EATON CORP
Form 11-K
June 29, 2006

**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**

þ **Annual report pursuant to Section 15(d) of the Securities Exchange Act of 1934 (Fee required)**
**For the fiscal year ended December 31, 2005**

**Or**

o **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 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

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**Table of Contents**

## 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 SAVINGS PLAN
Date: June 29, 2006
By: Eaton Corporation Pension Administration Committee By: /s/ B. K. Rawot B. K. Rawot Vice President and Controller
Eaton Corporation

**Table of Contents**

Audited Financial Statements and
Supplemental Schedule
Eaton Savings Plan
December 31, 2005 and 2004 and Year Ended December 31, 2005
With Report of Independent Registered Accounting Firm

**Table of Contents**

Eaton Savings Plan
Audited Financial Statements and Supplemental Schedule
December 31, 2005 and 2004 and
Year Ended December 31, 2005

**Contents**

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 statements of net assets available for benefits of the Eaton Savings Plan as of December 31, 2005 and the related statement of changes in net assets available for benefits for the year ended December 31, 2005. 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 audit. The financial statement of the Eaton Savings Plan as of December 31, 2004, was audited by other auditors whose report dated June 29, 2005, expressed an unqualified opinion on the financial statement.

We conducted our audit in accordance with auditing 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 for designing audit procedures that are appropriate in the circumstances, but not for the purposes of expressing an opinion on the effectiveness of the Plan s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 2005 financial statements referred to above present fairly, in all material respects, the net assets available for benefits of the Plan at December 31, 2005 and the changes in its net assets available for benefits for the year ended December 31, 2005, in conformity with U.S. generally accepted accounting principles.

Our audit was 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, 2005, is presented for 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. This supplemental schedule is the responsibility of the Plan s management. The supplemental schedule has been subjected to the auditing procedures applied in our audit 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.

MEADEN & MOORE, LTD
Cleveland, Ohio
June 14, 2006

**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 Savings Plan as of December 31, 2004. This financial statement is the responsibility of the Plan s management. Our responsibility is to express an opinion on this financial statement based on our audit.

We conducted our audit in accordance with auditing 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 statement is 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 for designing audit procedures that are appropriate in the circumstances, but not for the purposes of 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 statement. 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 audit provides a reasonable basis for our opinion.

In our opinion, the financial statement referred to above presents fairly, in all material respects, the net assets available for benefits of the Plan at December 31, 2004, in conformity with U.S. generally accepted accounting principles.

ERNST & YOUNG LLP

Cleveland, Ohio

June 29, 2005

**Table of Contents**

Eaton Savings Plan
Statements of Net Assets Available for Benefits

| | December 31 | |
|---|---|---|
| | **2005** | **2004** |
| **Assets** | | |
| Investments, at fair value: | | |
| Plan interest in Eaton Employee Savings Trust | **$2,218,953,948** | $2,219,862,339 |
| Participant notes receivable | **50,885,157** | 48,690,065 |
| Total investments | **2,269,839,105** | 2,268,552,404 |
| Receivables: | | |
| Contributions: | | |
| Participants | **2,991,640** | 297,839 |
| Employer | **3,458,260** | 149,551 |
| Interest | **812,076** | 18,383 |
| Total receivables | **7,261,976** | 465,773 |
| Net assets available for benefits | **$2,277,101,081** | $2,269,018,177 |

*See notes to financial statements.*

3

Table of Contents

Eaton Savings Plan
Statement of Changes in Net Assets Available for Benefits
Year Ended December 31, 2005

| | |
|---|---|
| **Additions** | |
| Investment income: | |
| Plan interest in Eaton Employee Savings Trust investment gain | **$ 55,270,474** |
| Interest | **3,660,486** |
| | **58,930,960** |
| Contributions: | |
| Participants | **91,661,962** |
| Rollovers | **11,914,512** |
| Employer | **41,692,981** |
| Total contributions | **145,269,455** |
| Transfers from other plans | **5,681,304** |
| Total additions | **209,881,719** |
| **Deductions** | |
| Benefits paid to participants | **201,008,980** |
| Administrative expenses | **423,815** |
| Transfer to other plans | **366,020** |
| Total deductions | **201,798,815** |
| Net increase | **8,082,904** |
| Net assets available for benefits at beginning of year | **2,269,018,177** |
| Net assets available for benefits at end of year | **$ 2,277,101,081** |

*See notes to financial statements.*

Table of Contents

Eaton Savings Plan
Notes to Financial Statements
December 31, 2005 and 2004 and
Year Ended December 31, 2005

**1. Significant Accounting Policies**

**Basis of Accounting**

The financial statements of the Eaton Savings Plan (the Plan) are prepared under the accrual method of accounting.

