June 15, 2008

Ms. Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, NE,
Washington DC 20549-1090

Re: Release No. 33-8836 – Discussion Paper for Consideration by the Advisory Committee on Improvements to Financial Reporting (File No. 265-24)

Dear Ms. Morris:

It is suggested that the following steps be taken to improve financial reporting:

- defining the objective of financial reporting as being stewardship (a traditional transactional-based accountability process) and not decision-making. Economic reporting deals with the decision-making objective. This is discussed in my article: *A Look at the IASB/FASB Conceptual Framework* published in the March 2007 issue of *SPARK* (also on the internet by the same title) and attached to my September 8th Comments to the SEC Concept Release.
- defining financial analysis as the discipline for achieving the stewardship objective and economic analysis as the discipline for achieving the decision-making objective (as shown in Exhibit A).
- defining how these disciplines relate to one another within the process of *Asset Management*. This is discussed in the accompanying article: *A Global Accounting Standards Roadmap* (starting on page 3) of the March 2008 issue of *SPARK*.

It is my contention that the improvement of financial reporting can not occur until the confusion between the two disciplines of *Financial Analysis* and *Economic Analysis* is resolved.

I thank the Securities and Exchange Commission for the opportunity to comment.

Yours Truly

Don Bjerke
178 Deergrove Crescent
Regina Saskatchewan
S4S-5M1
E-mail bjerke@sasktel.net
Phone no. (306) 584-5001

Exhibit A

Financial Analysis

Considers the performance of financial statements over a short term

Viewed on a company or business segment basis

Uses historic and projected financial information

Does not relate to valuation or appraisal

Factors Considered:
- Earning impact
- Legal and tax requirements
- Full cost recovery
- GAAP
- Allocation of common costs
- Financial regulatory requirements

Uses:
- Determining profitability on an accounting basis
- Constraint on economic decision-making
- Operational goal setting on a corporate and segment basis
- Determining full costs
- Setting revenue requirements on a segment or company basis

Capital Recovery:

- Depreciation + Debt Interest + Equity Interest

Indicators:
- EBITDA
- EBIT
- NOPLAT
- Net Income
- Return on Equity (or Capital Employed)
- Financial statements

Economic Analysis

Considers viability over the long term

Viewed on a company, project, product, or service basis

Uses current and future cash flows

Does relate to valuation or appraisal

Factors Considered:
- Opportunity costs
- Elasticity
- Causal cash flows
- Price/quantity relationships
- Contribution to common costs
- Economic regulatory requirements

Uses:
- Determining profitability on an economic basis
- Decisions to accept - reject or continue - discontinue
- Choosing the best of all possible alternatives
- Determining pricing “mark-ups”
- Determining minimum revenue requirements for pricing

Capital Recovery:

- Annuity $\{(a/p)^{r}$ or $(a/f)^{r}\}$ where r = cost of capital

Evaluators:
- Net Present Value
- Rate Of Return on Capital
- Present Worth of Annual Costs
- Annual Equivalent Costs
- Discounted Pay Back
- Economic statements

Fortnightly's Spark*
March, 2008
Utility Financial Reporting
A GLOBAL ACCOUNTING STANDARDS ROADMAP

Don Bjerke [FNa1]

"If you don't know where you want to go" said the Cheshire Cat "any road(map) will get you there" (the word "map" has been added). - *from Alice in Wonderland*

The Securities and Exchange Commission on August 7, 2007 issued a Concept Release on allowing U.S. issuers to prepare financial statements in accordance with International Financial Reporting Standards (IFRS), and invited comments to be made on or before November 13, 2007.[FN1] These comments are to assist the SEC to lay out a roadmap towards the development of a single set of global standards. To date, 100 jurisdictions, including Hong Kong, Australia, New Zealand and the EU countries, either require or permit the use of IFRS or a local variant of IFRS. Recently, other jurisdictions with large capital markets (*e.g*. Canada, Japan, and Korea) have announced plans to replace with IFRS their national GAAP for public companies.

