? If not, what alternative would you propose and why?

As a capital-intensive business, we have employed component accounting of capital assets for many years. We are concerned that smaller entities lacking significant infrastructure may find the requirements of the proposed SOP arduous. We encourage AcSEC to evaluate incremental cost versus anticipated benefit before mandating component accounting for all businesses.

Issue 13: Paragraphs 38 and 51 of the proposed SOP state that when existing PP&E is replaced or otherwise removed from service and the replacement is capitalized, the net book value of the replaced PP&E should be charged to depreciation expense in the period of replacement. Do you agree with this approach? If not, what alternative would you propose and why?

We do not agree with the approach of charging net book value of replaced PP&E to depreciation expense. Depreciation is a systematic and rationale expense allocation procedure. Per CON6, paragraph 149, such expense allocations are "applied if causal relations are generally, but not specifically, identified. For example, wear and tear from use is known to be a major cause of the expense called depreciation, but the amount of depreciation caused by wear and tear in a period normally cannot be measured. Those expenses are not related directly to either specific revenues or particular periods. Usually no traceable relationship exists, and they are recognized by allocating costs to periods in which assets are expected to be used and are related only *indirectly* (emphasis added) to the revenues that are recognized in the same period."

We propose writing off the net book value of replaced PP&E to non-operating expense(Other Expense-Net), maintaining comparability of reporting at the operating expense level. Our rationale is that conceptually depreciation costs are only indirectly related to revenues recognized in the same period and the decision to replace or otherwise remove PP&E from service may be extraneous to business operations in the current period. Per paragraph 87 of CON6, "Revenues and expenses result from an entity's ongoing major or central operations and activities...In contrast, gains and losses result from incidental or peripheral transactions of an enterprise". Paragraph 88 of CON6 elaborates further by saying "Distinctions between revenues and gains and expenses and losses in a particular entity depend to a significant extent on the nature of the entity, its operations, and its other activities." Disposition or replacement of PP&E is truly incidental to the business of Eli Lilly and Company. Recognizing additional depreciation expense when PP&E is replaced or disposed of would inappropriately distort operating income comparisons.

Issue 14: The proposed SOP requires the use of component accounting to depreciate identified components over their respective expected useful lives. Entities have developed and utilized various conventions to depreciate assets, including group depreciation or use of composite lives. Those conventions are acceptable only if they result in approximately the same gross PP&E, depreciation expense, accumulated depreciation, and gains or losses on disposals of PP&E as the component

accounting method required by this proposed SOP. Do you agree with this approach? If not, what alternative would you propose and why?

As stated in our response to Issue 12, we are concerned that the costs of implementing component accounting will be unduly burdensome for many entities and that incremental improvement in financial reporting will not offset the incremental cost of applying the proposed SOP.

Amendments to Other Guidance

Issue 15: Paragraphs 61 and 63 of the proposed SOP list amendments to SOP 85-3, Accounting by Agricultural Producers and Agricultural Cooperatives, and the AICPA Audit and Accounting Guide Audits of Agricultural Producers and Agricultural Cooperatives, respectively. Do you agree with the proposed amendments?

Due to the nature of our business, we are unable to provide meaningful commentary on this issue.

Transition

Issue 16: Prescribed component accounting guidance should be initially adopted for existing PP&E using one of two alternatives, the election and disclosure of which should be made when the SOP is adopted. Do you agree with that approach and, if so, do you agree with the choice of the two alternatives from which the election is to be made? If you do not agree with that approach for existing PP&E, what approach would you propose and why?

We feel that the retroactive option provided by AcSEC would be a tremendous burden and few, if any, companies would elect to apply the proposed SOP retroactively. The requirements for retroactive adoption as detailed in paragraph 71(a) indicate that attempts to retroactively apply the proposed guidance would be difficult and yield little incremental benefit to financial reporting.

Issue 17: Allocation of existing net book value to components at transition should be based on (a) allocation of original accounting records, if available, (b) relative fair values of components at date of transition, if original accounting records are not available, or (c) another reasonable method, if relative fair value is not practicable. Do you agree that that ordering of allocation methods is appropriate? If you believe that a different order would be appropriate, what order would you propose and why? Should the proposed SOP provide additional examples to illustrate what constitutes "another reasonable method"?

As stated above, we strongly disagree with retroactive adoption of the proposed SOP for entities that previously did not practice component accounting for PP&E. Example 3 in

Appendix C of the proposed SOP clearly illustrates that retroactive adoption using the proposed methods is incredibly complex and burdensome.

Issue 18: Paragraph 72 of the proposed SOP states that the SOP should be applied prospectively for all costs incurred after the adoption of the SOP. It also states that costs incurred prior to the adoption of the proposed SOP should not be re-characterized (as capital or expense items) to conform to the guidance in the SOP, with the exception of certain costs of planned major maintenance activities. Do you agree with that approach? If you do not agree with that approach, what approach would you propose and why?

We are of the opinion that the proposed SOP should only be applied prospectively. As noted in our response to Issue 8, we are not in agreement with AcSEC's proposed treatment of planned major maintenance activities.

Issue 19: An entity applying component accounting retroactively at date of adoption may calculate a difference between the pre-adoption balance of accumulated depreciation and the balance recalculated based on the estimated useful lives of components that previously were not accounted for as separate components. Under that paragraph, the difference is allocated back to the accumulated depreciation of each component based on the net book values of the components. Two alternatives considered were recording the difference as a cumulative effect type adjustment at adoption and recording the difference as additional depreciation expense at adoption. Do you agree with the proposed approach or either of the alternatives, and why?

While we do not support component accounting for all business entities nor retroactive adoption of the proposed SOP, we feel that the best alternative for recording the difference identified using retroactive adoption would be recording the difference as a cumulative effect at adoption. Our rationale is that the differences identified as a result of implementing the proposed SOP are due to a change in GAAP. Recording the change as additional depreciation expense only creates financial statement comparability issues.

Mr. Marc Simon
Technical Manager, Accounting Standards
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Mr. Simon:

As Chief Financial Officer of the United States Postal Service, I would like to comment on your recent exposure draft concerning Accounting for Certain Costs and Activities Related to Property, Plant and Equipment. Specifically, please refer to paragraphs 49 through 56 that discuss component accounting.

The Postal Service has one of the nation's largest inventories of property, plant, and equipment (PP&E). As of September 30, 2001, the Postal Service owned over 8,300 buildings with a cost of $18.2 billion and had PP&E with a cost of $38 billion and a net book value of $23 billion. I believe converting to component accounting would significantly expand the record-keeping and accounting effort associated with accounting for PP&E without adding any real or tangible value or cost benefit. Additionally we would incur significant costs to employ component accounting, which would far outweigh any benefits of a more precise depreciation accounting. Let me give you an example.

A building that was acquired for $1,000,000 could be broken down into components and assigned the estimated useful lives as illustrated in the following table:

Component	Book Value	Useful Life	Annual Depreciation
Roof	$200,000	30	$6,667
Elevator System	100,000	25	4,000
Security System	20,000	10	2,000
Building Shell	400,000	50	8,000
HVAC	280,000	25	11,200
Total	**$1,000,000**		**$25,267**

Under our present system, the $1,000,000 building would be depreciated over a 40-year useful life, and the annual depreciation would be $25,000. This is $267 or 1.1 percent less than the component method, a level of precision that is unnecessary. Depreciation itself is an estimate of the useful life of an asset.

In summary, I do not believe that estimating the life of the components of the asset as opposed to the asset as a whole will give postal management and other key stakeholders a better decision-making tool. I am, however, convinced that it would add significant costs and record keeping burdens that are unwarranted. Therefore, I respectfully ask that this proposed Statement of Position be rejected.

Sincerely,

Richard J. Strasser, Jr.

Microsoft Corporation
One Microsoft Way
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November 15, 2001

Mr. Marc Simon
Technical Manager, Accounting Standards
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Re: File 4210.CC

Dear Marc:

Microsoft appreciates the opportunity to comment on the Exposure Draft of the proposed Statement of Position (SOP), "Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment". We are opposed to the requirement for component accounting and are quite surprised by the lack of a meaningful cost/benefit analysis of this requirement in the Basis for Conclusions of the proposed SOP. In fact, except for retroactive application in transition, we can't find any discussion in the proposed SOP of the potential costs companies will incur because of this requirement.

Paragraph A44 of the Basis for Conclusions indicates that, "AcSEC chose component accounting rather than the composite method for a number of reasons", and lists six of those reasons (a. – f.). To us, five of those reasons (a. – d. and f.) are, in essence, the same reason, that component accounting more precisely allocates the cost of PP&E to the periods benefited by that PP&E. Furthermore, we totally reject the other reason (e.) which indicates that, "Control over PP&E may be reduced because detailed records may not be used". We trust that most companies have adequate internal control procedures over their assets and that it would not take an accounting rule such as this to safeguard certain assets. Being quite facetious and using the disclosure example in Appendix D of the proposed SOP, we can't recall the last time we heard of someone walking off with a roof, HVAC system, elevator, or building shell.

Assuming that a company accurately assigns estimated useful lives to the components of a property unit (and this is a big assumption given that estimates are being used), Microsoft agrees that component accounting more precisely allocates the cost of PP&E to the periods benefited by that PP&E. However, the critical question is whether the cost of producing this level of precision is justified. Furthermore, the guidance in paragraph A48 of the Basis for Conclusions of the proposed SOP which indicates that, "To the extent that an entity can demonstrate that those conventions [group depreciation/composite

lives] can be used and produce results . . . that are not materially different from those obtained under the component accounting prescribed in . . . this SOP, such practices are not precluded", is not helpful. There is other accounting literature with similar type wording and it seems that to prove to certain external parties that two different conventions produce results that are not materially different, companies are required to actually perform the two calculations.

Even if a company maintains certain component depreciation information for tax purposes, we still believe there would be significant costs involved in order to use this information for financial reporting purposes. Looking at the critical question of whether the cost of producing the level of precision called for by the proposed SOP is justified, Microsoft does not believe it is even close in most circumstances. In our opinion, what little increased precision that may be achieved by requiring component depreciation is greatly outweighed by the cost companies would incur in implementing such an accounting requirement. However, while we believe component depreciation should not be required, companies should be allowed to use this method if they believe the resulting precision is worth the cost of depreciating PP&E in this manner. For instance, a company that incurs planned major maintenance activities may chose component depreciation because that method more precisely captures periodic depreciation expense and the company believes that the benefits of that precision outweighs the cost to track and produce that information.

Microsoft does agree with the project stage framework in the proposed SOP and has found similar guidance in SOP 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use,* to be useful. However, we would ask that AcSEC provide a little more guidance on what is meant by the term "specific PP&E" as it relates to the distinction between the preliminary stage and the preacquisition stage. For example, we believe architectural design costs related to a building when construction is considered probable should be capitalized, even though a specific site for construction has not been chosen.

Our responses to the specific issues raised in the ED are attached. If you have any questions, please contact me at (425) 703-6094.

Sincerely,

Bob Laux
Director, External Reporting

Scope

Issue 1: Paragraph 10 of the proposed SOP states that the SOP does not provide specific guidance on lessor or lessee accounting for reimbursements of costs incurred by a lessor that are directly recoverable from lessees under the terms of one or more leases, and that the lessor and lessee should refer to FASB Statement No. 13, Accounting for Leases, and related lease accounting literature for guidance on accounting for such reimbursements. In many instances, depending on the terms of the lease, those reimbursements may constitute minimum lease payments or contingent rentals under FASB Statement No. 13. As discussed in paragraph A2 of the proposed SOP, AcSEC elected not to address the accounting for such transactions in this SOP because AcSEC did not want to create conflicts with existing lease accounting guidance and AcSEC did not believe it was appropriate to address the accounting under all of the various reimbursement scenarios and arrangement structures within the scope of this SOP. Are there significant practice issues or concerns related to the accounting for contractually recoverable expenditures that should be addressed in the proposed SOP? Do you believe that there are other areas addressed in the proposed SOP that, with respect to their application to lessors and lessees of PP&E, could create conflicts with existing lease accounting standards?

Response: We are not aware of any significant practice issues or concerns related to the accounting for contractually recoverable expenditures, nor are we aware of other areas addressed in the proposed SOP that would create conflicts with existing lease accounting standards.

