AMERICAN ELECTRIC POWER

Date 10/19/06

Subject Review of New GAAP – FAS 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*

From Hugh McCoy

To File

ISSUE OVERVIEW

The FASB issued Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* (FAS 158) on September 29, 2006. FAS 158 is the balance sheet result of Phase 1 of an FASB project that in Phase 2 will comprehensively reconsider the income statement effect and all aspects of current pension and postretirement benefit accounting rules. FAS 158 expands the balance sheet pension minimum liability and accumulated other comprehensive income (AOCI) provisions of FAS 87, *Employers' Accounting for Pensions* (FAS 87), by

(a) Computing the minimum pension liability and resulting after-tax AOCI charge to equity based on the funded position as measured by the fair value of plan assets as compared to the projected benefit obligation (PBO), rather than as compared to the accumulated benefit obligation (ABO). The ABO excludes the effect of future raises and is smaller than the PBO for benefit formulas that are affected by future raises.
(b) Requiring the minimum liability and AOCI measures for postretirement benefits in accordance with FAS 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions.*
(c) Requiring the minimum liability and AOCI measures for both overfunded and underfunded plans. This eliminates the ability to avoid AOCI through discretionary funding. It also means that AOCI equity can be either reduced or increased by FAS 158.

The effect of these changes is to adjust pre-tax AOCI equity at the end of each year, for both underfunded and overfunded pension and postretirement benefit plans, to an amount equal to the remaining unrecognized SFAS 87 and SFAS 106 smoothing deferrals for unamortized actuarial losses or gains, prior service costs, or transition obligations, such that remaining deferred costs result in an AOCI equity reduction and deferred gains result in an AOCI equity addition. Previously, deferred gains and losses and the funded position were disclosed only in a footnote.

The year-end AOCI measure is volatile based on fluctuating investment returns and discount rates. Favorable changes are higher returns that increase plan assets and higher discount rates that reduce the discounted benefit obligation.

FAS 158 requires a defined benefit pension or postretirement plan sponsor (a) recognize in its statement of financial position an asset for a plan's overfunded status or a liability for the plan's underfunded status, (b) measure the plan's assets and its obligations that determine its funded status as of the end of the employer's fiscal year (with limited exceptions), and (c) recognize, as a component of other comprehensive income, the changes in the funded status of the plan that arise during the year but are not recognized as a component of net periodic benefit cost pursuant to FAS 87 or FAS 106. It also requires an employer to disclose in the notes to financial statements additional information on how delayed recognition of certain changes in the funded status of a defined benefit postretirement plan affects net periodic benefit costs for the next fiscal year.

IMPACT ON AEP

The balance sheet AOCI effect of FAS 158 is effective for AEP beginning in its December 2006 financial statements. The actual amount to be recorded is based on the funded position at the close of business on the last business day of the year. The measurement date provisions do not affect AEP because we already use measurement at the balance sheet date.

AEP will record on its balance sheet the year-end funded position of its pension plan and its postretirement benefit plan. Based on current projections of 2006 year-end balances, we expect that initial implementation will reduce prepaid pension to the funded position of the overfunded qualified pension plan and increase the liability for the underfunded unqualified pension plan and postretirement benefit plan. To the extent that these adjustments relate to our FAS 71 regulated operations and qualify for a regulatory asset offset (about 73%), there will be no remaining effect on AOCI. Elsewhere, a deferred income tax asset will reduce the adjustment and the after-tax effect will reduce AOCI equity. Leading up to year-end 2006, we will continue to work on the by company effects and to document support of appropriate regulatory asset offsets.

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Date December 27, 2006

Subject Recordation of Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans (SFAS 158) Adjustments as of December 31, 2006

From Rod Griffin

To Amy Waffler, Tracy Harger, John Scalzo, Adell Esterak, Darlene Norris, Tyler Ross, Becky Buonavolonte, Julie Sherwood, Mike Baird, Bill DeRoy, Greg Adams, Sandra Bennett, Kevin Bethel, Don Hayes, Jerri Ruggiero, Neil Felber, Monica Parker

PURPOSE

This memo deals only with the mechanics of recording the year-end adjustments related to implementation of SFAS 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans in AEP's general ledgers. Hugh McCoy has written and distributed various documents regarding the theory and impact of SFAS 158, please refer to those items for additional background information.

