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Ms. Suzanne Bielstein
Director of Major Projects and Technical Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
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Letter of Comment No: 117
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Dear Ms. Bielstein:

The Committee for Improved Corporate Reporting (CICR) of the New York Society of Security Analysts (NYSSA) is pleased to comment on the Financial Accounting Standard Board's (FASB) Proposed Statement of Financial Accounting Standards on the Proposed Interpretation about Consolidation of Variable Interest Entities, which will modify FASB Interpretation No. 46. With 8,000 members, NYSSA is one of the largest organizations of investment professionals and the largest chapter society of the Association for Investment Management and Research (AIMR). The CICR is a standing committee of NYSSA generally charged with communicating important issues about accounting standards and financial reporting issues to our members, typically through special programs. From time to time, the CICR has also commented on specific proposals from standards setters, like the FASB.

The opinions given in this letter are primarily those of the author. A draft of this letter was distributed to Committee members for their comments and discussed on a conference call held on December 1, 2003. Input from fourteen committee members who participated on that call is reflected in this comment letter.

Neither the Board of Directors of NYSSA nor NYSSA members outside of the Committee were asked to respond to the opinions expressed in this comment letter. As such, neither the Board nor NYSSA vouch for the accuracy or completeness of the views expressed herein or the degree to which they represent the collective opinions of NYSSA members.

General Comments About FIN 46

We are aware that problems have arisen in the implementation of FIN 46 which have highlighted what many believe are its flaws. The issues that are addressed by FIN 46 are quite complex, which makes it difficult to apply a simple, "one size fits all" solution that will be acceptable to all affected parties in all situations. The complexity of off-balance sheet financing structures also makes it almost certain that FIN 46 will not work well in

certain applications, which gives rise to the need to make many small modifications to ensure that it will be universally applicable.

Accordingly, we have seen instances where preparers, auditors and users generally agree that the implementation of FIN 46 does not represent an improvement over existing accounting practices. It may sometimes result in financial statements that may be confusing or misleading to users. In more than a few instances, companies have argued that they are not fully responsible for the liabilities of variable interest entities, even though they are required to consolidate them.

At the same time, however, we have observed cases where preparers have reported only a small investment in an entity and professed no liability, but have subsequently made significant investments in that entity to shore it up. In those cases, consolidation of these vehicles or at least recognition of their liabilities in the footnotes is clearly appropriate.

Even when enterprises express legitimate objections, we believe that FIN 46 can provide information that is helpful to users in assessing the scale of off-balance sheet activities and therefore their potential impact upon these enterprises. This is especially true for non-financial corporations. In many cases, we believe the implementation of FIN 46 has facilitated productive discussions between preparers and users.

Ultimately, the best solution to the problems raised by off-balance sheet financing vehicles and the implementation of FIN 46 is a new accounting standard for consolidated financial statements. In the meantime, FIN 46 can help to facilitate the transition to a new consolidation standard. It has introduced a new condition for consolidation, based upon risks and rewards, which is one important way of determining who controls the entity. In order to overcome some of the difficulties and achieve a reasonable, fair and acceptable implementation, however, we believe that the Board should encourage auditors, preparers and users to come together to determine how to apply it specifically along industry lines. The Board should then use this input to craft a new consolidations standard.

Comments About the Process Chosen for this Proposed Interpretation

Although we recognize that the Board had to act fast in order to correct some of the most significant problems with the Interpretation in time for the preparation of the 2003 annual financial statements, the process it has chosen has made it difficult for financial statement users to provide useful and informed input. Most users are less proficient technically on these issues and have not had the opportunity to evaluate the full potential impact of the adoption of FIN 46 in the financial statements of the companies that they follow. At the same time, we do not believe that the exposure draft presents all of the proposed modifications in a manner that even a proficient financial analyst can grasp quickly. While it is great to see the Board moving swiftly on this issue, we believe that adding a few extra weeks to the process on the front end to produce a more complete exposure draft with clearer explanations and on the back end by providing some additional time to

allow commenters to evaluate this proposal and prepare their responses might have given the Board a better balanced response.