Project Stage Framework

Issue 2: The guidance in this proposed SOP is presented in terms of a project stage or time line framework and on the basis of the kinds of activities performed during the stages defined in the proposed SOP rather than on whether an expenditure fits into certain classification categories such as ordinary repairs and maintenance, extraordinary" repairs and maintenance, replacements, betterments, additions, redevelopments, renovations, rehabilitations, retrofits, rearrangements, refurbishments, and reinstallations. Do you agree with that approach? If not, what alternative would you propose and why?

Response: Yes. Microsoft has found similar guidance in SOP 98-1 to be useful.

Issue 3: Paragraph 16 of the proposed SOP states that the preliminary stage ends and the preacquisition stage begins when the acquisition of specific property, plant, and equipment (PP&E) is considered probable. Paragraph 22 of the proposed SOP states that, other than the costs of options to acquire PP&E, all costs incurred during the preliminary stage should be charged to expense as incurred. Do you agree with that conclusion? If not, how would you propose to modify the guidance and why?

Response: Yes. While it produces a good theoretical debate of whether there are other costs incurred during the preliminary stage that result in probable future economic benefits, we believe AcSEC has made the correct conclusion. Microsoft believes that if the costs to acquire options were required to be expensed as incurred, the representational faithfulness of financial reporting would be compromised. For example, it is not uncommon for a company to sell or assign an option to acquire PP&E in a structured lease transaction. If the option was required to be expensed when incurred, the strange financial reporting result of recognizing an expense upon purchase, recognizing a gain on the transfer of the option, and then recognizing the option expense over time in the form of higher lease expense would occur. However, we would ask that AcSEC provide a little more guidance on what is meant by the term "specific PP&E" as it relates to the distinction between the preliminary stage and the preacquisition stage. For instance, we believe architectural design costs related to a building when construction is considered probable should be capitalized, even though a specific site for construction has not been chosen.

Accounting for Costs Incurred

Issue 4: The proposed SOP states that PP&E-related costs incurred during the preacquisition, acquisition-or-construction, and in-service stages should be charged to expense unless the costs are directly identifiable with the specific PP&E. Directly identifiable costs include only (a) incremental direct costs incurred with independent third parties for the specific PP&E, (b) employee payroll and payroll benefit-related costs related to time spent on specified activities performed by the entity during those stages, (c) depreciation of machinery and equipment used directly in the construction or installation of PP&E and incremental costs directly associated with the utilization of that machinery and equipment during the acquisition-or-construction stage, and (d) inventory (including spare parts) used directly in the construction or installation of PP&E. All general and administrative and overhead costs incurred, including all costs of support functions, should be charged to expense. See paragraphs 24, 25, 29, and 30. Do you agree with those conclusions? If not, what alternatives would you propose and why?

Response: It is difficult to look at the existing accounting literature as a guide for addressing this issue since the existing literature is mixed on this point. However, we do not agree with paragraph A11 of the Basis for Conclusions which seems to suggest that AcSEC's conclusion is based, in part, on how long it has been since some of the existing literature was issued. As an alternative, Microsoft proposes that incremental direct costs incurred with non-independent third parties for specific PP&E should also be included in directly identifiable costs. We believe that the definition of incremental direct cost provided in the proposed SOP (costs of a PP&E project that would not be incurred but for that project) provides a good framework for this alternative approach. Under this alternative, we do not believe it would be necessary to try to define what is a "support function". For instance, we struggle with Example 8 in Appendix C which seems to indicate that the CEO is a support function. While we totally disagree with that characterization, under the alternative we propose, we still would not capitalize 15

percent of the CEO's payroll and payroll benefits in the example, since it seems hard to argue that those costs would not be incurred but for that project.

Issue 5: Paragraph 32 of the proposed SOP states that for real estate that is not being used in operations, costs of property taxes, insurance, and ground rentals should be capitalized, to the extent of the portion of the property that is under development, during the time that activities that are necessary to get the asset ready for its intended use are in progress. Do you agree with that conclusion? If not, what alternative would you propose and why?

Response: While, in certain circumstances, the accounting outcome may be the same, we do not agree with AcSEC introducing yet another concept/model ("avoidable costs") which is only applicable under certain facts and circumstances. Consistent with our suggestion above, Microsoft believes that the costs of property taxes, insurance, and ground rentals should be capitalized if those costs would not have been incurred but for the PP&E project.

Issue 6: Paragraph 37 of the proposed SOP states that the costs of normal, recurring, or periodic repairs and maintenance activities should be charged to expense as incurred. It also states that all other costs related to PP&E that are incurred during the in-service stage should be charged to expense as incurred unless the costs are incurred for (a) the acquisition of additional PP&E or components or (b) the replacement of existing PP&E or components of PP&E. Do you agree with those conclusions? If not, what alternatives would you propose and why?

Response: Partially. However, we are quite confused on what AcSEC's reasoning is in paragraph A31 of the Basis for Conclusions. The paragraph starts out by indicating that, "AcSEC considered extensions of expected useful life as a capitalization criterion", but, in our opinion, no substantive explanation is provided on why this alternative was rejected. The next sentence indicates that, "However, AcSEC believes that the determination of an expected useful life of a PP&E asset is based on a presumption that an entity will perform normal, ongoing or periodic required maintenance activities on that asset over its life." We agree with that statement, when estimating the expected useful life of a PP&E asset, normal, ongoing or periodic required maintenance activities should be taken into account. The next sentence indicates that, "As such, AcSEC concluded that costs incurred to restore PP&E to its original operating condition do not provide a future benefit but rather remedy the effects of having used the PP&E in the past and allow the PP&E to continue in use through its full expected useful life." Again, we agree with that statement, but still can't find an explanation of why AcSEC rejected the alternative of capitalizing costs that extend the expected useful life of a PP&E asset. Microsoft believes that costs which either extend the expected useful life of a PP&E asset (given that the existing expected useful life takes into account normal, ongoing or periodic maintenance activities) or improve upon a PP&E's original operating condition, should be capitalized.

Issue 7: Paragraph 39 of the proposed SOP states that costs of removal, except for certain limited situation demolition costs, should be charged to expense as incurred. Do you agree with that conclusion? If not, what alternative would you propose and why?

Response: Yes, we agree with that conclusion.

Issue 8: Paragraph 44 of the proposed SOP states that the total of costs incurred for planned major maintenance activities does not represent a separate PP&E asset or component. It states that certain of those costs should be capitalized if they represent acquisitions or replacements and that all other costs should be charged to expense as incurred. Paragraph 45 prohibits alternative accounting treatments including—(a) the accrual of a liability for the estimated costs of a planned major maintenance activity prior to their being incurred, and (b) the deferral and amortization of the entire cost of the activity. Do you agree with those conclusions? If not, what alternatives would you propose and why?

Response: As stated above, Microsoft believes the guidance can be straightforward and simple by just stating that costs should be expensed as incurred unless they extend the useful life of a PP&E asset or improve upon a PP&E asset's original operating condition. When estimating expected useful life, normal, ongoing or periodic maintenance activities should be taken into account.

Issue 9: Paragraph 45 of the proposed SOP further prohibits, as an alternative accounting treatment, the "built-in overhaul" method for costs incurred for planned major maintenance activities. Under that method, additional depreciation expense is recognized currently to give effect to the decline in service potential that is subsequently restored once the major maintenance activity occurs. When the major maintenance activity occurs, its cost is considered capitalizable. In lieu of the built-in overhaul method, AcSEC concluded that better cost allocation would result from the use of component accounting and limiting the major maintenance activities that would be capitalizable to costs that represent replacements of components of PP&E. Should the costs of restoring PP&E's service potential, in addition to the cost of replacements that would be capitalizable under this proposed SOP, be eligible for capitalization? Do you believe that prohibiting the built-in overhaul method is appropriate, or should it be allowed as an alternative method? If you believe that the built-in overhaul method should continue to be allowed, what industries or entities should be allowed to use it, and why?

Response: We agree that the costs of restoring PP&E's service potential should be expensed as incurred and that the built-in overhaul method should not be allowed.

Use of Inventory in Production of Internal-Use PP&E

Issue 10: Paragraphs 47, 48, and A41 of the proposed SOP discuss the situation in which an entity owns an asset that it intended to sell as inventory but subsequently

decided to retain for use in its own internal operations. Those paragraphs state that the entity should evaluate for impairment amounts included in PP&E that were previously capitalized as inventory but should not redetermine their carrying amount as PP&E using the guidance in the proposed SOP, unless the entity has a pattern of changing the intended use of assets from inventory to PP&E. Do you believe that guidance is appropriate, or should an entity be required to redetermine the carrying amount of PP&E assets previously capitalized as inventory, and why? Should AcSEC provide additional guidance on what kinds of changes in intended use constitute a "pattern," and why?

Response: Microsoft believes the guidance is appropriate and an entity should not be required to redetermine the carrying amount of PP&E assets previously capitalized as inventory. Also, AcSEC should leave it to a company, its auditors, and if necessary, the auditing literature, to determine what kinds of changes in intended use constitutes a "pattern".

PP&E-Type Assets Produced for Sale or Operating Lease

Issue 11: The proposed SOP requires assets that are produced by an entity to be leased to a lessee under an operating lease to be accounted for under the provisions of this SOP. As discussed in paragraph A43 of the proposed SOP, AcSEC recognizes that some entities routinely construct or manufacture products, some of which are sold directly and some of which are leased to lessees under sales-type leases whereas others are leased to lessees under operating leases. In some situations, the entity does not know the form the transaction will take until it occurs, and the customer decides whether its acquisition of product will be accomplished through purchase or lease. The proposed SOP requires an entity to accumulate costs differently for similar assets depending on whether the asset is sold outright or leased to a lessee under a sales-type lease (in either case, inventory cost accumulation rules would apply) or leased to a lessee under an operating lease (in which case, the cost accumulation provisions of the proposed SOP would apply). Do you agree with that conclusion and, if so, do you believe the proposed SOP should provide additional guidance on such cost accumulation? Or would it be preferable for a single cost accumulation model to apply during the production process and that there should be a presumption that the assets should be accounted for all as inventory or all as PP&E? If so, which presumption should be applied and why?

Response: We do not agree with AcSEC's conclusion and believe a single cost accumulation model should be used for specific PP&E, based on what is most likely to occur (sale, including a sales-type lease, or operating lease). If a portfolio of individual PP&E projects is being evaluated, an estimate of the percentage that is expected to be sold, including sales-type leases, versus the percentage that is expected to be under operating leases should be made, with cost accumulation based on those percentages. With respect to paragraph A43 in the Basis for Conclusions, while it indicates that an entity should accumulate costs differently, it doesn't seem to give any indication of how to actually account for the costs during the period of uncertainty or what to do at the time

that uncertainty is resolved. Furthermore, while we disagree with AcSEC's conclusion, if AcSEC retains this guidance, it should be included in the SOP's Conclusions, not in the Basis for Conclusions.

Component Accounting

Issue 12: Paragraphs 49 through 56 of the proposed SOP discuss component accounting and state that if a component has an expected useful life that differs from the expected useful life of the PP&E asset to which it relates, the component should be accounted for separately and depreciated or amortized over its separate expected useful life. Do you agree with this approach to accounting for PP&E? If not, what alternative would you propose and why?

Response: No. Microsoft is opposed to the requirement for component accounting and does not believe AcSEC has provided a convincing argument of how the cost of producing the potential level of precision under component accounting is justified. In fact, we do not believe the cost/benefit test is even close in most circumstances. In our opinion, what little increased precision that may be achieved by requiring component depreciation is greatly outweighed by the cost companies would incur in implementing such an accounting requirement. However, while we believe component depreciation should not be required, companies should be allowed to use this method if they believe the resulting precision is worth the cost of depreciating PP&E in this manner. For instance, a company that incurs planned major maintenance activities may chose component depreciation because that method more precisely captures periodic depreciation expense and the company believes that the benefits of that precision outweighs the cost to track and produce that information.

Issue 13: Paragraphs 38 and 51 of the proposed SOP state that when existing PP&E is replaced or otherwise removed from service and the replacement is capitalized, the net book value of the replaced PP&E should be charged to depreciation expense in the period of replacement. Do you agree with this approach? If not, what alternative would you propose and why?