Prior to 2006, the additional minimum liability (AML) was recorded in the same general ledger accounts that contained the accrued/prepaid pension balances. Given the complexities of FAS 158, we established new general ledger accounts to record the year-end FAS 158 adjustments to segregate this entry from the other activity.

Supplemental Employee Retirement Plan (SERP)

There are four issues related to recording the SERP additional minimum liability, accumulated other comprehensive income (AOCI) and the related deferred Federal income tax (DFIT).

1. The December 31, 2005 AML balance should be moved to the new general ledger liability account established to record the AML, FAS 158 SERP Payable Long Term (2283015). This entry was completed and posted December 26, 2006, the journal id is SERP_158 and the journal date is December 14, 2006.
2. Since there is no longer an intangible asset related to the AML/AOCI calculation, the intangible asset balance related to the SERP plan at December 31, 2005 in account 1740012 (Pension Plan) must be written off as a component of the year-end adjustment. Note that there will be no income statement impact when the intangible asset is written off.
3. Since the SERP is not funded, the portion of the total balance expected to be paid in 2007 must be recorded as a current liability as of December 31,

2006 in account 2420046 (FAS 158 SERP Payable – Current). Towers Perrin will provide this amount. Since there is no retrospective application of SFAS 158, it is not necessary to record any current portion as of December 31, 2005.

4. For our regulated companies, there will be no charge to equity for the AOCI balance; instead, this amount will be recorded as a regulated asset in account 1823167 (REG Asset FAS 158 SERP Plan). For AEPSC, the AOCI amount will be split between the regulated asset account and the equity account (2190004, OCI – Min Pen Liab FAS 158-SERP) using an allocation method not yet determined.

Qualified Plans

Since the qualified plans were prepaid as of December 31, 2005, there was no AML/AOCI amount recorded. As of December 21, 2006 we believe that the qualified plans will still be in a prepaid position after recordation of the 2006 AML. Therefore, the AML will be recorded as a credit in account 1650014 (FAS 158 Qual Contra Asset) which will reduce the prepaid balance on the balance sheet to the net prepaid position. If either plan (East or West) ends up in an accrued position after the AML calculation, the AML will be recorded in account 2283016 (FAS 158 Qual Payable Long Term) and the prepaid balance currently in account 1650010 (Prepaid Pension Benefits) will be moved to account 2283006 (SFAS 87 - Pensions). Since the value of the plan assets exceeds estimated payments for the next twelve months, no current portion will be recorded.

Similarly to the SERP plan, for our regulated companies, there will be no charge to equity for the AOCI balance; this amount will be recorded as a regulated asset in account 1823165 (REG Asset FAS 158 Qual Plan). For AEPSC, the AOCI amount will be split between the regulated asset account and the equity account (2190006, OCI – Min Pen Liab FAS 158-Qual) using an allocation method not yet determined.

Other Post Employment Benefits (OPEB)

Prior to SFAS 158 there was no AML recorded in relation to the OPEB accruals, so there is no beginning AML balance. Because the liability balance exceeds the plan assets, the AML will be recorded as an additional liability in account 2283016 (FAS 158 OPEB Payable Long Term). Because the plan is funded, and plan assets exceed the estimated payments for the next twelve months, no current liability will be recorded.

Similarly to the SERP and qualified plans, for our regulated companies, there will be no charge to equity for the AOCI balance. This amount will be recorded as a regulated asset in account 1823166 (REG Asset FAS 158 OPEB Plan). For AEPSC, the AOCI amount will be split between the regulated asset account and the equity account (2190007, OCI – Min Pen Liab FAS 158-OPEB) using an allocation method not yet determined.

