

EATON CORP
Form 11-K
June 24, 2008

Table of Contents

SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 11-K
Annual Report Pursuant to Section 15(d) of the
Securities Exchange Act of 1934

☐ **Annual report pursuant to Section 15(d) of the Securities Exchange Act of 1934 (Fee required)**
For the fiscal year ended December 31, 2007

Or

○ **Transition report pursuant to Section 15(d) of the Securities Exchange Act of 1934 (No fee required)**
For the transition period from _____ to _____

Commission file number _____

A. Full title of the plan and the address of the plan, if different from that of the issuer named below:

Eaton Electrical de Puerto Rico, Inc.

Retirement Savings Plan

B. Name of issuer of the securities held pursuant to the plan and the address of its principal executive office:

Eaton Corporation
1111 Superior Avenue
Cleveland, Ohio 44114-2584

SIGNATURES

The Plan. Pursuant to the requirements of the Securities Exchange Act of 1934, the trustees (or other persons who administer the employee benefit plan) have duly caused this annual report to be signed on its behalf by the undersigned hereunto duly authorized.

(Name of Plan)
EATON ELECTRICAL DE PUERTO RICO,
INC.
RETIREMENT SAVINGS PLAN

Date: June 24, 2008

By: Eaton Corporation Pension
Administration Committee

By: /s/ B. K. Rawot
B. K. Rawot
Vice President and Controller
Eaton Corporation

Table of Contents

EATON ELECTRICAL DE PUERTO RICO, INC.

RETIREMENT SAVINGS PLAN
FINANCIAL STATEMENTS
WITH
REPORT OF INDEPENDENT
REGISTERED PUBLIC ACCOUNTING FIRM
December 31, 2007

INDEX

| | Page |
|---|--------|
| <u>Report of Independent Registered Public Accounting Firm</u> | 1 |
| Financial Statements: | |
| <u>Statement of Net Assets Available for Benefits</u> | 2 |
| <u>Statement of Changes in Net Assets Available for Benefits</u> | 3 |
| <u>Notes to Financial Statements</u> | 4 - 10 |
| Supplemental Schedule: | |
| <u>Schedule of Assets Held for Investment Purposes at End of Year</u> <u>EX-23.1</u> | 11 |

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Pension Administration Committee and the
Pension Investment Committee Eaton Corporation

We have audited the accompanying Statement of Net Assets Available for Benefits of the EATON ELECTRICAL DE PUERTO RICO, INC. RETIREMENT SAVINGS PLAN as of December 31, 2007 and 2006, and the related Statement of Changes in Net Assets Available for Benefits for the years then ended. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Plan's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis of designing audit procedures that are appropriate in the circumstances, but not for expressing an opinion on the effectiveness of the Plan's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets available for benefits of Eaton Electrical De Puerto Rico, Inc. Retirement Savings Plan as of December 31, 2007 and 2006, and the changes in its net assets available for benefits for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Our audits were performed for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying supplemental schedule of assets (held at end of year) as of December 31, 2007, is presented for the purposes of additional analysis and is not a required part of the financial statements but is supplemental information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. The supplemental schedule is the responsibility of the Plan's management. The supplemental information has been subjected to the auditing procedures applied in our audits of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

/s/ MEADEN & MOORE, LTD.

Certified Public Accountants

June 2, 2008

Cleveland, Ohio

Table of Contents

STATEMENT OF NET ASSETS AVAILABLE FOR BENEFITS
Eaton Electrical de Puerto Rico, Inc.
Retirement Savings Plan