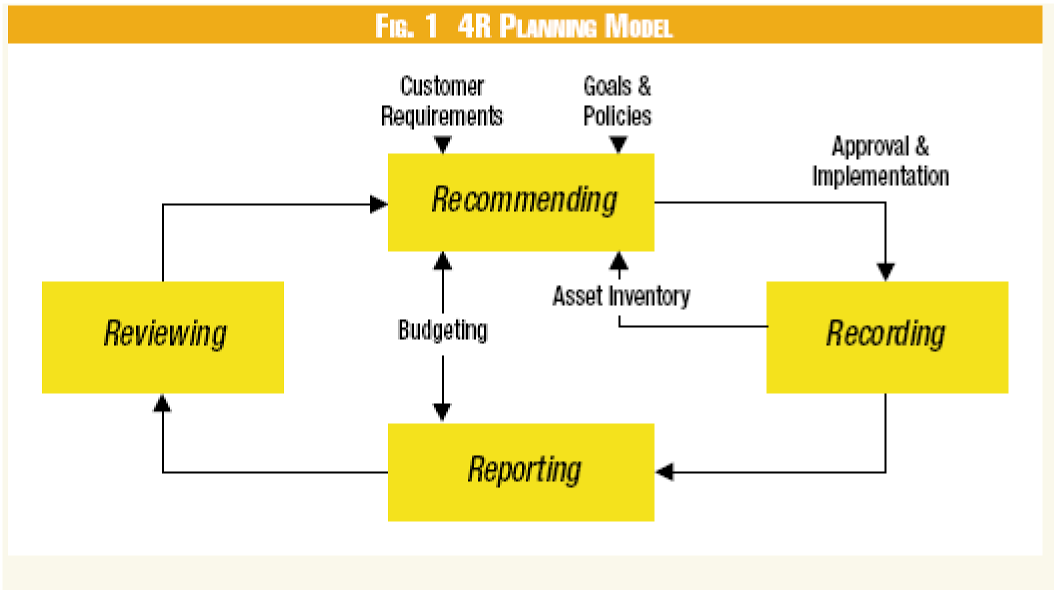
The roadmaps being discussed primarily are aimed at meeting the concerns of regulators, accounting-standard setters, financial analysts, companies, their auditors, creditors, investors and shareholders. But none address the overall information needs from the technical perspective of managing assets or *Asset Management*. Although many think of *Asset Management* as only dealing with stocks and bonds, organizations such as public utilities have far more assets than just those that can be invested in a bank. There is much more to it than just ensuring that one gets a good return on investment. *Asset Management* in this context is defined as the combination of management, financial, economic, engineering, and other practices applied to physical assets with the objective of providing the required level of service in the most-effective manner.[FN2] A roadmap to global accounting standards must coordinate the desires of all parties that use economic and financial information relating to physical assets for public utilities and other capital-intensive organizations.

Asset Management will be severely challenged from a financial, energy, and global-warming perspective in the days to come. The diminishing oil and gas reserves[FN3] are forcing us to look at alternate energy sources resulting in dramatic changes to our infrastructure (*i.e*. transportation systems, housing, food distribution, *etc*). Environmental conditions (droughts, rising sea levels, hurricanes, *etc*.) will be causing huge population pressures. Financing for future infrastructures will be limited so that decisions on the proper type of infrastructure must be correctly made.

The 4R Planning Model

The components of an *Asset Management* system can be described through the use of the following 4R Planning Model. (*see Fig. 1*)

The 4R Planning Model is described in the article: *A look at the IASB/FASB Conceptual Framework* published in the March 2007 issue of *SPARK* (found on the internet by the same title). It is also attached to the September 8th Comments to the SEC Concept Release. The components of *Asset Management* may be discussed within each module of the 4R Planning Model.



The *Recommending Module*

The objective of this module is to provide economic information in recommending the most viable alternative to those who need this information for decision-making purposes.

The FASB/FAF contends that the roadmap must be an “ideal global reporting system that supports decision-making across borders.”[FN4]

This approach, however, was contested by almost 90% of the respondents in the preliminary views on the conceptual framework. These respondents stated that decision-making should not be “the single, overriding objective of financial reporting.”[FN5]

For them, the objective of providing information to help users assess the stewardship or accountability of management is not encompassed within the decision-usefulness objective, but stated as a separate objective. This is the stewardship objective located within the Reporting module.

Asset Management is a decision-making framework that determines the optimum plant programs within the *Recommending module* described as:

• establishing the customer performance expectations and the organizational goals and objectives that will meet these expectations.

• determining whether the infrastructure being used will meet these expectations by using the inventory collected in the Recording module and by determining whether a change in future operating conditions will require a change in this infrastructure.

• determining alternative courses of action whether to maintain, upgrade, modify, or replace this infrastructure in meeting the future customer requirements.

• producing the optimum cost-effective alternative that is within budgetary guidelines in meeting the organization's needs and recommending this optimum alternative to upper management. This would include a risk assessment such as a sensitivity analysis to determine the most critical variable(s) contributing to the success of the optimum alternative.

Determining the optimum alternative involves conducting an economic study using six current and/or future cash flows consisting of revenue, capital expenditure, cash expense, income tax, gross salvage and cost of removal over a study period using the current cost of capital. The asset inventory, appraised at its fair value in the *Reporting Module*, is used in this study as a capital expenditure cash flow. Economic statements will show the value of the plant facilities and hence determine whether they should be maintained or replaced in meeting future customer requirements. The designers of the roadmap to global accounting standards must therefore realize that decision-making information is being generated within the *Recommending module* of the *Asset Management* process (usually every three years) and these are available from economic statements that may be formatted in different ways.