Response: It seems more logical to us that the net book value of replaced PP&E should be shown as a loss on disposal rather than depreciation expense.

Issue 14: The proposed SOP requires the use of component accounting to depreciate identified components over their respective expected useful lives. As noted in paragraph A48 of the proposed SOP, entities have developed and utilized various conventions to depreciate assets, including group depreciation or use of composite lives. Those conventions are acceptable only if they result in approximately the same gross PP&E, depreciation expense, accumulated depreciation, and gains or losses on disposals of PP&E as the component accounting method required by this proposed SOP. Do you agree with this approach? If not, what alternative would you propose and why?

Response: No. The guidance in paragraph A48 of the Basis for Conclusions of the proposed SOP is not helpful. There is other accounting literature with similar type wording and it seems that to prove to certain external parties that two different conventions produce results that are not materially different, companies are required to

actually perform the two calculations. As stated previously, while we believe component depreciation should not be required, companies should be allowed to use this method if they believe the resulting precision is worth the cost of depreciating PP&E in this manner.

Amendments to Other Guidance

Issue 15: Paragraphs 61 and 63 of the proposed SOP list amendments to SOP 85-3, Accounting by Agricultural Producers and Agricultural Cooperatives, and the AICPA Audit and Accounting Guide Audits of Agricultural Producers and Agricultural Cooperatives, respectively. Do you agree with the proposed amendments? Do you believe that there are unique aspects of agricultural accounting, such as the accounting for breeding and production animals and the accounting for plants and vines, that should not be amended by the proposed SOP, and why?

Response: We do not have the expertise to comment on this issue.

Transition

Issue 16: Paragraph 71 of the proposed SOP states that the prescribed component accounting guidance should be initially adopted for existing PP&E using one of two alternatives, the election and disclosure of which should be made when the SOP is adopted. Do you agree with that approach and, if so, do you agree with the choice of the two alternatives from which the election is to be made? If you do not agree with that approach for existing PP&E, what approach would you propose and why?

Response: For those entities that elect to change to component depreciation, we agree that either retroactive or prospective transition should be allowed.

Issue 17: Under paragraph 71(a) of the proposed SOP, the allocation of existing net book value to components at transition should be based on (a) allocation of original accounting records, if available, (b) relative fair values of components at date of transition, if original accounting records are not available, or (c) another reasonable method, if relative fair value is not practicable. Do you agree that that ordering of allocation methods is appropriate? If you believe that a different order would be appropriate, what order would you propose and why? Should the proposed SOP provide additional examples to illustrate what constitutes "another reasonable method"?

Response: Microsoft agrees with the ordering of allocation methods and does not believe it is necessary for the proposed SOP to provide additional examples to illustrate what constitutes another reasonable method.

Issue 18: Paragraph 72 of the proposed SOP states that the SOP should be applied prospectively for all costs incurred after the adoption of the SOP. It also states that costs incurred prior to the adoption of the proposed SOP should not be re-characterized (as

capital or expense items) to conform to the guidance in the SOP, with the exception of certain costs of planned major maintenance activities. Do you agree with that approach? If you do not agree with that approach, what approach would you propose and why?

Response: We believe companies should have an option to adopt the guidance for costs of planned major maintenance activities on either a retroactive or prospective basis.

Issue 19: Under paragraph 71(a) of the proposed SOP, and as illustrated in Example 3 in appendix C, an entity applying component accounting retroactively at date of adoption may calculate a difference between the pre-adoption balance of accumulated depreciation and the balance recalculated based on the estimated useful lives of components that previously were not accounted for as separate components. Under that paragraph, the difference is allocated back to the accumulated depreciation of each component based on the net book values of the components. Two alternatives considered were recording the difference as a cumulative effect type adjustment at adoption and recording the difference as additional depreciation expense at adoption. Do you agree with the proposed approach or either of the alternatives, and why?

Response: In order to correctly reflect adoption on a retroactive basis, we believe the difference should be recorded as a cumulative effect type adjustment.

WPS Resources Corporation
700 North Adams Street
P.O. Box 19001
Green Bay, WI 54307-9001

November 19, 2001

Mr. Mark Simon
Technical Manager, Accounting Standards
File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Mr. Simon:

WPS Resources Corporation (WPSR) is pleased to offer comments concerning the Exposure Draft of Proposed Statement of Position, "Accounting for Certain Costs and Activities Related to Property, Plant and Equipment." WPSR is a utility holding company based in Green Bay, Wisconsin. WPSR is comprised of two regulated utility companies, Wisconsin Public Service Corporation and Upper Peninsula Power Company, and two major non-regulated energy companies, WPS Energy Services, Inc. and WPS Power Development, Inc.

WPSR would like to state its agreement with the comments submitted by the American Gas Association and the Edison Electric Institute. Both describe well the difficulties regulated utilities would face with the proposed SOP. Specifically, the component accounting requirement would result in significant changes to our regulated utilities.

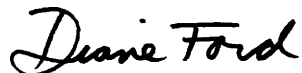
Currently, our regulated utilities use mass property accounting, where assets with similar characteristics are grouped together and depreciated based on group rates. These group rates of depreciation are derived from statistically-based book depreciation studies that identify average service lives, retirement dispersion, and net salvage and test the adequacy of the accumulated depreciation reserve. We feel that this method of depreciation closely matches the productive capabilities of our assets and results in depreciation that is not materially different from that proposed by the SOP.

Additionally, we want to emphasize the significant amount of record keeping that will result from having to implant the component method of depreciation. Our regulated utilities will be forced to keep two sets of books, one for regulatory purposes and one for GAAP purposes. But with the use of regulatory assets and liabilities the results will be similar. Even though the financial statements will have the same final outcome, financial statement users will be more confused by the additional regulatory assets and liabilities.

Furthermore, the proposed SOP provides for the use of alternative methods of depreciation, but only if the result is not materially different from that provided by the use of the component method. While the SOP acknowledges that other methods of depreciation are acceptable, the required test involves the application of component accounting to establish a benchmark. The substantial amount of effort required in establishing the benchmark (i.e. applying component accounting) discourages the use of any alternative method. Assuming the test would have to be performed on a regular basis, the required effort would multiply and strongly discourage the use of alternative methods.

For the above reasons, WPSR agrees with the American Gas Association and Edison Electric Institute when they request that regulated entities be excluded from component accounting as it is proposed in the SOP. Finally, we would like to emphasize our agreement with the other comments made by the American Gas Association and Edison Electric Institute.

Sincerely,



Diane L. Ford
Vice President-Controller

THE ROUSE COMPANY

November 12, 2001

Mr. Marc Simon
Technical Manager, Accounting Standards
File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

RE: Proposed Statement of Position: *Accounting for Certain Costs and Activities Related to Property, Plant and Equipment*

Dear Mr. Simon:

The Rouse Company is pleased to respond to the proposed Statement of Position (SOP) referred to above. The Rouse Company has been a public company for over 40 years and has been active with and supportive of the AICPA and other organizations in efforts to improve the quality of public financial reporting by real estate companies. The Rouse Company has been instrumental in developing financial reporting that we believe appropriately reflects the economics of owning and operating real estate assets for the long term. As one of the then few public real estate companies, the Company began presenting an alternative benchmark for operating performance as early as 1963 which evolved to Earnings Before Depreciation and Deferred Taxes in the late eighties, a predecessor to Funds From Operations (FFO) used today. Additionally, in the mid seventies, we began including current value basis financial statements in our annual reports to provide users with needed information regarding the value of our real estate assets and the changes therein. This information, which we believed necessary at the time to understand the economics of our real estate business, was otherwise not provided as part of the financial statements prepared in accordance with generally accepted accounting principles. We recognized then, and still believe strongly today, that clear, concise, and relevant financial information is critical to users of financial statements and vital to the long-term capital strategy of the Company. We believe the real estate business is particularly complex and in need of helpful disclosure for the investing public. Accordingly, we will continue to be active in and supportive of the development of accounting and reporting standards that enhance understanding of the economics of the real estate business.

10275 Little Patuxent Parkway Columbia, Maryland 21044-3456

We recognize that the current accounting guidance related to property, plant and equipment (PP&E) could be improved, and we support new guidance that would reduce the inconsistent treatment of costs, improve comparability and achieve greater transparency in financial reporting for the industry. However, we have serious concerns about whether the proposed SOP will deliver these results, including the following:

- The "probability" guidance proposed in the project stage framework will not solve the perceived diversity in practice in accounting for development project costs, as the probability standard is difficult to make operational and apply consistently.

- We don't consider the direct costing method to be a better alternative to a sophisticated, project-specific full cost allocation system, and we don't see the need to dictate a different accounting treatment for assets to be held for use and assets to be sold.

- With the degree of componentization and the determinations of useful lives and related salvage values ascribed to the components being left to each company's interpretation and judgment, we don't see how the proposed SOP will improve clarity and consistency of financial reporting.

- We don't believe the component method, for all practical purposes, should be considered the only alternative for depreciating long-lived assets. We believe a well-constructed composite life or group method of depreciation should still be acceptable.

Overall, we do not understand how the proposed SOP achieves greater clarity in financial reporting. We believe the SOP focuses on accounting for the elements comprising fixed assets and not on the business of owning and operating real estate assets for the long term. We believe this is a clear example of "treating the disease and not the patient." Generally accepted accounting principles used in the United States continue to lag those used by other countries in recognizing that real estate assets generally appreciate in value rather than depreciate. We believe this SOP not only widens this gap but moves in a direction totally contrary to these global standards.

Specific areas of concern that we believe warrant additional consideration are summarized below:

- Capitalization of overhead, general and administrative costs

  The requirement to expense overhead, general and administrative costs for development projects to be held and used is inconsistent with the accounting guidance for many other industries that produce products. We don't understand the need to differentiate the development of a real estate project from the production of a "widget" as it relates to the types of costs eligible for capitalization during the development process. This requirement is also contrary to the costs we use to measure and evaluate development opportunities. We believe this inconsistency will cause confusion rather than clarity for investors and place the real estate industry at a substantial disadvantage in the capital markets.

- Component Accounting

  We believe the proposals related to component accounting and depreciation are onerous and impracticable to apply in a cost-justifiable manner. We have provided several realistic and practical examples in Attachment 2 illustrating our point. We also have included some alternative proposals that would be effective in accomplishing the objectives of the SOP and more practical to apply.

  We believe a 1903 quote from The Accountant still applies today, "The question of depreciation is one upon which so many articles have been written and so many opinions expressed that there would not appear to be much more which could profitably be said on the subject."

- Definition of an asset and matching principle

  The proposal suggests that the definition of an asset, as set forth in FASB's Concept Statement No. 6, *Elements of Financial Statements,* is no longer applicable to certain expenditures made by a real estate company and that the importance of matching principle has been greatly diminished. We believe this proposed treatment, once again, puts the real estate industry at a disadvantage in the capital markets and doesn't achieve the objective of clarity in financial reporting.

The attachments to this letter are organized as follows:

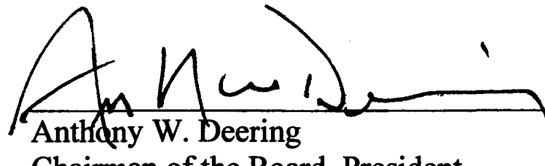
- Attachment 1 includes comments to the specific issues identified by the SOP. Areas requiring specific attention are noted as such.

- Attachment 2 includes realistic examples demonstrating the difficulty companies in our industry will have in applying component accounting.

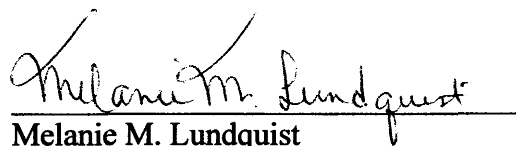
- Attachment 3 includes examples of alternative accounting proposals included in our responses to specific comments.

As one of the real estate companies with the longest public reporting history, we appreciate the opportunity to comment on this proposal. We would welcome the opportunity to further discuss these comments with you personally and are always available to answer questions or clarify our responses. Please don't hesitate to contact Melanie at (410) 992-6364.

Very truly yours,



Anthony W. Deering
Chairman of the Board, President
and Chief Executive Officer



Melanie M. Lundquist
Vice President and Corporate Controller

Comments on Specific Issues **Attachment 1**

Issue 1. Recoverable Cost

We believe that this matter should be addressed outside the scope of the SOP.