| | December 31 | |
|--|--------------------------|-------------------|
| | 2007 | 2006 |
| ASSETS | | |
| Receivable Employer contributions | \$ 19,862 | \$ 109,261 |
| Receivable Employee contributions | 40,179 | 262,769 |
| Receivable Interest | | 3,148 |
| Total Receivables | 60,041 | 375,178 |
| Investments: | | |
| Key Bank EB Magic Fund | 22,970,944 | 20,081,129 |
| Vanguard Institutional Index | 4,888,424 | |
| Victory Stock Index Fund | | 5,093,276 |
| Eaton Corporation Common Stock | 4,953,332 | 4,160,877 |
| Vanguard Balanced Index Fund | 965,010 | 832,743 |
| Vanguard Developed Markets Index | 1,167,594 | 930,085 |
| EB Money Market Fund | | 10 |
| Total Investments | 34,945,304 | 31,098,120 |
| Total Assets | 35,005,345 | 31,473,298 |
| LIABILITIES | | |
| Net Pending Purchases | | 2,965 |
| Net Assets Available for Benefits at Fair Value | 35,005,345 | 31,470,333 |
| Adjustment from fair value to contract value for fully benefit- responsive investment contract | 229,604 | 399,777 |
| Net Assets Available for Benefits | \$ 35,234,949 | \$ 31,870,110 |

See accompanying notes.

Table of Contents

STATEMENT OF CHANGES IN NET ASSETS AVAILABLE FOR BENEFITS
Eaton Electrical de Puerto Rico, Inc.
Retirement Savings Plan

| | Year Ended December 31 | |
|---|------------------------|---------------|
| | 2007 | 2006 |
| Additions to Net Assets Attributed to: | | |
| Contributions: | | |
| Employer | \$ 1,131,634 | \$ 1,107,455 |
| Employee | 2,856,880 | 2,724,500 |
| | 3,988,514 | 3,831,955 |
| Interest and dividend income | 239,875 | 200,777 |
| Net unrealized/realized appreciation | 2,438,866 | 2,178,214 |
| | | |
| Total Additions | 6,667,255 | 6,210,946 |
| Deductions from Net Assets Attributed to: | | |
| Benefits paid to participants | 3,300,881 | 3,281,344 |
| Administrative Expenses | 1,535 | |
| | | |
| Total Deductions | 3,302,416 | 3,281,344 |
| | | |
| Net Increase | 3,364,839 | 2,929,602 |
| | | |
| Net Assets Available for Benefits: | | |
| Beginning of Year | 31,870,110 | 28,940,508 |
| | | |
| End of Year | \$ 35,234,949 | \$ 31,870,110 |

See accompanying notes.

Table of Contents

NOTES TO FINANCIAL STATEMENTS
Eaton Electrical de Puerto Rico, Inc.
Retirement Savings Plan

1 Description of Plan

The following description of The Eaton Electrical de Puerto Rico, Inc. Retirement Savings Plan provides only general information. Participants should refer to the Plan document and summary plan description, which is available from the Human Resources Department upon request, for a complete description of the Plan's provisions.

General:

Effective February 1, 1994, Eaton Electrical de Puerto Rico, Inc. (the Company or the Plan Sponsor), which was formerly known as Cutler-Hammer de Puerto Rico, Inc., a wholly owned subsidiary of Eaton Corporation, established the Plan.

Eligibility:

The Plan provides that all full-time employees not covered under a collective bargaining agreement of the Company are eligible to participate in the Plan immediately upon employment.

Contributions:

Employee Contributions Eligible employees may elect to make before-tax contributions to the Plan up to a maximum of 10% of their compensation.

Employer Contributions The Company has agreed to make a voluntarily matching contribution of 50% of the employee contributions not to exceed 3% of the total compensation of the employee.

Contributions are subject to limitations on annual additions and other limitations imposed by Section 1165(e) of the Puerto Rico Internal Revenue Code, as amended from time to time, as defined in the Plan agreement.

Participants' Accounts:

Each participant's account is credited with the participant's contributions and allocations of Company contributions, Plan earnings and transaction costs. Allocations are based on participant earnings or account balances, as defined. The benefit to which a participant is entitled is the benefit that can be provided from the participant's account. On termination of service, a participant is eligible to receive a lump-sum amount equal to the vested value of his or her account.