The *Recording Module*

After the program is approved and implemented, the purpose of the *Recording module* is to collect, summarize and analyze data in the most cost-effective manner. *Asset Management* is a data-intensive process, with information management at its centre. It requires inventory-based information on all the physical assets in the program. This includes descriptions, types and number, functional responsibilities, and past, current and expected future condition. This is required in providing asset inventory appraised at its fair value to the *Recommending module* and to provide asset inventory in historical and budgetary dollars to the *Recording module*. The determination of the fair value of plant and equipment is based on taking the asset replacement cost and subtracting from this asset replacement cost the depreciation reserve based on this cost. Historical and budget dollars consist of plant balances, accumulated depreciation, and depreciation. Similar information is required in determining both types of inventory studies such as plant additions, the vintage year of plant additions, survivor curves, and average service lives. Additional information for the determination of the asset inventory at its fair value consists of different types of plant indices and service factors. Both studies include a life-cycle cost analysis consisting of a depreciation system defined as a method (*i.e*. straight line), a procedure (*i.e*. equal life group), and a technique (*i.e*. whole life).

An asset-management plan also must be developed to specify what data is to be collected. The plan should include frequency of data collection, quality standards and who is to do the data tracking. The plan must include the costs involved in tracking the data. This asset management-tracking plan must be consistent with the organizational goals as expressed in its performance measurements.

The *Reporting Module*

The purpose of the *Reporting module* is to provide financial statements in order to evaluate the performance of an organization. The reporting of performance and budget information within this module is important to the *Asset Management* process. The programs proposed within the *Recommending module* must be within budget.

In the attempt to represent economic reality, the U.S. GAAP and, to a lesser extent, IFRS continue to generate financial statements based on a mixed-attribute model where some assets and liabilities are shown in historical dollars and others are shown in fair value dollars. As a result, the mixed-attribute model creates asset/liability mismatches. It fails to represent economic reality and it fails to report the true performance of an organization. The mixed-attribute model leads to highly complex and confusing rules and standards and introduces volatility in the financial statements. Included in the roadmap or blueprint towards the “ideal global reporting system,” FASB is taking deliberate steps towards fair-value accounting. This is evident in its Statements 133, 155, 157 and 159. From an *Asset Management* perspective, this information already exists within the *Recommending module*. The various roadmaps (fair value, historical cost, and mixed-attribute) point to an urgent requirement of a conceptual framework for determining one uniform global objective for financial reporting that incorporates the main driving force of any organization - technology.

The *Reviewing Module*

The purpose of the *Reviewing module* is to judge the performance of an organization in comparing what it actually did to what it should have done. The success of *Asset Management* program strategies and practices is measured by the variance in performance in what it actually did to what it should have done. The variance in performance is a feedback mechanism to the *Recommending module* to allow decision-makers to take corrective action in meeting performance targets.

One of the concerns in judging an organization's performance from a legal perspective is the move from a rules-based U.S. system to a principles-based IFRS system. A move to a principles-based IFRS system will increase the reliance on the professional judgment exercised by both preparers and auditors. Some contend that the current U.S. legal and regulatory environment subjects preparers and auditors to second-guessing by regulators and potential litigants and inhibits the use of professional judgment. If the regulators or the auditors are viewed as creating written or unwritten rules to accompany what is purported to be principles-based standards, then principles-based standards will no longer exist. With the adoption of transaction-based historical financial statements, it is suggested that financial statements can remain rules-based. These statements would be less complex and more transparent, because concepts such as fair value would not be used. Disclosures would be less detailed and less lengthy because information for investment decisions would be obtained from the *Recommending module*. Economic statements in the *Recommending module* would then be principles-based. They would be allowed a greater level of discretion and subjectivity. This would allow for greater professional judgment and not be subject to the same level of audit rigor as are financial statements.

Conclusion

Asset Management is defined as the combination of management, financial, economic, engineering, and other practices applied to physical assets with the objective of providing the required level of service in the most-effective manner. In providing the required level of service in the most-effective manner, *Asset Management* will require simple and effective tools to assess economic alternatives and an accounting score card to assess how well we are doing. What is required is a simple planning model where decisions can be made using basic economic principles and where these decisions can be tracked using basic accounting rules. The one thing that is not needed is a mixed-attribute model that fails to represent the economic reality and fails to represent the true performance of an organization, such as a public utility. In order to get where one needs to go, the above factors must be considered to lead to a global roadmap.

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FNa1. *Don Bjerke is a retired Professional Engineering with work experience in the area of Economic & Financial Analysis with Saskatchewan Telecommunications (SaskTel). He may be contacted at bjerke@sasktel.net.*

FN1. These comments can be seen on the SEC website under "IFRS Roadmap," then click on "are available."

FN2. From N.Z. Infrastructure Asset Valuation & Depreciation Guidelines - Version 2.0, 2006 Page x.

FN3. Studies are showing that peak oil production already reached its peak in May 2005 and there is now a declining slope of oil production that will force finding and using alternate energy alternatives. See the web site: The Oil Drum/Discussions about Energy and Our Future. The Peak Oil Update shows Crude Oil and NGL (Natural Gas Liquids) peak to be May 2005.

FN4. Comment letter on SEC's *Concept Release on Allowing U.S. Issuers to Prepare Financial Statements in Accordance with International Financial Standards* dated Nov. 7, 2007 page 4.

FN5. Agenda paper 3A. *Conceptual Framework - Comment letter summary Chapter 1 and 2 of the Conceptual Framework Discussion Paper*, 20 Feb. 2007 item #40.