Issues 2. – 3. Project Stage Framework

The Basis for Conclusions Appendix of the SOP indicates that "AcSEC concluded that the guidance would be more operational if capitalization criteria were based on the kinds of activities performed and kinds of costs incurred rather than on whether a particular expenditure fits into one of a large number of classification categories." We agree with this position. Unfortunately, the SOP proposes the use of a timeline and probability of acquisition approach to capitalization rather than an approach based on the type of cost and activity. The specific types of costs and activities cited in paragraph 17 of the SOP as common in the preliminary stage are often incurred in the preacquisition, acquisition or construction stage.

The timeline/probability approach put forth in the SOP may require that costs for similar or identical activities be accounted for differently based on when they are incurred and/or on a highly subjective evaluation of probability as defined by SFAS No. 5. We do not believe this is appropriate. Instead, we believe that, in the case of investment real estate projects, obtaining land control by option, lease or purchase should be the triggering event for capitalization. We believe this position is consistent with the definition and characteristics of assets in FASB Concept Statement No. 6, paragraphs 25 through 33.

In certain areas of the country, barriers to entry for large commercial real estate projects are very high. It is often these same high barriers to entry that enhance the value of a project. Assessing probability of acquisition in these cases can be very difficult, particularly as obtaining favorable zoning decisions and development rights can take years and significant effort and cost. Developers are generally willing to ultimately increase the cost of successful efforts by entering into option arrangements to mitigate the risk of failing to overcome these barriers. We believe that the costs to overcome these barriers to entry enhance the value of the underlying land and that they should qualify as development costs and be capitalized after land control is obtained.

We believe that the SOP's reliance on probability of acquisition as a trigger for cost capitalization will be applied with a great deal of subjectivity and inconsistency in the interpretation and assessment of "probable." We believe

the probability framework will lead to more diversity in practice in the capitalization of costs. Further, we believe that the inconsistencies and problems inherent in assessing probability of acquisition could be overcome if costs of specific projects incurred subsequent to obtaining land control were capitalized and regularly assessed for impairment. The acquisition of an option represents an asset, as proposed by the SOP, and we believe that the value of the underlying land is increased as zoning and entitlements are pursued and obtained. The FASB has indicated in its impairment discussions that it believes assets under development are similar to assets held for use. Accordingly, we believe that an impairment test using either expected cash flows or "best estimate" cash flows should be performed on carrying values of all costs incurred subsequent to acquiring the land option, regardless of when they are incurred in the project timeline. Under the expected cash flows methodology, the net carrying value of a proposed project would decline as its successful completion becomes less certain. Using the alternative approach, all costs incurred in the acquisition and development of a successful project would be reflected in its carrying value, allowing the financial statement user to evaluate such important capital allocation measures as return on cost and return on equity. This approach also has the benefit of an alignment with impairment guidance already in use. We have included an example of our proposed approach in Attachment 3.

Issue 4. Expensing of Indirect Costs

We believe this area requires further consideration. We do not agree with the conclusions related to expensing general, administrative and overhead costs. We support the guidance in ARB No. 43 Paragraph 5, Chapter 4 and SFAS No. 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects*, that provides for the inclusion of these costs to the extent they clearly relate to the asset. We believe that real estate companies should be allowed to include general, administrative and overhead costs as a cost of their projects consistent with the costing methodologies utilized by manufacturing concerns. They meet the criteria of being direct and incremental as they would be eliminated if development efforts ceased. We do not see the need to dictate a different accounting treatment for assets to be held for use and assets to be sold. In fact, these costs are included in evaluating the economics of real estate projects. Thus, the accounting treatment would be symmetrical with the economic evaluations.

The Company has a long-standing history of successfully developing projects for its own use. Over the years, we have created a sophisticated cost accounting system that is used to budget, monitor and forecast development project costs and allocate costs, including general, administrative and

overhead costs, to specific projects. One element of this system is an extensive "effort reporting system" that captures hours worked on specific projects by employees as part of the payroll process. The costs capitalized to projects are based on a rate specific to each individual and the number of hours worked on that specific project. The rates used for each individual include general, administrative and overhead costs allocable to the individual. We believe this is a rational and systematic approach for ascribing costs directly related to specific projects and is not based on general allocations of costs.

The financing structure for real estate projects also supports the Company's position that project specific general, administrative and overhead costs should be capitalized as project costs. Funding for these projects is typically provided through a combination of joint venture partner capital contributions and bank construction financing. The level of detail that the Company maintains regarding these project specific cost allocations is consistent with what is typically required by partners and lenders. With appropriate support, these costs are recognized as project costs and are funded through the proceeds of construction financing or partner contributions. Thus, both of these constituencies recognize general, administrative and overhead costs as valid project costs.

In addition, we believe it is not appropriate to proscribe capitalization of costs based merely on the title of the employee. Certain members of executive management may be directly responsible for managing development projects. Capitalization of costs should be dictated by job responsibilities rather than job title.

We believe that recognizing general, administrative and overhead costs as project costs is supported by Concepts Statement No. 6, *Elements of Financial Statements,* which states that "Accrual accounting uses accrual, deferral, and allocation procedures whose goal is to relate revenues, expenses, gains, and losses to periods to reflect an entity's performance during a period instead of merely listing its cash receipts and outlays." Concepts Statement No. 6 further states "Matching of costs and revenues is simultaneous or combined recognition of the revenues and expenses that result directly in and jointly from the same transactions or other events." Real estate projects are long-term investments. We believe that it is appropriate to capitalize the full costs of the projects, including applicable general, administrative and overhead costs, and match them with the revenues generated over the period of expected benefit.

Issue 5. Capitalization of property taxes, insurance and ground rents

We concur strongly with the conclusions that these costs should be capitalized during the period that an asset is under development and that such treatment is consistent with the conclusions set forth in SFAS No. 34, *Capitalization of Interest Cost* (SFAS No. 34).

However, we disagree that … "Capitalization of costs incurred for property taxes, insurance, and ground rents should cease if the building or structure is substantially complete and ready for its intended use but no later than the date initial operations commence in any portion of the building or structure." We believe it is inappropriate to expense all tax and insurance costs for a real estate project on the basis of one tenant commencing operation. For example, if a developer constructs a ten story office building and a tenant commences operations on the top two floors while tenant improvements and finishes are under construction on the remaining floors, we believe that capitalization of taxes and insurance related to the unoccupied floors is appropriate. We believe that this SOP should follow the guidance in Paragraph 18 of SFAS No. 34. Using this guidance as a model, capitalization of taxes and insurance would continue to the extent part of an asset is not complete.

Issue 6. Normal, recurring and periodic maintenance

Our response to this issue is addressed in our response to Issues 12 –13.

Issue 7. Demolition and Removal Costs

We strongly agree that demolition costs associated with the acquisition of real estate should be capitalized. However, we do not agree that these costs should be expensed if not contemplated at acquisition. The economic rationale supporting the capitalization of demolition costs in an acquisition scenario is equally valid when applied to a re-development effort, as demolition of an existing structure to allow redevelopment enhances the fair value of the underlying land.

We propose the alternative provided under SFAS No. 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects,* Paragraph 15. This paragraph outlines the accounting treatment for a real estate asset when there is a change in use that arises after significant development and construction costs have been incurred. Under this accounting standard, "If the change in use is made pursuant to a formal plan for a project that is expected to produce a higher economic yield, the costs to be charged to expense shall

be limited to the amount by which the capitalized costs incurred, and to be incurred, exceed the estimated value of the revised project when it is substantially complete and ready for its intended use."

We also disagree with the imposition of a "reasonable" limitation on the development timeline. In the most extreme case, commercial development in master planned communities can take two to three decades to complete, while still adhering to the general plan contemplated at land acquisition. Many commercial development programs plan completion in phases, with phased uses, covering a number of years. In any event, this limitation would not be necessary if the alternative approach under SFAS No. 67 discussed above is adopted.

Further, we disagree with the conclusion of paragraph 39 regarding the expensing of removal costs. Application of this proposal will be difficult in practice, and is extremely subjective. Our experience indicates that contractors typically do not separately price these activities as part of their normal business practice. We believe this will lead to arbitrary pricing that will undermine the intent of the SOP. Independent verification of the costs associated with these activities would be arduous and not subject to precise determination, and there would certainly be inconsistencies between contractors.

Issue 8. Major Maintenance Activities

We agree with the theory of the proposed SOP; however, we are concerned that it is not consistent with criteria No. 4 of the Foreword to the SOP which states that the benefits of the proposal will exceed the costs of applying it.

Issue 9. "Built-in-overhaul" method

N/A

Issue 10. Transfer of use from inventory to held for own use

Our response is included in our comments related to Issue 4.

Issue 11. Assets produced for sale or operating lease

Our response is included in our comments related to Issue 4.

Issue 12. – 13. Component accounting

We do not agree with the requirement that each tangible part or portion of PP&E that can be separately identified as an asset, and which has a useful life different than the asset to which it relates, be accounted for separately and depreciated or amortized over its separate expected useful life. Further, we disagree with the provision of paragraph 51 that dictates that an estimate of the remaining net book value of an individually capitalized replacement be charged to expense. As discussed below and illustrated in Attachment 3, we have provided alternatives that we believe accomplish the objectives of the SOP without requiring significant additional administrative costs.

Our disagreement with the guidance provided in paragraphs 49 through 56 of the proposed SOP is primarily centered on the additional cost burden that implementation would impose. There will be additional financial costs, as well as the opportunity costs imposed by management time spent on the physical tracking of a multitude of assets throughout the Company.

Direct Costs:

- Personnel – We currently maintain records for approximately 30,000 assets in our fixed asset system. We estimate the implementation of the SOP, as proposed, would initially generate between a seven- and ten-fold increase in the number of fixed asset records and will only be compounded over time. We estimate that we will require somewhere between 3 – 5 additional staff to accurately maintain the additional accounting records that will enable us to capitalize costs at the levels we capitalize today.

- Computer Hardware – We have not yet completed a full study of the impact of the proposed SOP on computerized record storage capacity, but we estimate it will require a significant increase in storage and processing requirements and will likely require the purchase of additional hardware.

- Investment in inventory tracking system for component assets – We believe we would need to invest in some type of asset tracking system to accurately and efficiently account for the physical movement of specific asset components at our properties. We believe this is impractical to

administer given the number and widely dispersed geographic locations of our properties.

Indirect Costs:

- We believe there will be a significant increase in the demands placed on both the property management and capital project management staff to comply with the tracking element inherent in the component accounting provisions of the proposed SOP. We do not believe that the increased tracking of physical assets warrants this level of additional cost. Some of the significant additional managerial requirements include:

  1. Tagging and monitoring the movement of individual assets or parts of assets;

  2. Mapping and maintaining allocation schemes for homogenous assets (such as roofing costs and parking lot paving costs); and

  3. Accurately and promptly communicating the removal of the appropriate assets upon asset retirement or replacement.

There are literally tens of thousands of components in a typical retail center or office building. In addition, it is not practical to account for homogeneous assets that are part of these projects (e.g., parking lots, roofs, flooring, electrical, etc.) as components. The costs and effort required to identify and track the individual components of large-scale real estate projects, compared to possible alternatives, is simply not justified in relation to the overall benefits. For this reason, the Company and many others have developed and used composite or group depreciation methods for many years. These methods are contemplated by ARB 43 and are practical and appropriate alternatives to component accounting. We believe they should be recognized as acceptable on their own merits. In this regard, we note that the problem of estimating depreciation for a major real estate project is not unlike the problem of estimating the allowance for losses for a large, diversified loan portfolio. Each of these assets is made up of numerous individual component parts. In Statement No. 114, *Accounting by Creditors for Impairment of a Loan*, the FASB concluded that the Statement should not apply to large groups of smaller-balance homogeneous loans (e.g., residential mortgages, installment loans, etc.) that are collectively evaluated for impairment and often comprise a large portion of the loans in a portfolio. In reaching that conclusion, the Board decided not to change the practical approach creditors had adopted of using formulas (based on various relevant factors) to estimate losses related to these types of loans. This conclusion recognizes that a group

or composite approach is a realistic and effective alternative to requiring a review of every component of the portfolio. A comparable alternative also makes sense and should be available for real estate assets.

