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Director, TA&I—FSP Financial Accounting Standards Board 401 Merritt 7 PO Box 5116 Norwalk, CT 06856-5116 Letter of Comment No: 7
File Reference: FSPFAS13-A
Date Received:

Re:

Proposed FASB Staff Position FSP No 13-a, "Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease"

Dear Director:

We appreciate the opportunity to respond to the proposed staff position, FSP 13-a. It is in the spirit of enhancing the clarity of that guidance that we provide the following comments to you.

1) Paragraph 9 indicates that when the expected timing of income tax cash flows generated by a leverage lease is revised, actual cash flows shall be used from the beginning of the transaction until the expected settlement date. Specifically the guidance states:

The recalculation shall include octual cash flows that occurred up to and including the point of the actual settlement or expected settlement and the estimated cash flows thereafter. Additionally, the recalculation shall include any interest and penalties assessed or expected to be assessed by the taxing authority.

The emphasis throughout the guidance on the use of actual cash flow in the recalculation up to and including the point of actual or expected settlement seems sensible. However, the inclusion of interest and penalties in the recalculation appears to present conflicts within the guidance in situations where no actual cash interest or penalties is assessed.

Taxing authorities, including the Internal Revenue Service (Service), compute interest and most penalties based on the overall net tax deficiencies of a taxpayer for a taxable year rather than on an issue-by-issue basis. Therefore in cases where a taxpayer's settlement or expected settlement does not result in a tax deficiency by virtue of the taxpayer's overall tax attributes there are no

assessed interest or penalties. The leveraged lease transaction can impact such overall tax attributes in different ways. For example, a taxpayer can be in an overall net operating loss (NOL) position before and after the settlement of the leveraged lease transaction; or a taxpayer's settlement of a leveraged lease transaction may increase its foreign tax credit limitation thereby offset or eliminate any tax deficiencies associated with the settlement. The purpose of Footnote 5 may be to address this potential conflict, but it seems to apply a "hypothetical" rather than actual cash approach. To eliminate the potential conflict we recommend that Footnote 5 be clarified as follows:

The recalculation should be based on the settlement or expected settlement amount <u>specifically</u> designated by the Service as attributable to the leveraged lease transaction and actually assessed and paid. (changes underlined)

2) Paragraph 15 of the guidance indicates that the cumulative effect charge associated with implementing this guidance should be accounted for in accordance with APB No. 26. However this paragraph also indicates:

The amount to be reported as a cumulative-effect adjustment in the statement of operations shall be the gain or loss recognized pursuant to the provisions of paragraphs 9 and 11 of this FSP. Leveraged leases shall be reclassified pursuant to paragraph 11 as of the effective date of this FSP.

However, paragraph 11 of the FSP states in part:

The difference between those balances and the balance of the net investment in the leverage lease prior to the recalculation shall be recognized as a gain or loss in the period in which the assumption changes. The gain or loss shall be included in income from continuing operations before income taxes in the same line item used when leveraged lease income is recognized.

There appears to be a conflict between recording the charge associated with the initial adoption as a below the line cumulative effect adjustment (paragraph 15) and as part of operating income (paragraph 11). Our assumption is that the Board would not have mentioned the cumulative effect adjustment in paragraph 15 if the intention was to have the charge apply to operating income. However, we do believe that this matter should be clarified in the final guidance. One way to clarify this would be to separate paragraph 11 into two paragraphs, and have paragraph 15 refer only to the new paragraph that refers to the reclassifications that would arise from the loss of leveraged lease accounting.

3) The proposed FSP casts a light on the subject of recalculations of leveraged leases, following a significant change in assumptions. FAS 13 requires that, when a recalculation is required, the

investor in the leveraged lease adjust the investment in the lease to the amount that would have resulted, had the updated assumptions been available at the inception of the leveraged lease arrangement.

Due to the focus the proposed FSP has placed on that aspect of FAS 13, we question whether a retroactive adjustment is appropriate. The basic approach to leveraged lease accounting is an effective yield approach. In other cases under existing literature (in particular, EITF Issue 99-20, "Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets"), changes in assumptions about cash flows (as they occur and expectations about the future) result in changes to the effective yield that generally forms a prospective adjustment approach, with possible impairment losses. While leveraged lease accounting has certain peculiarities (regarding the periods in which income is earned) as compared to beneficial interests in securitized financial assets, we cannot identify a conceptual basis for the different treatment. We believe the Board should specifically consider whether retrospective adjustments continue to be appropriate for leveraged leases, but not for other assets.

Sincerely,

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