Table of Contents

NOTES TO FINANCIAL STATEMENTS
Eaton Electrical de Puerto Rico, Inc.
Retirement Savings Plan

1 Description of Plan, Continued

Vesting:

All participants are 100% vested in their contributions plus actual earnings thereon. Vesting in the Company contribution portion of their accounts plus actual earnings thereon is based on years of continuous service. Participants are 100% vested after three years of credited service or upon the death of the participant.

Forfeitures:

Forfeited non-vested accounts totaled \$21,023 and \$37,665 as of December 31, 2007 and 2006, respectively. Future employer contributions will be reduced by these amounts.

Hardship Withdrawals:

Hardship withdrawals are permitted in accordance with Internal Revenue Service guidelines.

Investment Options:

Contributions may be invested in any of the fund options available under the Plan.

2 Summary of Significant Accounting Policies

Basis of Accounting:

The financial statements of the Eaton Electrical de Puerto Rico, Inc. Retirement Savings Plan (the Plan) are prepared under the accrual method of accounting.

Investment Valuation and Income Recognition:

Investments are stated at fair value as measured by quoted prices in active markets except for the common/collective trust fund and the money market fund, which are stated at fair value as determined by the trustee.

Purchases and sales of securities are recorded on a trade-date basis. Dividends are recorded on the ex-dividend date.

Table of Contents

NOTES TO FINANCIAL STATEMENTS
Eaton Electrical de Puerto Rico, Inc.
Retirement Savings Plan

2 Summary of Significant Accounting Policies, Continued

Investment Valuation and Income Recognition, Continued:

As described in Financial Accounting Standards Board Staff Position, FSP AAG INV-1 and SOP 94-4-1, Reporting of Fully Benefit-Responsive Investment Contracts Held by Certain Investment Companies Subject to the AICPA Investment Company Guide and Defined-Contribution Health and Welfare and Pension Plans (the FSP), investment contracts held by a defined-contribution plan are required to be reported at fair value. However, contract value is the relevant measurement attribute for that portion of the net assets available for benefits of a defined-contribution plan attributable to fully benefit-responsive investment contracts because contract value is the amount participants would receive if they were to initiate permitted transactions under the terms of the plan. As required by the FSP, the Statement of Net Assets Available for Benefits presents the fair value of the investment contracts as well as the adjustment of the fully benefit-responsive investment contracts from fair value to contract value. The Statement of Changes in Net Assets Available for Benefits is prepared on a contract value basis.

Use of Estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Administrative Fees:

Substantially all administrative, management fees and other expenses of the Plan are paid by the Company. Certain transaction costs are paid by the participants.

Plan Termination:

The Company may amend, modify, suspend or terminate the Plan, provided that no assets held by the Plan or income thereon received for the purposes of the Plan shall be used for, or diverted to, purposes other than for the exclusive benefit of participating employees or their beneficiaries.

Table of Contents

NOTES TO FINANCIAL STATEMENTS
Eaton Electrical de Puerto Rico, Inc.
Retirement Savings Plan

2 Summary of Significant Accounting Policies, Continued***Risks and Uncertainties:***

The Plan's investment include investments in mutual funds and collective funds holding investment contracts with varying degrees of risk, such as interest rate, credit and overall market volatility risks. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the values of investment securities will occur in the near term and such changes could materially affect the amounts reported in the statement of net assets available for Plan benefits.