Proposed Alternative

We propose an approach that we believe retains the benefits of a more precise method of determining and allocating the cost of a component asset over the expected period of benefit, while not imposing unreasonable costs of implementing and ongoing administration.

1. Entities would group and classify assets in categories and subcategories based on their nature. For example, a category could be mechanical systems, with vertical transportation, HVAC systems and fire protection systems as subcategories, among others.

2. The depreciable life for each subcategory would be based on estimated useful lives of the individual assets and would consider replacement of component parts. This approach would consider each entity's experience and plans for replacement or refurbishment of these assets. The application of this proposed methodology will result in a systematic and rational allocation of costs over the useful lives of the assets in the subcategory.

3. An entity would capitalize a replacement to an entire component or a subcomponent. The entity would not be required to write-off the remaining net book value of the component or estimated remaining net book value of a subcomponent because this circumstance should be considered in the estimated useful life being used to depreciate the asset.

4. Management would annually review the useful lives of the assets and adjust, as necessary, based on actual experience.

5. We believe required disclosure of property, plant and equipment should include, for each asset class, the types of assets in each class, weighted-average and range of useful lives, gross costs and accumulated depreciation, and additions in each period. We believe this enhanced disclosure will shed light on any diversity in useful lives and enhance the transparency of financial statements.

Included in Attachment 3 is an example of a depreciation calculation for a retail project using this alternative method.

Issue 14. Component depreciation

The Company believes that the composite life alternative for computing depreciation expense as specified in the exposure draft is impractical and cannot be reasonably made operational. The requirement that depreciation expense computed using a composite life method must yield a similar result as the expense that would be computed if the components were separately depreciated effectively eliminates the composite life alternative. Companies would be required to perform the depreciation calculations using both methods in order to positively assert that the results would be similar, thereby increasing the bookkeeping required for a method designed to reduce bookkeeping efforts.

Issue 15. Amendments to other guidance

N/A

Issue 16. Existing PP&E

We agree with the approach proposed and with the choice of selecting one of the two alternatives proposed.

Issue 17. Allocation of existing net book value

We disagree with the methodology proscribed in Appendix C, Example 2 – *Replacement and write-off of remaining net book value after adopting SOP*. This method fails to recognize the different useful lives of the building's identifiable parts or portions. This method will result in a charge to depreciation greater than if the replaced item had initially been accounted for using component accounting (as described in Paragraph 51). Ultimately, this method will result in a significant understatement of the net book value of the remaining assets. We recommend that entities be permitted to estimate the net book value of the replaced item based on the estimated useful life inherent in the building's overall useful life.

Issue 18. Prospective application for subsequent costs incurred

We agree that costs incurred prior to adoption of the SOP should not be recharacterized.

Issue 19. Retroactive adoption

We support the position that any differences in accumulated depreciation resulting from the adoption of the SOP be accounted for as a cumulative effect of a change in accounting.

Examples of Issues with Component Accounting **Attachment 2**

Listed below are some examples of asset groups that we consider "homogeneous" in nature. They are numerous, physically similar, and/or difficult to separately identify and track.

Heating and Cooling Systems
Asphalt
Roof
Site lighting
Vertical Transportation

Using the asset groups listed above, we have provided below realistic examples that illustrate the difficulty of applying component accounting as proposed by the SOP. Examples 1 and 2 demonstrate the difficulty in separately identifying a component. Examples 3 through 5 provide narrative discussions of the variety of other issues facing companies in the real estate industry in the application of component accounting.

Example 1: Heating and Cooling Systems

The Company has many properties that use a roof-top DX style system to provide heating, cooling and ventilation to the interior spaces of the building. A typical retail property for the Company could contain 200 roof-top units (this is based on one per tenant, plus 20 common area units.) The key components of a rooftop unit are:

- Compressor
- Heat exchanger
- Condenser
- Fan
- Pump
- Housing unit

The components listed above typically have shorter lives than the overall HVAC unit to which they relate; and therefore, the cost of these components under the proposed SOP would have to be accounted for separately. At the average property of the company, this would mean 1,200 separately identified components that would require maintenance in the Company's fixed asset system.

Example 2: Asphalt

1) Assume that the company develops a new retail center and closes out the parking lot (asphalt) as four assets of equal value - North, South, East and West, with a 10-year life; total cost $4.0M.
2) Year 8, the company repaves 60% of lots South and East, and 40% of lot North. Estimated at 40% of the original total area, the cost is $2.0M.
3) Year 9, the company repaves West for $1.4M.
4) Year 10, the company repaves 80% of section North and 50% of sections South and East at a cost of $2.5M.

Using the information provided above, we have summarized the year-end gross fixed asset balances accounted for using the approach recommended by the SOP in TABLE 1 that follows.

Note that the asset that is being written off becomes somewhat arbitrary, as it will become difficult to determine, in the case of North, if the 80% replaced in Year 10 is the remaining 60% original, and 20% Year 8 lot replacement. In addition, re-evaluating the level of component accounting and associated lives of similar assets in the remainder of the portfolio, as required by paragraph 54 of the SOP, would be nearly impossible using this realistic example.

Assume for a moment that the company simply closed out one asset at inception, Asphalt, for $4.0M, and expensed all subsequent additions as they could not be separately identified as an asset, as required by the SOP. In the above scenario, the company would come to year 10 with essentially brand new parking lots, but have no asset on the books.

TABLE 1
Rollforward of Gross Fixed Asset Balance of Asphalt - Using Method Proposed by SOP
(in 000's)

NOTE: all assets are assumed placed in service or disposed of on 1/1 each year.

GROSS ASSETS		Year 1	2	3	4	5	6	7	8	9	10	TOTAL
North	Beginning Balance	$ -	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,100	1,100	$ -
	Additions	1,000	-	-	-	-	-	-	500	-	1,111	2,611
	Disposals	-	-	-	-	-	-	-	(120)	-	(260)	(380)
	Retirements	-	-	-	-	-	-	-	(280)	-	(590)	(870)
	Ending Balance	$ 1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,100	1,100	1,361	$ 1,361
South	Beginning Balance	$ -	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,150	1,150	$ -
	Additions	1,000	-	-	-	-	-	-	750	-	694	2,444
	Disposals	-	-	-	-	-	-	-	(180)	-	(140)	(320)
	Retirements	-	-	-	-	-	-	-	(420)	-	(385)	(805)
	Ending Balance	$ 1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,150	1,150	1,319	$ 1,319
East	Beginning Balance	$ -	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,150	1,150	$ -
	Additions	1,000	-	-	-	-	-	-	750	-	694	2,444
	Disposals	-	-	-	-	-	-	-	(180)	-	(140)	(320)
	Retirements	-	-	-	-	-	-	-	(420)	-	(385)	(805)
	Ending Balance	$ 1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,150	1,150	1,319	$ 1,319
West	Beginning Balance	$ -	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,400	$ -
	Additions	1,000	-	-	-	-	-	-	-	1,400	-	2,400
	Disposals	-	-	-	-	-	-	-	-	(200)	-	(200)
	Retirements	-	-	-	-	-	-	-	-	(800)	-	(800)
	Ending Balance	$ 1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,400	1,400	$ 1,400
TOTAL GROSS ASSETS - SOP Method												
	Beginning Balance	$ -	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,400	4,800	$ -
	Additions	4,000	-	-	-	-	-	-	2,000	1,400	2,500	9,900
	Disposals	-	-	-	-	-	-	-	(480)	(200)	(540)	(1,220)
	Retirements	-	-	-	-	-	-	-	(1,120)	(800)	(1,360)	(3,280)
	Ending Balance	$ 4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,400	4,800	5,400	$ 5,400

Example 3: Roof

There is a wide variety of roofing products on the market today, many of which are used by the company. There is a single ply roof that has a typical life of 10 years, while at the other end of the spectrum, there is a copper roof that can last 100 years. There is a broad range of other roofing products in between, with greatly varying lives.

Assume that the company constructs a new retail center, and installs a 3-ply roof with an anticipated useful life of 20 years. Our typical example mall may be 1,000,000 sf. The mall may be separated into 10 parts by firewalls or anchor department stores; thus each section can range from 10,000 sf. to 200,000 sf. These sections will wear and age at varying rates, depending on foot traffic, use and weather. One 100,000 sf. section may begin to fail at 15 years, while the rest of the roof may be fine.

The Company typically considers two options when a roof begins to fail; re-roofing the failing section or "resetting" the section. Resetting the section means that a one-ply roof would be placed over the existing roof to extend the life of the original roof an additional 10 years.

Reality can be even more convoluted, as it is not uncommon in the real estate industry that there are different roofing components within the same retail center. An anchor department store may require a roof over their store with a specification and life span that is different from the standard 3-ply, 20-year average roof used in the example above.

In summary, there are many variables that would have to be tracked by the company, which would require more manpower from operations, construction project managers and accounting personnel.

Example 4: Site Lighting

The Company utilizes many different site lighting products on the premises of its commercial real estate properties. A standard retail center can have up to 200 bollard lights along the pedestrian paths, hundreds of landscape lights, and in excess of 250 site lighting poles.

There are three main site lighting components that are considered in this asset class; the underground wiring and conduit, the pole and base, and the intensity of the light. In standard site lighting poles, the typical life can range from 15-30 years depending on the composition of the pole (steel, aluminum, concrete, etc.) and the alkalinity of the soil. The climate in the area can also impact the life span of all three components.

Changing light intensity requirements also impact the useful life of this asset class as legal liability and market conditions continue to push the foot-candle brightness higher. Fifteen years ago, a 1-foot candle per square foot was a minimum requirement. Today, this minimum brightness has more than tripled, requiring modification to, or replacement of, our lighting systems.

On existing properties, we typically phase replacement of site lighting due to the high number of individual assets and the cost associated with such effort. Tracking individual sub-components and writing off the replaced components would be a monumental effort.

Example 5: Vertical Transportation

This asset class includes escalators and elevators. The lives of these assets are affected by a number of variables as well. Our experience indicates a 15-20 year life for elevators and 15-30 years for escalators, though the actual life depends upon usage. Heavy traffic can wear out the transportation assembly. In addition, escalators located outside near water or reflection pools corrode more quickly than escalators located within a center.

The main components that we review in an elevator are the cab, piston, cable, cladding, casings and pump. Typically if an elevator begins to fail, we salvage one or several of the foregoing components and replace the failed components. At one project, due to the high water table, we had to replace the piston, the casings and the pump of one elevator, but we were able to salvage the cab. In contrast, frequently we may replace only the cab of certain elevators, because of the heavy use inside. We find that within a 20-year span, 10% of our hydraulic elevators fail. The gear elevators are usually more reliable.

With escalators, we can typically salvage components of an existing asset for a major rehabilitation and extend the useful life an additional 10 years. Treads, gears, changes and motors are all significant investments, so we attempt to salvage as much as possible.

Another issue that can complicate vertical transportation is code changes. For example, there is a review that is suggesting that the code be changed to modify the dimensions of the escalator step clearance. If this code is modified, we may have to accelerate our escalator renovations.

This demonstrates the difficulty of identifying, tracking and accounting for the components of only one asset group. A well constructed asset group with an appropriately assigned useful life would recognize these factors and provide for these modifications easily.

In summary, we have only provided a few examples of the enormous challenges that will be faced by real estate companies in implementing component accounting.

Example of Project Staging Alternative

Assume Company A and Company B are developing identical projects. The only difference is Company A acquired an option for the site and Company B purchases the site. Assume Company A's probability assessment indicates that the project is probable only after obtaining favorable zoning, which takes one year. Assume at that point Company A purchases the land. The following tables summarize the costs of the project upon completion.

(costs, in thousands)	Company A	Company B
Land cost	$ 0	$ 10,000
Option cost	500	0
Zoning effort	5,000	5,000
Land cost	10,000	0
Building cost	50,000	50,000
Capitalized interest	7,200	8,000
Total cost	$ 72,700	$ 73,000

Under the proposed SOP, Company A would have capitalized all of the above costs except for those related to the zoning effort which took place prior to the assessment that the project's completion was probable. Accordingly, the total capitalized cost for the project would be $67,700, some $5 million less than capitalized by Company B. This is the case even though the activities and costs of both companies were essentially the same, except that Company A managed its risk by obtaining land control via an option instead of purchasing it up front. We do not believe this difference in accounting treatment is appropriate.