AEP
AMERICAN ELECTRIC POWER

Date January 9, 2007

Subject Journal entries to record adjustments of implementing Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans (SFAS 158) as of December 31, 2006

From Rod Griffin, Amy Waffler, Tracy Harger, John Scalzo

To Adell Esterak, Darlene Norris, Tyler Ross, Becky Buonavolonte, Mike Baird, Bill DeRoy, Greg Adams, Sandra Bennett, Kevin Bethel, Don Hayes, Jerri Ruggiero, Neil Felber, Monica Parker, Andrea Wallace, Marsena Hartless, Julie Pierson, Mike Kelly, Jeff Bartsch, Randy Roush, Vicky Williams, Scott Travis, Diana Gregory, Scott Krawec, Craig Adelman, Hugh McCoy

This is a more detailed summary of the journal entries made to record the SFAS 158 amounts in the ledgers as of December 31, 2006. This memo should be read in conjunction with the December 27, 2006 memo describing the SFAS 158 impact.

Summary of pension and benefit adjustments at December 31, 2006:

FAS 112

- Reclassified the current portion of the FAS 112 liability to a new current liability account (2420027). The amount was calculated from the FAS 112 data found in the 2006 actuarial reports provided by Towers Perrin. The 2006 Projected Benefit Payments for medical, dental and life, COBRA continuation and health care continuation for UMWA pensioners were combined to calculate the total current liability.
- Reclassified the over-funded LTD portion of FAS 112 to a new asset account (1650016). These assets are held in a trust fund at Mellon Bank and used to pay LTD benefits. As of December 31, 2006, the east company trust fund assets exceeded the liability calculated by Towers Perrin and were therefore reclassified to the asset account. For the west companies, the liability exceeded the assets; consequently these amounts remained in the accrual account. However, to have the proper net asset balance for AEP consolidated, the total of the west companies liability was reclassified to the asset account within an elimination company. Note: the net balance in the LTD trust fund previously was recorded as a reduction to the FAS 112 liability recorded in account 2283005.

SERP

- Initially, the December 31, 2005 additional minimum liability (AML) was moved from account 2283000 to the newly created SERP FAS 158 liability account 2283015.
    - Before the December 31, 2006 FAS 158 calculations were received from Towers Perrin, all the balances related to the AML at December 31, 2005 were reversed. The intangible asset (1740012) and the deferred tax asset (1900009) were credited and the AML in 2283015 was debited.

FAS 158

We received the FAS 158 calculations from Towers Perrin Friday evening January 5, 2007 and prepared our calculations for journal entries as follows:

SERP

- Reconciled Towers' accrual balance to our ledger balances.
- Combined Towers' East and West calculations (accrual, unfunded position and estimated payments for 2007)
- Prepared journal entries to record the unfunded position to the long-term FAS 158 accrual account (2283015).
  For non-regulated companies, 65% of the offset was recorded to the AOCI account (2190004) and 35% was recorded to DFIT (1900009).
  For regulated companies, a spreadsheet provided by Hugh McCoy showing the percentage of regulatory asset offsets was used to calculate the portion of the offset that was recorded to the regulatory asset account (1823167).
- For AEPSC, (a non-regulated company) the FAS 158 adjustment was recorded as noted above for non-regulated companies. However, since a significant portion of the items billed by AEPSC are billed to regulated companies, 65% of the offset was reclassified to the regulatory asset account (1823167) on an elimination company, which was offset by credits to the AOCI (65%) and DFIT (35%) accounts.
- The 2007 estimated payments were reclassified to the current FAS 158 accrual (2420046), from the long-term FAS 158 accrual account (2283015).

See the table below for a summary of the accounts used to record the FAS 158 SERP balances as of December 31, 2006.

SERP	Unfunded Liability (Credit)	Other Comprehensive Income (OCI) (Debit)	Deferred FIT (Debit)	Regulatory Asset (Debit)
Non-regulated Companies	Long-Term 2283015 Current 2420046	2190004 (65% of unfunded liability)	1900009 (35% of unfunded liability)	
Regulated Companies	Long-Term 2283015 Current 2420046	2190004 (Only recorded if reg asset is not 100% of unfunded liability)	1900009 (Only recorded if reg asset is not 100% of unfunded liability)	1823167 (percentage per H. McCoy's spreadsheet)
Elimination BU for AEPSC reclassification		2190004 (65% of unfunded liability) (CREDIT)	1900009 (35% of unfunded liability) (CREDIT)	1823167 (65% of AEPSC's unfunded liability)