3 Investments

The Plan's funds are invested in various investments through the Key Trust Company throughout 2006 and through August 2007. Between the period of July and August 2007, Key Trust served as co-trustee. Effective July 1, 2007 Banco Popular became the sole trustee. Investments which constitute more than 5% of the Plan's net assets are:

| | 2007 | 2006 |
|--|---------------------|--------------|
| Key Bank EB Managed Guaranteed Investment Contract Fund | \$22,970,944 | \$20,081,129 |
| Vanguard Institutional Index | \$ 4,888,424 | NA |
| Victory Stock Index Fund | NA | \$ 5,093,276 |
| Eaton Corporation Common Shares (A unitized fund of Eaton Shares and cash as of July 1, 2007) | \$ 4,953,332 | \$ 4,160,877 |
| During 2007 and 2006, the Plan's investments (including investments purchased, sold as well as held during the year) appreciated in fair value as follows: | | |
| Common/collective trust funds | \$ 1,011,850 | \$ 900,543 |
| Common stock | 1,162,356 | 443,878 |
| Mutual funds | 264,660 | 833,793 |
| | \$ 2,438,866 | \$ 2,178,214 |

Table of Contents

NOTES TO FINANCIAL STATEMENTS
Eaton Electrical de Puerto Rico, Inc.
Retirement Savings Plan

4 Tax Status

The Plan has received a determination letter from the Puerto Rico Treasury Department dated August 24, 1999, stating that the Plan meets the requirements for qualification under Puerto Rico income tax laws and that the related trust is exempt from income taxes. Subsequent to this determination the Plan was amended. Once qualified, the Plan is required to operate in conformity with the income tax laws of Puerto Rico to maintain its qualification. The Plan administrator believes the Plan is being operated in compliance with the applicable requirements of the income tax laws of Puerto Rico and, therefore, believes that the Plan, as amended, is qualified and the related trust is tax exempt.

5 Reconciliation of Financial Statements to Form 5500

The following is a reconciliation of net assets available for benefits per the financial statements to the Form 5500:

| | Year Ended December 31 | |
|--|---------------------------|---------------|
| | 2007 | 2006 |
| Net assets available for benefits per the financial statements | \$ 35,234,949 | \$ 31,870,110 |
| Amounts allocated to withdrawing participants | | (700,246) |
| Net assets available for benefits per Form 5500 | \$ 35,234,949 | \$ 31,169,864 |

The following is a reconciliation of the benefits paid to participants per the financial statements to the Form 5500:

| | Year Ended December 31 | |
|--|---------------------------|--------------|
| | 2007 | 2006 |
| Benefits paid to participants per the financial statements | \$ 3,300,881 | \$ 3,281,344 |
| Add amounts allocated to withdrawing participants at December 31, 2007 | | |
| at December 31, 2006 | | 700,246 |
| Deduct amounts allocated to withdrawing participants at December 31, 2006 | (700,246) | |
| at December 31, 2005 | | (615,178) |
| Benefits paid to participants per Form 5500 | \$ 2,600,635 | \$ 3,366,412 |

Table of Contents

NOTES TO FINANCIAL STATEMENTS

Eaton Electrical de Puerto Rico, Inc.

Retirement Savings Plan

5 Reconciliation of Financial Statements to Form 5500, Continued

Amounts allocated to withdrawing participants are recorded on the Form 5500 for benefit claims that have been processed and approved for payment prior to the end of the Plan year but not yet paid.

6 Party-in-Interest Transactions

Party-in-interest transactions include the investment in the common stock of Eaton Corporation, the investment in the investment funds of the trustee and the payment of administrative expenses by the Company. Such transactions are exempt from being prohibited transactions.

During 2007 and 2006, the Plan received \$88,835 and \$81,836, respectively, in common stock dividends from Eaton Corporation.

7 Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements (FAS 157). This standard clarifies the definition of fair value for financial reporting, establishes a framework for measuring fair value and requires additional disclosures about the use of fair value measurements. FAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The adoption of FAS 157 will not impact the amounts reported in the financial statements, however, additional disclosures will be required to describe the inputs used to develop the measurements of fair value and the effect of certain of the measurements reported in the statement of operations for a fiscal period.

