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Mr. Lawrence W. Smith
Director of Technical Application and Implementation Activities
Financial Accounting Standards Board
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Proposed FASB Staff Position No. FIN 46(R)-b, "Implicit Variable Interests Resulting from Related Party Relationships under FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*"

Dear Mr. Smith:

We appreciate the opportunity to comment on the exposure draft of the proposed FASB Staff Position, "Implicit Variable Interests Resulting from Related Party Relationships under FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*" (the proposed FSP). While we support the staff's efforts to provide implementation guidance concerning the application of FIN 46R to implicit variable interests, we believe that additional guidance is needed on determining whether an implicit variable interest exists to provide a framework for consistent application of the staff's position. Our principal concerns and observations are as follows:

1. While the proposed FSP would require reporting enterprises to *consider* whether they have an implicit variable interest in a variable interest entity (VIE), there is no guidance provided about *how* to determine whether an entity actually has an implicit variable interest in a VIE. The proposed FSP indicates that "[t]he determination as to whether an implicit variable interest exists should be based on whether, in substance, the reporting enterprise through its relationship with its related party will absorb the variability of the VIE." We believe that additional guidance on factors to consider in making that determination would result in greater consistency in applying the staff position. That guidance should specifically address situations in which the related

party group is under common control since such situations are particularly difficult to evaluate in practice. We also believe the staff should provide guidance about how implicit variable interests held by other parties should affect the consolidation analysis by the holder(s) of explicit variable interests.

The question of whether an interest absorbs variability in a VIE is under consideration by the EITF in Issue No. 04-7, "Determining Whether an Interest is a Variable Interest in a Potential Variable Interest Entity." Any conclusions reached by the EITF in Issue 04-7 may have implications on guidance provided by the staff regarding implicit variable interests. Accordingly, the FASB staff should consider any conclusions reached in Issue 04-7 in developing its final guidance on the evaluation of implicit variable interests.

2. The proposed FSP uses an example in which a parent company (investor) has two subsidiaries (investments) – one a VIE and the other a non-VIE. The proposed FSP indicates that the non-VIE subsidiary should consider whether it has made an implicit guarantee to its parent (investor) to absorb the VIE's variability. Assuming that the parent company (investor) owns the same proportion of both the VIE and non-VIE subsidiaries, the parent company will be affected by the variability of both subsidiaries. In essence, the non-VIE subsidiary will not reduce the parent's exposure to the VIE because any of the VIE's variability absorbed by the non-VIE will affect the parent through its interest in the non-VIE. For the parent, the result of that arrangement generally will be the same as if the parent absorbed the VIE's variability directly. In the example, it appears that the parent should consolidate both subsidiaries directly unless the parent has explicitly directed the non-VIE subsidiary to control the VIE.

3. Although not explicitly stated, the proposed FSP may be interpreted to require that an entity consider whether it has an implicit variable interest in a VIE when it has no *explicit* variable interests in the VIE and its related parties have *involvement* with the VIE, but no *explicit* variable interests in the VIE. If that interpretation is consistent with the staff's intent, it would be helpful to make that guidance more explicit.

4. Footnote 3 of the proposed FSP states that "[r]egardless of whether a related party relationship exists, the determination as to whether an implicit variable interest exists should always be based on whether, in substance, the reporting enterprise will absorb the variability of a VIE." It is unclear, based on that statement, whether the staff intended for the concept of an implicit variable interest to apply to situations in which the reporting entity has no *explicit* variable interests in the VIE and no other parties that are involved with the VIE are related parties of the entity. We believe that if none of the other parties involved with a VIE are related parties of the reporting

enterprise, the concept of an implicit variable interest would not apply and that the staff should clarify the guidance in the proposed FSP accordingly.

However, we do believe it is possible for an enterprise to have an *indirect* variable interest in a VIE even when no related parties are involved with a VIE and that it would be helpful for the FASB staff to distinguish between an implicit variable interest and an indirect variable interest. A party that has a direct interest in a VIE may enter into a "back-to-back" arrangement with an unrelated party (third party) with respect to that variable interest. For example, if a party that is exposed to credit losses of receivables in a VIE enters into an arrangement with a financial guarantor to transfer some of that credit risk to the guarantor, that back-to-back arrangement may establish an indirect variable interest by the third party guarantor in the VIE. Back-to-back arrangements are common in practice, and it would be helpful for the staff to provide guidance on factors to consider in evaluating whether an interest held by the third party (such as the guarantor in the example) is considered an indirect variable interest. Such factors may include whether the third party's interest pertains to unique assets held by the VIE and whether the back-to-back arrangement was entered into at or near the VIE's inception.

5. The example in the proposed FSP involves a leasing transaction. Footnote 5 indicates that the proposed FSP does not change the requirement of FASB Statement No. 13, *Accounting for Leases*, to disregard the fact that a leasing transaction is among related parties in accounting for the lease except in cases where it is clear that the terms of the transaction have been significantly affected by the fact that the lessee and lessor are related. If the terms of a leasing transaction have not been significantly affected by the fact that the lessee and lessor are related parties, we are uncertain why it would be appropriate to conclude that either party would be deemed to have an implicit interest in the other. We believe the FASB staff should clarify in what circumstances, if any, the lessee would be deemed to have an implicit variable interest in a VIE lessor if lease accounting under Statement 13 is not affected as a result of the fact that the lease is between related parties.

6. The last sentence in paragraph 6 of the proposed FSP should be modified to add the following phrase after the first VIE in the sentence: "and is a related party (as defined in paragraph 16 of Interpretation 46(R)) of other variable interest holders".

7. The effective date and transition guidance in the proposed FSP implies that the effect of adoption should be a cumulative effect adjustment if the restatement transition alternative is not elected. We believe the FASB staff should be explicit regarding the appropriate accounting for the impact of adoption. In addition, we believe the proposed FSP should become effective on the same date as Issue 04-7 and should have the same transition provisions as Issue 04-7.

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If you have questions about our comments or wish to discuss any of the matters addressed herein, please contact Mark Bielstein at (212) 909-5419 or Kimber Bascom at (212) 909-5664.

Very truly yours,

KPMG LLP