Under our proposed alternative, both companies would capitalize all costs associated with the project. Both would test the asset carrying value for impairment using the expected cash flows method. Assuming that there is a 50% probability that the proposed project will produce $150 million in cash flows over its expected useful life and a 50% probability that the project will not be constructed, the zoning costs would remain in the carrying value of the asset.

Assume that upon an unfavorable zoning decision, possible outcomes are revised to indicate that there is a 70% probability that the land will be sold for $20 million and a 30% probability that it will be sold for $12 million. No loss would need to be recorded by either Company, as neither has a carrying value of the asset in excess of $17.6 million ($20 x .7) + ($12 x .3).

As of the next balance sheet date, the possible outcomes have changed again to a 100% probability that the land will be sold for $14 million. Company A would record a loss of $1.5 million ($14 million expected cash flows less $15.5 million carrying value). Company B would record a loss of $1 million ($14 million expected cash flows less $15 million carrying value).

Example of Proposed Depreciation Method – Aggregate Project View

As discussed in Attachment 1, the Company proposes an alternative to the component accounting proposed by the SOP. This alternative proposes that an entity group and classify assets based on their nature. The depreciable life for each asset group will consider the variability in the expected useful lives of the sub-components that comprise the group.

Summarized in the TABLE 2 below is an alternative to the component accounting proposed by the SOP. Using the information provided in Attachment 2, TABLE 1 on Asphalt, we compare the depreciation calculated using the component accounting method proposed by the SOP (assuming a 10-year depreciable life, with disposals) to the method proposed by the Company (assuming a 9-year depreciable life, with no disposals).

Please note that this method is inherently conservative, as all assets in the group will be written off, regardless of whether they are still in service at the end of their depreciable life.

TABLE 2 FOLLOWS

TABLE 2
Comparison of Depreciation Expense - SOP Method vs. Proposed Method
($ in 000's)

NOTE: all assets are assumed placed in service or disposed of on 1/1 each year.

	Life	Year 1	2	3	4	5	6	7	8	9	10	TOTAL
TOTAL GROSS ASSETS - SOP Method												
Beginning Balance		$ -	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,400	4,800	$ -
Additions		4,000	-	-	-	-	-	-	2,000	1,400	2,500	9,900
Disposals		-	-	-	-	-	-	-	(480)	(200)	(540)	(1,220)
Retirements		-	-	-	-	-	-	-	(1,120)	(800)	(1,360)	(3,280)
Ending Balance		$ 4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,400	4,800	5,400	$ 5,400
Depreciation Expense - SOP Method:	**Life**											
On ending gross assets	**10**	$ 400	400	400	400	400	400	400	440	480	540	$ 4,260
Write off of disposed assets		-	-	-	-	-	-	-	480	200	540	1,220
Total Depreciation Expense - SOP Method		$ 400	400	400	400	400	400	400	920	680	1,080	$ 5,480
TOTAL GROSS ASSETS - Proposed Method												
Beginning Balance		$ -	4,000	4,000	4,000	4,000	4,000	4,000	4,000	6,000	7,400	$ -
Additions		4,000	-	-	-	-	-	-	2,000	1,400	2,500	9,900
Retirements		-	-	-	-	-	-	-	-	-	-	-
Ending Balance		$ 4,000	4,000	4,000	4,000	4,000	4,000	4,000	6,000	7,400	9,900	$ 9,900
Depreciation Expense - Proposed Method	9	$ 444	444	444	444	444	444	444	667	822	1,100	$ 5,700
VARIANCE - SOP > (<) Proposed		**$ (44)**	**(44)**	**(44)**	**(44)**	**(44)**	**(44)**	**(44)**	**253**	**(142)**	**(20)**	**$ (220)**
Cumulative Variance		**$ (44)**	**(89)**	**(133)**	**(178)**	**(222)**	**(267)**	**(311)**	**(58)**	**(200)**	**(220)**	

Examples of Proposed Alternatives

Attachment 3

Example of Enhanced Disclosure Alternative

Property, plant and equipment at December 31, 20xx and 20xx are summarized as follows:

	20xx				20xx			
	Cost	Accumulated Depreciation	Range of Expected Useful Lives	Weighted-average remaining Useful Life	Cost	Accumulated Depreciation	Range of Expected Useful Lives	Weighted-average remaining Useful Life
Building and improvements								
Flooring and finishes								
Roofing and weather-proofing								
Mechanical systems								
Furnishings and fixtures								
Tenant improvements								
Land								
Total								

Additions to existing properties in 20xx and 20xx are summarized as follows:

	20xx	20xx
Building	$	$
Flooring and finishes		
Roofing and weatherproofing		
Mechanical systems		
Furnishings and fixtures		
Tenant improvements		
Land		
Total	$	$

Examples of Proposed Alternatives **Attachment 3**

Properties acquired/placed in service in 20xx and 20xx are summarized as follows:

	20xx	20xx
Building	$	$
Flooring and finishes		
Roofing and weatherproofing		
Mechanical systems		
Furnishings and fixtures		
Tenant improvements		
Land		
Total	$	$

Division of Financial Affairs

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November 26, 2001

Mr. Marc Simon
Technical Manager, Accounting Standards
File 4210.cc
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Proposed Statement of Position: Accounting for Certain Costs and Activities Related to Property, Plant and Equipment.

Dear Mr. Simon,

Cornell University values this opportunity to comment on the proposed Statement of Position (SOP) that will have a tremendous impact on the accounting for plant, property and equipment. We understand and appreciate that the current practice with respect to accounting for costs of PP&E may not be uniform and that this diversity may result in financial statement reports that are not fully comparable. With respect to uniformity, it is more important for private universities to be comparable with similar organizations (public universities) instead of being consistent with for-profit corporations. In addition, we feel that the benefits of this proposal will **not** exceed the costs of applying it. For reasons set out below, Cornell University urges the Accounting Standards Executive Committee to exempt private not-for-profit colleges and universities from the application of the Statement of Position.

Inconsistencies of accounting for PP&E:

Cornell University is the land grant college for New York State. Within our university structure, we have public and private colleges consolidated into the University financial statements. Four of our colleges are considered contract colleges that were created by an Act of the State Legislature and receive direct funding from New York State. Therefore, these colleges are also reported under the financial statements of the State University of New York (public colleges). By imposing this SOP on only private institutions; once again the financial reports of the Higher Education industry are not comparable.

In addition, inconsistencies will also be created at the project level in relation to the preacquisition stage costs. The SOP guidance on capitalization of preacquisition stage costs applies when management has implicitly or explicitly authorized and committed to funding the acquisition or construction of a specific asset Based on the limited resources of the university, two similar projects may be accounted for differently based on university commitment and availability of funding. Project A could have both the resources identified and the University commitment, while project B is lobbying for university support of the project along with the identification of funding sources. Based on the proposed SOP, the preacquisition stage costs of project A would be capitalized and the costs of project B would be expensed when incurred.

To give you an idea of the volume, Cornell University is currently managing 175 open capital construction projects with an identified $1 billion of proposed projects within the next five years. Accounting for PP&E in different stages would be a substantial administrative burden.

Increased Financing Costs:

Cornell University borrows funds for capital expansion through the issuance of tax-exempt securities. Section 145 of Title 26 of the U.S. Code limits the use of tax-exempt financing debt by non-governmental organizations for capital expenditure purposes. The proposed SOP changes the current capitalization of costs based on project stages. Therefore, a significant amount of costs currently capitalized will now be recorded as an expense. This will significantly reduce the amount of tax-exempt debt available for financing projects, thus significantly increasing the cost of borrowing.

In addition, the proposed SOP defines PP&E to be accounted for based on component basis. The effect of applying component accounting to the PP&E assets of the university would reduce the composite life of capital assets. Section 147 of Title 26 of the U.S. Code provides, in part, that the average maturity of qualified (for tax-exemption) debt may not exceed 120 percent of the expected economic life of the assets being financed. Therefore, a reduction in the composite life of the asset would result in a reduction in the average maturity of the debt. This reduction will create additional costs for refinancing debt.

Implication for Federal Research Funding:

Cornell University is a leading research university with revenue from sponsored activity of approximately 19 percentage of income. We are required to conform to Generally Accepted Accounting Principles and also must conform to federal regulations. Under the proposed SOP, the Facilities and Administration costs could increase due to changing preliminary stage costs and certain preacquisition costs from capital to expense and also accelerating depreciation expense based on component accounting. Consequently, these changes would increase the Facilities and Administrative cost rates in its research grant proposals. This would place Cornell University at a disadvantage whenever the university competes with

public colleges for research funding for which this SOP is not applicable. In addition, this would increase the cost of funding research to the federal government.

Additionally, the proposed Statement would require Cornell University to gain approval for changing depreciation methods from our cognizant audit agency. According to OMB Circular A-21 (paragraph J(12)(b)(2)) depreciation methods once used shall not be changed unless approved in advance. The depreciation methods used to calculate the depreciation amounts for F&A rate purposes shall be the same methods used by the institution for its financial statements. With only a few months before implementation, it would be difficult to gain approval for the change in depreciation methods before the effective date of the SOP.

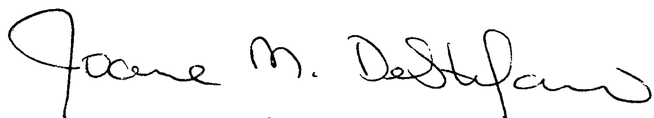
Implementation Schedule:

Similar to other higher education institutions, Cornell University's fiscal year begins July 1. Therefore, if the Statement of Position becomes effective as proposed, it would be effective July 1, 2002. This effective date gives private universities limited time to implement procedures necessary to comply with the standard.

We believe the consequences described above are unintended by the Accounting Standards Executive Committee and if implemented would cause hardship to Cornell University and our peers at private universities. We believe the comparability between private not-for-profit colleges and universities and our peers at public universities are more important than comparability with publicly traded corporations.

Therefore, we respectively request that the Accounting Standards Executive Committee exempt colleges and universities from the application of the Statement of Position.

Respectively,



Joanne DeStefano
Vice President for Financial Affairs
and University Controller

In Reply Refer To:
OED-DRAP

November 15, 2001

Mr. Marc Simon
Technical Manager Accounting Standards
File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Mr. Simon:

The Federal Energy Regulatory Commission (FERC) is an independent agency with regulatory responsibilities over significant portions of the electric utilities, natural gas pipelines, and oil pipelines that are engaged in interstate commerce. Such responsibilities encompass, among other things, rate regulation, accounting and financial reporting.

On June 29, 2001, the Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants posted its exposure draft, "*Accounting for Certain Costs and Activities Related to Property, Plant and Equipment*," for public comment. Comments are due by November 15, 2001, with an effective date of January 1, 2003, for most companies.

We appreciate the opportunity to comment on the exposure draft. The following comments represent the views of the FERC staff on AcSEC's proposed changes to the existing accounting framework for plant, property and equipment.

Based upon our review of the exposure draft, the major impacts resulting from AcSEC's proposal on the industries we regulate would be (1) the expensing of preliminary survey and investigation costs, (2) the prohibition of capitalizing all construction related overhead costs, and (3) the requirement that component depreciation be used to depreciate assets. For the reasons outlined below we do not believe that these changes result in improved financial reporting, or that the proposed guidance is needed

for the industries FERC regulates.

Deferral of Preliminary Survey and Investigation Costs Pending Construction

The exposure draft would prohibit the deferral of preliminary survey and investigation costs pending a determination on the probability of a proposed capital project. The capital projects undertaken in the utility industry are planned and carried out from the preliminary period through the construction period based on adequately documented policies and procedures to ensure the completion of all processes required to achieve commercial operations. The preliminary survey and investigation activities require pursuing with reasonable diligence full compliance with all regulatory and governmental requirements, conditions, and regulations before construction can begin. Such activities involve obtaining a license, permit, certification, or similar authorization or permission to construct a capital project. The costs associated with these preliminary survey and investigation activities are capitalizable based on their adding value to the project and providing future benefits to the entity. By using this approach, self constructed assets will reflect the preliminary survey and investigation costs incurred on the project, and will reflect in assigning its cost to the future periods that benefit from it.