Qualified Pension Plan

- Reconciled Towers' prepaid balance to our ledger balances.
- Combined Towers' East and West calculations (prepaid and unfunded position)
- Prepared journal entries to record the projected benefit obligation to the FAS 158 contra-asset account (1650014). Since the plans are still in a net prepaid position after recording the unfunded projected benefit obligation, the prepaid asset was reduced in lieu of recording a liability.
  For non-regulated companies, 65% of the offset was recorded to the AOCI account (2190006) and 35% was recorded to DFIT (1900009).
  For regulated companies, a spreadsheet provided by Hugh McCoy showing the percentage of regulatory asset offsets was used to calculate the portion of the offset that was recorded to the regulatory asset account (1823165).
- For AEPSC, (a non-regulated company) the FAS 158 adjustment was recorded as noted above for non-regulated companies. However, since a significant portion of the items billed by AEPSC are billed to regulated companies, 65% of the offset was reclassified to the regulatory asset account (1823165) on an elimination company, which was offset by credits to the AOCI (65%) and DFIT (35%) accounts.
- Since the plan assets exceed the 2007 estimated payments, no current liability exists.

See the table below for a summary of the accounts used to record the FAS 158 qualified plan balances as of December 31, 2006.

Qualified Pension Plan	Unfunded Liability (Credit)	Other Comprehensive Income (OCI) (Debit)	Deferred FIT (Debit)	Regulatory Asset (Debit)
Non-regulated Companies	Long-Term 2283016	2190006 (65% of unfunded liability)	1900009 (35% of unfunded liability)	
Regulated Companies	Long-Term 2283016	2190006 (Only recorded if reg asset is not 100% of unfunded liability)	1900006 (Only recorded if reg asset is not 100% of unfunded liability)	1823165 (percentage per H. McCoy's spreadsheet)
Elimination BU for AEPSC reclassification		2190006 (65% of unfunded liability) (CREDIT)	1900009 (35% of unfunded liability) (CREDIT)	1823165 (65% of AEPSC's unfunded liability)

OPEB

- Reconciled Towers' accrual balance to our ledger balances.
- Combined Towers' East and West calculations (accrual, unfunded position and estimated payments for 2007)
- Prepared journal entries to record the unfunded position to the long-term FAS 158 accrual account (2283017).
  For non-regulated companies, 65% of the offset was recorded to the AOCI account (2190007) and 35% was recorded to DFIT (1900009).
  For regulated companies, a spreadsheet provided by Hugh McCoy showing the percentage of regulatory asset offsets was used to calculate the portion of the offset that was recorded to the regulatory asset account (1823166).
- For AEPSC, (a non-regulated company) the FAS 158 adjustment was recorded as noted above for non-regulated companies. However, since a significant portion of the items billed by AEPSC are billed to regulated companies, 57% of the offset was reclassified to the regulatory asset account (1823166) on an elimination company, which was offset by credits to the AOCI (65%) and DFIT (35%) accounts.
- The 2007 estimated payments for the non-UMWA plan were reclassified to the current FAS 158 accrual (2420080); the offset was the long-term FAS 158 accrual account (2283017). Since the plan assets exceed the 2007 estimated payments for the UMWA plan, no current liability exists for that plan.

See the table below for a summary of the accounts used to record the FAS 158 qualified plan balances as of December 31, 2006.

OPEB	Projected Benefit Obligation (Credit)	Other Comprehensive Income (OCI) (Debit)	Deferred FIT (Debit)	Regulatory Asset (Debit)
Non-regulated Companies	Long-Term 2283017 Current 2420080	2190007 (65% of unfunded liability)	1900009 (35% of unfunded liability)	
Regulated Companies	Long-Term 2283017 Current 2420080	2190007 (Only recorded if reg asset is not 100% of unfunded liability)	1900009 (Only recorded if reg asset is not 100% of unfunded liability)	1823166 (percentage per H. McCoy's spreadsheet)
Elimination BU for AEPSC reclassification		2190007 (65% of unfunded liability) (CREDIT)	1900009 (35% of unfunded liability) (CREDIT)	1823166 (57% of AEPSC's unfunded liability)