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TA & I Director – File Reference No. 1082-300 Financial Accounting Standards Board Financial Accounting Standards Foundation

Dear FASB:

I am writing in response to Exposure Draft No. 1082-300 on the Proposed Interpretation on Consolidation of Variable Interest Entities (a modification of FASB Interpretation No. 46).

Background

When FASB Interpretation No. 46 (FIN 46) was issued this past January, it went largely ignored by myself as well as most other practitioners. In initially going through FIN 46, it appeared that it was issued to address complex situations that were designed to keep selected assets, liabilities, and operating activity out of an entity's financial statements, and to require that such items be consolidated into the financial statements in certain situations. In other words, it appeared to be a direct response to the Enron situation where numerous "special purpose entities" were specifically designed to be kept "off balance sheet".

In the real world, in which the small business backbone of this country resides, well outside the Fortune 500 world of complex high-finance, these intricately crafted "special purpose entities" don't exist. Small businesses don't employ slick accounting experts to identify razor thin loopholes to cook up such creatures as these. Therefore, it was not expected that FIN 46 would be of any significant relevance.

However, as FIN 46 was further digested, it started to become clear that it could be much more far-reaching than was first anticipated. Even small businesses often establish separate entities to house related enterprises that need to be kept separate for certain business reasons, such as liability purposes. Also, it is very common for commercial real estate to be owned by a separate real estate partnership or limited liability company for income tax or financing reasons. Such situations appear to be covered by FIN 46.

Complexities

Therefore, a thorough understanding of FIN 46 is needed even for some of this country's smallest businesses to see if consolidation is required. However, FIN 46 is so complex that it is practically incomprehensible. It introduces new terms, not the least of which are: variable interest entities, expected residual returns, variable interests, primary beneficiaries, expected losses, expected residual returns, and expected variability. There is an attempt in FIN 46 to define these new terms, but the definitions are confusing and often circular in nature. In fact, the definitions of expected losses, expected residual returns, and expected variability that are in paragraph 2b of FIN 46 end up being defined by reference to Appendix A. Appendix A is nothing more than an illustration of how these things can be calculated, and the illustration uses a convenient set of assumptions that has no connection to the real world whatsoever. To impose reality on the illustration would be to render it incomprehensible. Therefore, the basic concepts needed to get past the very first test required in FIN 46 have terminology that can only be defined through some sort of fairyland illustration. Please, try to understand the absurdity of this.

Now, imagine walking into that small machine shop business and explaining this gibberish to the owners to help determine if their building partnership needs to be consolidated with the operating entity. Trust me, the business owners would think you're on drugs. Unfortunately, the bank loan agreement has a requirement that the company needs to produce monthly financial statements prepared on GAAP. Hence, we are stuck with FIN 46.

Personally, I have read and reread FIN 46 countless times, I have read articles on it, and I have attended three seminars on it. Yet, I am as confused as when I started. Each of the three instructors I have had at the seminars has had vastly differing views of what FIN 46 requires – you wouldn't even think that they were all talking about the very same pronouncement.

The accounting pronouncements that are being issued are getting more and more complex and esoteric to the point where this particular pronouncement is virtually unintelligible. FIN 46 is so vague and confusing that just eight months after it was issued, before it even became effective, we are already facing this current modification.

More Problems

Since FIN 46 was dreamed up in some theoretical ivory tower rather than here on planet earth, it became clear that gathering some of the information needed to apply this pronouncement would be an exercise in pure futility (what exists in theory may not be found in reality). Therefore, this proposed modification proposes an "exception for certain enterprises that are unable to obtain information" needed to apply FIN 46. Doesn't the need to include such an exception indicate to anyone just how ridiculous this thing really is? Naturally, this proposed exception has the requirement that "the enterprise must have made and must continue to make exhaustive efforts to obtain the information." First, what in the world is the definition of exhaustive efforts? Second,

should accounting pronouncements really require actual exhaustion on the part of those enterprises to which they apply?

Another symptom of the pervasive problems with the underlying foundation of FIN 46 is the fact that the proposed modification will require recognition of goodwill where applicable. This is being proposed because "the Board has been informed that some enterprises might consider structuring entities they plan to acquire as variable interest entities to avoid goodwill recognition." Duh, no kidding! Even as the ink dries on these new pronouncements, there are certain parties out there scrutinizing every possible loophole to find some mechanism to sidestep the very situations that the pronouncements were designed to address. These certain parties design ever more complex arrangements to get around the rules. This, in turn, causes the standard setters (FASB) to design even more complex pronouncements, which in turn... You get the idea. The result is a set of ridiculously complicated and incomprehensible rules.

One of the criticisms of the American approach to accounting rules is that they are "too rule-oriented" – the accounting rules are applied more on the fine technicalities included in the precise wording of the accounting pronouncements rather than on the "spirit" of the rules. FIN 46 and this proposed modification are perfect examples of that. There is new terminology, new definitions, and complex concepts (including use of probability modeling) included in this pronouncement. But, if we step back for a minute, do we really need all this complexity? If we accept the "spirit" of the concept of consolidation, isn't it clear (without reading the technical fine print of the rules) that the Enron "special purpose entities" really should have been consolidated into Enron? Did the FASB really need to produce the bilge of FIN 46 to address this?

Timing

One thing of which I am certain is that this letter of comments is a futile exercise akin to sending a note of distress in a tiny bottle out into the endless expanse of ocean. Therefore, I expect this modification will become effective together with the remainder of FIN 46. Hence, my only possible hope is that the FASB reconsiders the effective date. This proposed modification points to the extreme complexity of the pronouncement. Yet, the effective date is upon us. More time is needed for practitioners, businesses, lenders, and other users of financial statements to understand these new rules.

Accordingly, I beseech you to please consider delaying the effective date of FIN 46. It is the very least that those of us in the real world can ask for.

Thank you.

Respectfully submitted,

David E. Andrysco, CPA