**Investment Valuation and Income Recognition**

Effective January 3, 2002, trustee responsibilities for the Plan were transferred from Key Trust Company of Ohio, N.A., to Fidelity Management Trust Company, and the Plan s investments, excluding participant loans, were invested in the Eaton Employee Savings Trust (Master Trust), which was established for the investment of assets of the Plan and the Eaton Personal Investment Plan. The fair value of the Plan s interest in the individual funds of the Master Trust is based on the value of the Plan s interest in the fund as of the transfer date plus actual contributions and allocated investment income (loss) less actual distributions.

The investments of the Plan, except for the Eaton Stable Value Fund in the Master Trust, are stated at fair value. Securities traded on a national securities exchange are valued at the last reported sales price on the last business day of the Plan year. Investments traded in the over-the-counter market and listed securities for which no sale was reported on that date are valued at the average of the last reported bid and asked prices. Common/collective trust funds and pooled separate accounts are valued at the redemption value of units held at year-end. Participant loans are valued at cost, which approximates fair value. The Eaton Stable Value Fund invests primarily in investment contracts issued by insurance companies. The investment contracts within the Eaton Stable Value Fund are stated at contract value, which approximates fair value.

Purchases of sales and securities are recorded on a trade-date basis.

**Estimates**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates that affect the amounts reported in the financial statements and accompanying notes. Actual results are not expected to differ from these estimates.

**Table of Contents**

Eaton Savings Plan
Notes to Financial Statements (continued)

**2. Description of Plan**

Effective July 1, 1974, Eaton Corporation (Eaton, the Company, or the Plan Sponsor) established the Plan. The Plan was established to encourage eligible employees to make systematic savings through payroll deductions, to provide additional security at retirement and to acquire a proprietary interest in the Company. Effective July 5, 1989, the portion of the Plan attributable to Company contributions was designed to be invested primarily in Eaton Common Shares and constitute an employee stock ownership plan within the meaning of Code Section 4975(e)(7). Effective January 1, 2002, the Plan was amended and restated. In conjunction with the amendment and restatement, the Plan was renamed the Eaton Savings Plan.

The Plan generally provides that an Eaton employee who is in the regular service of a class of an employee in a division or group to which Eaton Corporation has extended eligibility for membership in the Plan (other than a temporary employee who is hired for a specific, limited period of time or for the performance of a specific, limited assignment or employees covered by a collective bargaining agreement that does not specify coverage under the Plan) will be eligible to participate on any date established in accordance with administrative procedures which follows the date an employee first incurs an hour of service.

Employees may make a combination of before-tax and after-tax contributions ranging from 1% to 30% of their compensation. Effective May 1, 2003, catch-up contributions were permitted in the Plan, allowing participants age 50 and older to defer an additional amount of their compensation as prescribed by the Internal Revenue Code.

Participants of the Plan receive a Company matching contribution of 100% of the first 3% of their compensation, plus 50% of the next 2% of compensation. Employees are 100% vested in their matching contributions.

Employee contributions may be invested in any of the fund options available under the Plan. Participants may reallocate their accumulated contributions daily among the various funds consistent with the ratios specified in the Plan.

Table of Contents

Eaton Savings Plan
Notes to Financial Statements (continued)

**2. Description of Plan (continued)**

Each participant s account is credited with the participant s contributions and Company matching contributions and allocation of the Plan s earnings and is charged with an allocation of administrative expenses. Allocations are based on participant account balances. The benefit to which a participant is entitled is the benefit that can be provided from the participant s account. Participants are immediately vested in their contributions and actual earnings thereon. On termination of service, a participant is eligible to receive a lump-sum amount equal to the value of his account.

Participants may borrow from their fund accounts up to the lesser of $50,000 or 50% of their vested account balance (excluding any contributions made under a Savings Plan, Individual Retirement Account or Company contributions made in the previous 24 months), reduced by their highest outstanding loan balance during the preceding 12 months. Loan terms range from 1-5 years except for loans used for the purchase of a primary residence. The loans are secured by the balance in the participant s account and bear interest at a rate based on the prime interest rate as determined daily by the Trustee. Principal and interest are paid through payroll deductions.

All administrative and transaction costs, management fees and expenses of the Plan are paid by the trustee from the Master Trust unless such costs, fees and expenses are paid by the Company. The Company elected to pay certain administrative costs during 2005 on behalf of the Plan.

Eaton may amend, modify, suspend or terminate the Plan. No amendment, modification, suspension or termination of the Plan shall have the effect of providing that any amounts then held under the Plan may be used or diverted to any purpose other than for the exclusive benefit of members or their beneficiaries.

Information about the Plan is contained in the Plan document, which is available from the Company s Human Resources Department upon request.

**3. Investments**

Effective January 3, 2002, Fidelity Management Trust Company, trustee and recordkeeper of the Plan, holds the Plan s investment assets and executes investment transactions, and all investment assets of the Plan, except for participant loans, are pooled for investment purposes in the Master Trust.