AcSEC's proposal would add additional complexity into the process by requiring management to make arbitrary distinctions between different phases of construction that begin with preliminary survey and investigation activity. Attempting to create certain distinctions between different phases of activity within a fluid construction process would be very difficult to implement in practice. AcSEC's proposal would result in inconsistent accounting for similar types of costs between companies and industries, and would not add clarity to the accounting literature regarding the proper accounting for these types of costs.

Capitalizing Overheads and Administrative Costs Should Be Allowed

The exposure draft would prohibit the capitalization of overhead costs, including all costs of support related activities (e.g., contracting, procurement, information systems, etc.). Under the proposal, only costs that are directly assignable, or are essentially incremental in nature, may be capitalized as part of the cost of the project. It is our view that costs related to construction activities, even overhead and related administrative type costs, should be capitalized provided that there is a proven relationship to construction.

AcSEC's proposal to capitalize costs that are only directly identifiable, or incremental in nature, is overly restrictive and will not provide an appropriate measurement of the cost of a self constructed asset. An entity should be permitted to use other rational measurement techniques, such as the use of time studies, to determine the extent to which other types of costs are properly assignable to construction. AcSEC has not clearly articulated why it has excluded other techniques used by regulated industries

over the decades, to assign overheads and other types of costs to construction.

Component Depreciation and Assets Retirements

Under the proposal, entities would be required to use component depreciation on all assets. Under component deprecation all assets are subdivided into components, or elements, and each element is individually tracked and separately depreciated. The industries we regulate are very capital intensive, and the self constructed assets are composed of millions of component type parts. It is our view that it would be impractical to implement component deprecation in a meaningful manner due to the nature of the assets involved in the electric, natural gas, and oil pipeline industry.

For example, regulated utilities have transmission lines and pipelines that are composed of homogeneous assets consisting of thousands of smaller units such as poles, circuit breakers, meters, valves, etc. Under the proposal, regulated utilities would be required to track and depreciate *each* of these small components. This requirement would be unduly burdensome and costly to regulated industries since they do not maintain detailed fixed asset cost records at this level, or compute depreciation expense for each individual component.

The use of component deprecation would significantly increase the record keeping complexity and ultimately the transaction costs for regulated entities. Additionally, it would increase the measurement error for computing depreciation expense as regulated entities apply the same life of component to all other components of similar type. The more components, the greater the measurement error. In our opinion, the use of component depreciation would increase volatility, and impose additional costs on regulated entities without producing any relevant benefits to the users of the financial information.

Finally, under the AcSEC proposal, regulated entities would be required to charge depreciation expense immediately with the net book value of normal retirements. This would be a significant departure from existing accounting treatment for normal retirements made by regulated entities. Traditionally, regulated entities have charged accumulated depreciation with the net book value of normal retirements, and adjusted future depreciation rates through periodic detailed depreciation studies. This accounting mirrored the rate making process in that rates were designed to include any over or under accruals related to misestimates of depreciation expense.

AcSEC's proposed accounting changes for normal retirements would not be practical for rate regulated industries and would not reflect the underlying economics of the rate process. The adoption of the proposal would add an additional record keeping burden to industry without improving the quality of the information reported to shareholders and other users of the financial information.

In conclusion, we appreciate the opportunity to comment on this proposal and thank AcSEC for its consideration on this matter.

Sincerely,

John M. Delaware
Deputy Executive Director
and Chief Accountant

cc: Mr. Timothy Lucas
Director of Research and Technical Activities
Financial Accounting Standards Board

November 16, 2001

Marc Simon:

I've spoken with various members practicing and working in the NPO arena, including but not limited to the college and university arena, about the June 29, 2001 ED of the proposed AICPA SOP, *Accounting for Certain Costs and Activities Related to Property, Plant and Equipment*. Though we will not be drafting a formal comment letter from members representing the NPO arena, please ask the Task Force and AcSEC to consider the issues raised in this memo to the extent that they are not already raised in formal comment letters.

1. The U.S. government and other sponsoring organizations consider depreciation expense in determining overhead cost recovery rates for transactions such as research grants. The U.S. Office of Management and Budget (OMB) requires that depreciation expense used for cost recovery purposes conform to depreciation expense reported in conformity with GAAP. Many major institutions have complied with this requirement as recently as the last year or so. The result has been some costly undertakings to conform the depreciation methodologies and some significant changes in accounting or accounting estimates. Some believe that any changes made by the OMB in reaction to changes in GAAP as per the ED would be slow or nonexistent, resulting in unintended consequences, such as changes in amounts reimbursed under government contracts.

2. Under federal tax regulations, NPOs are permitted to issue debt with tax-exempt interest (and therefore at lower interest rates) provided that they meet certain requirements, including a requirement that the average life of the outstanding notes and bonds cannot exceed 120% of the average expected useful life of the financed PPE. (Though the average expected useful life of the financed PPE for purposes of the tax regulations does not necessarily have to conform to the average expected useful life for GAAP purposes, industry representatives believe that using expected lives for purposes of the tax regulations that differ from expected lives for GAAP purposes would require overcoming high hurdles.) The provisions of the SOP, including requiring NPOs to componetize PPE, may reduce the average expected useful life of the PPE for GAAP purposes, which may affect the amount of time the bonds can be outstanding. For example, this might prevent NPOs from issuing bonds with balloon payments due in 40 years.

3. Users of NPO's financial statements focus on service efforts and accomplishments and management stewardship, in addition to periodic measurement of the changes in the amount and nature of the net resources of

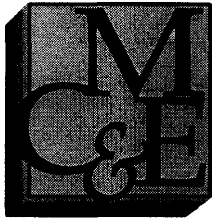
the NPO. Accordingly, the NPO reporting model has less of a bottom-line focus than does the for-profit model. Some believe that the information provided based on the guidance in the ED is therefore less meaningful for users of NPO's financial statements than it is for users of for-profit entity's financial statements. In addition, most NPOs function with resources that are more limited than resources available to for-profit entities. AcSEC should consider whether the costs of implementing the guidance in the ED would be justified by the benefits provided for the NPO sector. (Some note that rating agencies ignore depreciation expense when using NPO financial statements.)

4. The NPO sector was affected significantly in 1990 by the implementation of FASB Statement No. 93, *Recognition of Depreciation by No-for-Profit Organizations*. Some in the NPO arena believe it would punitive to require NPOs to again change their accounting for PPE so soon after the changes required by FASB Statement No. 93. (Further, some believe that implementing FASB Statement No. 93, particularly for colleges and universities, provided little, if any, useful information for financial statement users.)

5. Though colleges and universities appear to be the most affected NPO sector, other NPOs may be similarly affected.

Thanks

Joel



Maner,
Costerisan
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Timothy H. Adams
David B. Caldwell
David R. Fassezke
Edward L. Williams, III

Walter P. Maner, Jr.
Floyd L. Costerisan
Leon A. Ellis (1933-1988)

November 14, 2001

Marc Simon, Technical Manager
Accounting Standards, File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of Americas
New York, NY 10036-8775

RE: Exposure Draft: Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment

Dear Sir:

On behalf of the Michigan Electric Cooperative Association (MECA) and its member cooperatives, I wish to express my opposition to the proposed accounting standards. MECA is a state trade association representing the collective interests of Michigan's rural electric cooperatives. The membership of MECA consists of nine distribution rural electric cooperative, Alger Delta Cooperative Electric Association (headquartered in Gladstone, Michigan), Cherryland Electric Cooperative (headquartered in Grawn, Michigan), Cloverland Electric Cooperative (headquartered in Dafter, Michigan), Great Lakes Energy Cooperative (headquartered in Boyne City and Newaygo, Michigan), HomeWorks Tri-County Electric Cooperative (headquartered in Portland, Michigan), Midwest Energy Cooperative (headquartered in Cassopolis, Michigan), The Ontonagon County Rural Electrification Association (headquartered in Ontonagon, Michigan), Presque Isle Electric & Gas Co-op (headquartered in Onaway, Michigan) and Thumb Electric Cooperative (headquartered in Ubly, Michigan). With the exception of Wolverine Power Supply Cooperative, Inc., these electric cooperatives are consumer owned retail electric utilities, which have been regulated by the Michigan Public Service Commission since December 22, 1965. Wolverine Power Supply Cooperative, Inc., a wholesale power supplier, is regulated by the Federal Energy Regulatory Commission ("FERC").

Statement of Financial Accounting Standards No. 71 (FASB 71) states, "Regulation of an enterprise's prices is sometimes based on the enterprise's costs." This is particularly true in the case of regulated electric cooperatives and is the basis upon which current accounting practices have been developed. Specific industry practices have been designed to minimize the volatility of energy prices and will be eliminated under the proposed standards. The economic impact of these changes has not been measured and should be considered before any implementation is contemplated.

544 Cherbourg Drive ı Suite 200 ı Lansing, Michigan ı 48917-5010 ı (517) 323-7500 ı Fax (517) 323-6346

Industry guidelines established by Rural Utility Services (RUS) have long provided practices that allow for consistent and fair rate making. Several of these accounting practices are not normally utilized in the non-regulated environment. Examples include:

1) "Group Accounting" which allows for grouping the cost of similar assets within a facility
2) Recognition of gains and losses on the disposal of an asset over time as part of the depreciation rate
3) Capitalization of the cost of removal of an asset
4) Capitalization of overhead costs associated with an asset.

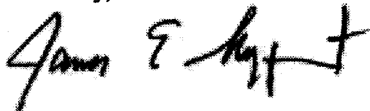
All of these practices have been designed to smooth the volatility of energy costs to consumers. Regulators have historically been able to establish rates that have been consistent to consumers while covering the costs of energy providers. This is in large part attributable to consistent operating results of utilities. The new standards will eliminate this consistency and will create variability in rates. Regulators will be required to permit these rate fluctuations or face the possibility that energy providers will no longer be able to cover costs on a consistent basis.

Variability in operating results will place a further burden on energy providers that are required to borrow funds to finance necessary infrastructure. Lenders such as RUS have advocated accounting practices that have supported lending at levels sufficient to keep energy flowing. Changing the rules will at a minimum upset the ability of RUS and other lenders to interpret the financial health of a utility and will undoubtedly jeopardize the borrowers ability to obtain necessary financing.

Further, the administrative and organizational burden of implementation and maintenance of the new standards will place a significant and unnecessary burden on energy providers that will ultimately be passed on to the energy consumer in the form of increased energy costs.

It is the position of the Michigan Electric Cooperative Association and its members that regulated industries should be specifically excluded from the proposed accounting rules.

Sincerely,



James E. Nyquist, CPA

cc: Michael Peters, MECA
MECA member cooperatives

Marc Simon

11/16/2001 03:14 PM

To: agadkins@uss.com, bdrake@kpmg.com, cdaugherty@dttus.com, james_ross@csx.com, jbrant@deloitte.com, leonard.gatti@us.pwcglobal.com, lmayshak@dttus.com, msimon@aicpa.org, richard.h.moseley@aexp.com, rrendino@pgrt.com, Sharon Macey/NY/AICPA@AICPA
cc:
Subject: cl #308

cl #308
----- Forwarded by Marc Simon/NY/AICPA on 11/16/01 03:19 PM -----

hkostizak@admin.rochester.edu

11/16/01 03:10 PM

To: MSimon@aicpa.org
cc:
Subject: RE: Comments SOP

November 16, 2001

Mr. Marc Simon
Technical Manager, Accounting Standards
File 4210.CC
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Proposed Statement of Position: Accounting for Certain Costs and
Activities Related to Property, Plant and Equipment.

Dear Mr. Simon:

This letter provides the University of Rochester's comments on the "Proposed
Statement of Position: Accounting for Certain Costs and Activities Related
to Property, Plant and Equipment" (SOP). The University of Rochester is a
private, national research university and a member of the Council on
Governmental Relations (COGR). While we understand the need for uniform
and comparable financial information, we agree with the analysis and
comments made in the COGR comment letter that was recently sent to you. The
cost of implementing this policy in a not-for-profit

institution, and in
particular a private university, far outweighs the benefits. Additionally,
we do not believe there is a critical need for full comparability between
the financial statements of not-for-profit and for-profit organizations.

There are two general areas in which private, not-for-profit colleges and
universities could be negatively impacted by the requirements of this
proposal: tax-exempt financing and federal research funding.