In March 2008, the FASB issued SFAS 161, Disclosure about Derivative Instruments and Hedging Activities , which amends the disclosure requirements of SFAS 133. SFAS 161 requires increased disclosures about derivative instruments and hedging activities and their effects on an entity s financial position, financial performance, and cash flows. SFAS 161 is effective for fiscal years beginning after November 15, 2008, with early adoption permitted. The effect of SFAS 161 has not yet been determined.

Table of Contents

NOTES TO FINANCIAL STATEMENTS

Eaton Electrical de Puerto Rico, Inc.

Retirement Savings Plan

7 Recent Accounting Pronouncements, Continued

In May 2008, the Financial Accounting Standards Board (FASB) issued Statement of Financial Account Standards (SFAS) 162, The hierarchy of Generally Accepted Accounting Principles , which is intended to improve financial reporting by indentifying the sources of accounting principles and a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with U.S. GAAP for nongovernmental entities. SFAS 162 will be effected 60 days after U.S. Securities and Exchange Commission approves the Public Company Accounting Oversight Board s amendments to AU section 411, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles . SFAS 162 is not expected to have a material impact on the Plan s financial statements.

8 Benefit-Responsive Investment Contract

The Plan holds an interest in a benefit-responsive investment contract with Key Bank National Association (Key Bank). Key Bank maintains the contributions in a general account. The account is credited with earnings on the underlying investments and charged for participant withdrawals and administrative expenses. The guaranteed investment contract issuer is contractually obligated to repay the principal and a specified interest rate that is guaranteed to the Plan.

As described in Note 2, because the guaranteed investment contract is fully benefit-responsive, contract value is the relevant measurement attribute for that portion of the net assets available for benefits attributable to the guaranteed investment contract. Contract value, as reported to the Plan by Key Bank, represents contributions made under the contract, plus earnings, less participant withdrawals and administrative expenses. Participants may ordinarily direct the withdrawal or transfer of all or a portion of their investment at contract value.

The average market yield of the Fund for 2007 and 2006 was 4.49% and 4.71%, respectively. This yield is calculated based on actual investment income from the underlying investments for the last month of the year, annualized and divided by the fair value of the investment portfolio on the report date. The average yield of the Fund with an adjustment to reflect the actual interest rate credited to participants in the Fund was 4.54% and 4.63%, respectively.

There are no reserves against contract value for credit risk of the contract issuer or otherwise. The crediting interest rate is based on a formula agreed upon with the issuer, but it may not be less than zero percent. Such interest rates are reviewed on a quarterly basis for resetting.

The fair value is based on various valuation approaches dependent on the underlying investments of the contract.

Certain events limit the ability of the Plan to transact at contract value with the issuer. The Plan Administrator does not believe that the occurrence of any such value event, which would limit the Plan s ability to transact at contract value with participants is probable. The issuer may terminate the contract for cause at any time.

Table of Contents

SCHEDULE OF ASSETS HELD FOR INVESTMENT PURPOSES AT END OF YEAR

Form 5500, Schedule H, Part IV, Line 4i

Eaton Electrical de Puerto Rico, Inc.

Retirement Savings Plan

EIN 34-1756466

Plan Number 002

December 31, 2007

| (a) | (b) Identity of Issue, Borrower, Lessor, or Similar Party | (c) Description of Investment Including Maturity Date, Rate of Interest, Collateral, Par or Maturity Value | (d) Cost | (e) Current Value |
|-----|--|---|-------------|-------------------------|
| * | Key Bank EB Magic Fund | Common/collective trust funds - contract value | N/A | \$ 23,200,548 |
| | Vanguard Institutional Index | Mutual Funds | N/A | 4,888,424 |
| | Eaton Corporation Common | Common stock | N/A | 4,953,332 |
| * | Stock | | | |
| | Vanguard Balanced Index | Mutual Funds | N/A | 965,010 |
| | Fund | | | |
| | Vanguard Developed Markets | Mutual Funds | N/A | 1,167,594 |
| | Index | | | |
| | | | | \$ 35,174,908 |

* Party-in-interest to the Plan.