**Table of Contents**

Eaton Savings Plan
Notes to Financial Statements (continued)

**3. Investments (continued)**

A summary of the investments of the Master Trust is as follows:

| | December 31 | |
|---|---|---|
| | **2005** | **2004** |
| Registered investment companies | $1,205,693,957 | $1,094,819,401 |
| Eaton common shares | 681,419,041 | 762,087,126 |
| Guaranteed investment contracts | 121,193,933 | 124,947,892 |
| Common collective trusts | 114,671,154 | 115,012,357 |
| U.S. government securities | 100,191,289 | 105,110,762 |
| Corporate debt instruments | 46,162,926 | 57,353,396 |
| Interest-bearing cash | 31,246,681 | 41,114,942 |
| Non interest-bearing cash | 2,185,559 | |
| Receivables | 184,900 | |
| Pooled separate accounts | 428,491 | 420,748 |
| Total investments | $2,303,377,931 | $2,300,866,624 |

The Plan had a 96.3% and 96.5% interest in the investments of the Master Trust as of December 31, 2005 and 2004, respectively.

Investment income and administrative expenses relating to the Master Trust are allocated to the individual Plans based upon the average balance invested by each Plan in each of the individual funds of the Master Trust. A summary of the Master Trust s net investment income allocated to the participating Plans for the year ended December 31, 2005, is as follows:

| | |
|---|---|
| Interest and dividend income | $ 69,538,718 |
| Net appreciation in fair value of investments: | |
| Eaton Common Shares Fund | (52,986,119) |
| Registered investment companies | 38,669,415 |
| Eaton Fixed Income Fund | 3,215,842 |
| | $ 58,437,856 |

At December 31, 2005, the Eaton Fixed Income Fund was comprised of U.S. government securities (63%), corporate debt instruments (29%), interest-bearing and non interest-bearing cash (7%), and pooled separate accounts (1%).

Table of Contents

Eaton Savings Plan
Notes to Financial Statements (continued)

**4. Income Tax Status**

The Plan has received a determination letter from the Internal Revenue Service dated May 16, 2003, stating that the Plan is qualified under Section 401(a) of the Internal Revenue Code (the Code) and, therefore, the related trust is exempt from taxation. Subsequent to this determination by the Internal Revenue Service, the Plan was amended. Once qualified, the Plan is required to operate in conformity with the Code to maintain its qualification. The Plan Administrator believes the Plan is being operated in compliance with the applicable requirements of the Code and, therefore, believes that the Plan, as amended, is qualified and the related trust is tax exempt.

**5. Transactions with Parties in Interest**

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

During 2005, the Master Trust received $13,305,236 in common stock dividends from the Company.

**6. Risks and Uncertainties**

The Master Trust invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect participants account balances and the amounts reported in the statements of net assets available for benefits.

**7. Transfers In and Transfers Out**

On September 23, 2005, a deposit was made to the Plan of $5,391,439.39. This deposit was the result of participants electing to rollover their funds from a 401(k) account held with Hayward Industries, Inc. Eaton acquired Hayward Filtration, a division of Hayward Industries, Inc. during 2005. The balance of the transfers relate to other Eaton Plans.

Table of Contents

Eaton Savings Plan
Notes to Financial Statements (continued)

**8. Subsequent Events**

During an internal review of the Plan, it was found between January 1, 2002 and October 26, 2005, participants who requested certain in-service withdrawals were erroneously suspended from receiving company matching contributions for a six-month period following the withdrawal request. According to Safe Harbor provisions, participants should not have been suspended from receiving company matching contributions. It was management s intention to self correct the Plan according to IRS guidelines. Accordingly, Eaton Corporation deposited $2,054,059 in company matching contributions on June 2, 2006 and $713,312 in missed earnings on June 16, 2006, to participant s accounts. These amounts have been recorded as a receivable at December 31, 2005.

**9. Recently issued accounting pronouncements**

In December 2005, the FASB issued FASB Staff Position AAG-INV-A. The new pronouncement requires fully benefit-responsive investment contracts be valued at fair value instead of contract value. The pronouncement will be effective for the year ended December 31, 2006. The effect of this pronouncement on these financial statements has not been determined.

Supplemental Schedule
Eaton Savings Plan
EIN #34-0196300 Plan #055
Schedule H, Line 4i Schedule of Assets
(Held at End of Year)
December 31, 2005

| Identity of Issue, Borrower, Lessor or Similar Party | Description of Investment Including Maturity Date, Rate of Interest, Collateral, Par or Maturity Value | Current Value |
|---|---|---|
| Interest in Eaton Employee Savings Trust Master Trust | | $ 2,218,953,948 |
| *Participant notes receivable | 5%-10.5%, various maturity dates | 50,885,157 |
| | | $ 2,269,839,105 |

* Indicates party in interest to the Plan.

11