In the area of tax-exempt financing, we believe the expenses allowable under
the SOP would be substantially decreased resulting in a loss of eligible
financing for those expenses. The federal tax code stipulates that private
universities may apply the proceeds of tax-exempt borrowing only to the
acquisition of capital assets. Application of the "Project Stage Framework"
as defined in the SOP would result in a decrease in the reported capital
assets of research universities. These expenses would then need to be
financed through operations or taxable financing which would create a
substantial burden on the institution.

Additionally, we are concerned about the potential implications of this SOP
on federal research costs and comparability of costs between public and
private institutions, which are competing for the same federal research
funding. Private, not-for-profit universities are subject to the
requirements of both Generally Accepted Accounting Principals and the Office
of Management and Budget (OMB) Circular A-21, Cost Principles for
Educational Institutions. Currently, there is symmetry between the cost
principles under each of the regulations. The change in the SOP would cause
more expenses to flow through to the facilities and administration recovery
rate (F&A) due to the shift of formerly capitalizable costs to an indirect
expense. The impact of this could result in grants being awarded to public

institutions, which are not required to implement this
SOP and, therefore,
have lower costs due to the ability to capitalize
costs that private
institutions would have to expense. In addition,
increasing F&A costs
resulting from a change in accounting principles may
cause the OMB to
consider separating A-21 accounting rules from GAAP.
This would result in
universities having to maintain separate records and
having multiple
reporting and external audit requirements.

In conclusion, we urge you to consider the impact the
proposed SOP may have
on private, not-for-profit research universities. We
believe the cost of
implementing this SOP far out weighs the intended
benefit of having all
entities conform in their accounting for Property,
Plant and Equipment. We
believe that having comparability between private,
not-for-profit
universities and publicly traded corporations is less
important than
comparability of costs between private and public
universities. We,
therefore, request that the Accounting Standards
Executive Committee exempt
private, not-for-profit universities from the
Statement of Position.

Sincerely,

Ronald J. Paprocki

Senior Vice President for Administration
and

Finance and Chief Financial Officer

University of Rochester

> -----Original Message-----
> From: MSimon@aicpa.org
[SMTP:MSimon@aicpa.org]
> Sent: Friday, November 16, 2001 2:59 PM
> To: Kostizak, Helen W.
> Subject: Re: Comments SOP
>

>
> Helen -
>
> It arrived with a "dat" suffix instead of a "doc "
suffix and so is
> unreadable.
>
> Could you please cut and paste the Word document
into an e-mail and send
> that to me, so that there is no need to deal with
attachments?
>
> Thanks very much,
> Marc Simon
>
>
>
>
>
> hkostizak@admin.roc
>
> hester.edu To:
msimon@aicpa.org
>
> cc:
>
> 11/16/01 02:34 PM
Subject: Comments SOP
>
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>
>
>
>
>
>
>
> Mr. Simon,
> Attached is a letter (Word document) from Ronald J.
Paprocki, Senior Vice
> President for Administration and Finance and Chief
Financial Officer at
> the
> University of Rochester, Rochester, New York. The
letter contains the
> University of Rochester's comments on the Proposed
Statement of Position:
> Accounting for Certain Costs and Activities Related
to Property, Plant and
> Equipment.
>
>
>
>

>
> If you have any questions, please let me know.
>
>
> Helen W. Kostizak
> Assistant to the Senior Vice President and CFO
> University of Rochester
> Wallis Hall, Room 208
> Rochester, NY 14627-0023
>
> Phone: 585-275-2800
> Fax: 585-461-1046
> (See attached file: atth1p2d.dat)
> << File: atth1p2d.dat >>

Grant Thornton LLP
The US Member Firm of
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Grant Thornton

November 16, 2001

Mr. Marc Simon
Technical Manager, Accounting Standards
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

File 4210.CC

Dear Mr. Simon:

We appreciate the opportunity to comment on the proposed Statement of Position (SOP), *Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment*. The proposed Statement of Position would significantly change the accounting for property, plant and equipment (PP&E), the basis for depreciating PP&E, and the accounting for planned major maintenance activities for substantially all nongovernmental entities. While the conclusions reached by AcSEC have conceptual merit, we are concerned that application of the proposed SOP, principally the requirement to use component accounting, will place a significant, ongoing burden on many companies, especially middle market companies. We believe the costs to apply component accounting will exceed the benefits for these companies.

Our responses to the specific issues raised in the Exposure Draft and other comments on the proposed SOP are discussed below.

Scope

Issue 1: We are not aware of significant practice issues related to the accounting for contractually recoverable expenditures.

Project Stage Framework

Issue 2: We agree with AcSEC's conclusion that the guidance in the proposed Statement of Position would be more operational if a project stage or time line framework is used

rather than developing capitalization criteria based on classification categories for expenditures. We believe this approach is consistent with the guidance in other literature, such as Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*. Since determining a project stage may not always be clear, especially when activities overlap, we recommend that AcSEC include an example of a PP&E project from inception to completion to illustrate the interaction of activities between stages.

Issue 3: We agree that all costs incurred during the preliminary stage should be charged to expense except for the costs of options to acquire PP&E. However, the guidance in the proposed SOP for determining the point at which the preliminary stage ends and the preacquisition stage begins needs to be clarified. According to the proposed SOP, the preliminary stage ends when the acquisition or construction of specific PP&E is probable. The proposed SOP does not include a definition of *specific PP&E*. Example 4 illustrates a situation in which it is probable a manufacturing plant will be built, however, the site for the plant has not been selected. The conclusion is that the entity is in the preliminary stage with respect to the manufacturing plant because the probability determination is at the specific PP&E level not the project level. As a result, the costs incurred (market distribution and labor studies) would be expensed as incurred.

Assessing probability at the specific PP&E level could result in inappropriate accounting if it means, in the case of Example 4, that no PP&E costs should be recognized until acquisition of a specific construction site is probable. Assume the board of directors approved the construction of the manufacturing plant in Example 4 even though a specific location had not been decided on. Simultaneous with beginning the site selection process, the company hires an architect to design the plant. They also order other material to be able to begin construction as soon as the site is selected. In addition, equipment to be used in the plant is ordered because there is a long lead-time to get the equipment. Under the guidance in the proposed SOP, as illustrated in Example 4, one could conclude that the architectural costs, material costs, and equipment costs would be expensed as incurred because the project was determined to be in the preliminary stage. Alternatively, if specific PP&E refers separately to each major asset type, such as the land, the building, and the equipment, and construction of a particular type of building and acquisition of a particular brand of equipment are probable, one would capitalize the design, material, and equipment costs, while expensing the costs referred to in Example 4 related to site selection—market distribution and labor studies. We believe the design, material, and equipment costs in this illustration are capitalizable.

Accounting for Costs Incurred

Issue 4: We agree that all general and administrative and overhead costs incurred during the preacquisition, acquisition-or-construction, and in-service stages should be expensed as incurred.

Issue 5: We do not agree that costs of property taxes, insurance, and ground rentals should be capitalized during the time that activities that are necessary to get the asset ready for its intended use are in progress. We believe these are period costs that should be expensed as incurred.

Issue 6: We agree with the proposed accounting for costs incurred during the in-service stage.

Issue 7: We agree that removal costs should be charged to expense as incurred. However, we believe that the costs to accumulate this information may exceed the benefits.

Issue 8: We agree with the proposed accounting for planned major maintenance activities.

Issue 9: We agree with AcSEC's conclusion prohibiting the use of the built-in overhaul method.

Use of Inventory in Production of Internal-Use PP&E

Issue 10: We agree that an entity should evaluate for impairment PP&E assets previously capitalized as inventory, but should not redetermine their carrying amount as PP&E if transfers occur infrequently (no pattern of transferring inventory to PP&E) and a valid business reason exists for the transfer.

PP&E-Type Assets Produced for Sale or Operating Lease

Issue 11: Certain costs are excluded from PP&E under the guidance in the proposed SOP because of a concern over the method of allocating costs to PP&E and the effect the allocations could have on period-to-period comparability of income statements, as explained in paragraph A11. We believe these concerns are not relevant in a situation in which a company produces equipment for sale or lease. Companies normally have costing systems to allocate costs to routine activities, such as producing equipment for sale or lease. Accordingly, we believe an inventory cost accumulation approach should be used for PP&E-type assets produced for sale or operating lease.

Component Accounting

Issue 12: We agree with the conceptual merits of component accounting, however, we have significant concerns about the costs to apply component accounting. In our view, component accounting will place a significant, ongoing burden on many companies, especially middle market companies. We believe the costs to apply component accounting will exceed the benefit for many middle market companies, which have financial and human resource constraints that larger companies may not have.

An alternative would be to permit the use of composite depreciation. If AcSEC decides to permit the use of composite depreciation, it should consider providing guidance on applying composite depreciation. The guidance should take into consideration the issues raised in paragraph A44 of the proposed SOP. In addition, the guidance in paragraphs 38 and 51 would be appropriate for situations in which an entity using composite depreciation replaces existing PP&E, and the replacement is capitalized.

Issue 13: We believe the approach in paragraphs 38 and 51 is a practical solution to the problem. AcSEC should consider requiring disclosure of the additional depreciation expense in the period of replacement, if material.

Issue 14: In concept, we agree that the approaches described in paragraph A48 would be acceptable if they produce results that are not materially different from the results from applying component depreciation. Accordingly, we suggest that the discussion in paragraph A48 be included in the standard section of the document so it can be easily located. However, we believe that there should be an exception to permit group depreciation methods for large homogenous asset groups. We do not believe the substantial additional cost of maintaining component depreciation records or performing calculations necessary to determine if group depreciation is materially different would significantly improve financial reporting for items, such as electric utility distribution plant components.

Amendments to Other Guidance

Issue 15: We have no comment on this issue.

Transition

Issue 16: We agree with offering two alternatives to initially apply component accounting. Although retroactive application would result in better financial reporting, we believe the costs and time to retroactively apply component accounting would far exceed the benefits. We found the explanation of retroactive application in paragraph 71(a) difficult to follow. We suggest that AcSEC list the steps that have to be performed rather than a narrative description of the process.

Issue 17: We agree with the ordering of the allocation methods described in paragraph 71(a). We would also like to see additional examples illustrating other reasonable methods of allocation.

Issue 18: We agree that the proposed SOP should be applied prospectively with the exception of certain costs of planned major maintenance activities.

Issue 19: We agree that a difference arising from retroactively applying component accounting should be accounted for prospectively as a change in estimate. The difference

results from assigning estimated useful lives to components that are different from the composite useful life previously used. This is similar to reassessing the useful life of PP&E, which is accounted for as a change in estimate.

Other Comments

Incremental Direct Costs: Paragraphs 23 and 28 provide guidance on directly identifiable costs that can be capitalized in the preacquisition and acquisition-or-construction stages. Paragraphs 23(a) and 28(a) permit capitalization of incremental direct costs incurred in transactions with independent third parties. The proposed SOP does not provide guidance on incremental direct costs incurred in transactions with other than independent third parties. Does the absence of guidance mean that these costs cannot be capitalized?

Liquidating Damages: Paragraph 57 states that liquidating damages in excess of the total PP&E should be recognized as income. AcSEC may want to clarify that the excess should not be recorded in revenues or gross margins.

We would be pleased to discuss any of our comments with AcSEC or the Accounting Standards staff. Please direct your comments to John Archambault at (312) 602-8701.

Very truly yours,

Grant Thornton LLP

November 7, 2001

Mr. Marc Simon, Technical Manager
Accounting Standards, File 4210.CC
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Exposure Draft - Proposed Statement of Position - Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment

Dear Mr. Simon:

The Accounting Principles and Auditing Procedures Committee is the senior technical committee of the Massachusetts Society of Certified Public Accountants. The Committee consists of members who are affiliated with public accounting firms of various sizes, from sole proprietorships to international "big five" firms, as well as members in both industry and academia. The Committee has reviewed and discussed the above mentioned exposure draft. The views expressed in this comment letter are solely those of the Committee and do not reflect the views of the organizations with which the Committee members are affiliated.

The Committee members are in agreement with the exposure draft.

We appreciate the opportunity to present our comments and thank you for your consideration.

Very truly yours.

Philip B. Pacino, CPA, Chairman
Accounting Principles and Auditing
Auditing Procedures Committee
Massachusetts Society of Certified Public
Accountants