As a result of these concerns, we urge the Board to get additional input on this Proposed Interpretation from the user community, even if it means pushing Board approval of the Proposed Interpretation back for several weeks. We recognize that the longer the delay, the greater the risk that the approaching fourth quarter earnings reporting season will be affected. Hopefully, this can be avoided; but if not, it would still be worthwhile to encourage greater input in order to reach a better solution on FIN 46 now, especially if it helps to avoid another potential modification at a later date.

Some Specific Comments About the Proposed Interpretation

Our specific comments generally follow each of the points raised in the Summary to the exposure draft:

Issue 1. We do not object to the clarification of the scope exception to include not-for-profit health care organizations, provided that these organizations do not use the exception to circumvent the provisions of this Interpretation.

Issue 2. We do not object to the Board's decision to provide an exception to entities created before February 1, 2003, for which the reporting enterprise is unable to obtain sufficient information to apply the Interpretation, provided that the exception is not used as a means of circumventing the Interpretation. Unfortunately, we do not see that the Board has any choice but to grant the exception, since enterprises may not have a legal right to obtain this information. Despite the Board's expectation that the application of this scope exception will be infrequent (para. A12), we are concerned that many companies will use this provision to circumvent the rules, since it may be difficult to prove whether or not the reporting entity could have obtained the information. Nevertheless, when enterprises make use of this exception, we believe that they must be prepared to prove why they have failed in their efforts. As the Board has noted, the circumstances surrounding the creation of the entity will be key to this determination as well as the nature of the ongoing relationship, including the rights of the reporting enterprise to control other aspects of the entity's operations. We also note that enterprises often obtain financial statements from their customers in order to determine whether and in what amount they should extend credit, even in situations where they do not exercise any appreciable degree of control. While the determination of a VIE may require more than just simple financial statements, it is difficult to imagine in the great majority of cases that reporting enterprises could not get the required information, since this information is often necessary to assess the risks associated with their interests.

The broadening of the exception due to insufficient information may also cause problems of comparability for companies operating within the same industry. In those cases, companies who are able to obtain sufficient information with which to apply the Interpretation may feel that they are being unjustly penalized, especially if they (and their other stakeholders) do not believe that application of the Interpretation yields an

acceptable or relevant presentation of their financial condition. This highlights the importance of establishing industry guidelines for Interpretation 46. It also suggests that footnote disclosure (or at least presentation of consolidating financial statements) may be preferable to simple consolidation. For these reasons, we believe that the FASB must begin work on a new consolidation standard as quickly as possible.

The disclosures as enumerated in proposed paragraph 25A seem to be complete. However, we would also suggest that paragraph 25 be clarified to distinguish between (a) information about entities disclosed under Statement 140 that are deemed to be VIEs, (b) information about entities disclosed under Statement 140 that are not deemed to be VIEs and (c) information about VIEs that are not otherwise covered under Statement 140 disclosures. Hopefully, reporting entities would make these distinctions in their disclosures anyway, but some may choose not to do so, which may make their disclosures incomplete and possibly confusing.

Issue 3. We do not object to providing an exception to the application of FIN 46 to mutual funds in the form of trusts and trusts of a bank's trust department and similar arrangements, provided that they are not used by an enterprise to circumvent the provisions of FIN 46.

Issue 4. We do not object to the clarification that the equity investment in a potential VIE may be deemed to be insufficient if the entity cannot finance its activities without additional subordinated financial provided by any party, including the equity investors.

Issue 5. We do not support the clarification as proposed under paragraph 5(a) regarding qualitative consideration in determining whether the equity at risk is insufficient. Under the existing Interpretation, an entity is deemed to require additional financial support when the equity investment at risk is not greater than the expected losses of the entity. Under the proposal, the Board proposes to use an analysis of the entity's expected losses as the benchmark for assessing the sufficiency of equity, while at the same time acknowledging that other qualitative considerations may apply. Thus, under the proposal, the Board would substitute a "rules-based" standard that will be easier to manipulate for the existing "principles-based" standard that gives equal weight to all methods of determining the sufficiency of the equity investment. We are concerned that more reporting enterprises will use this new "benchmark" as a way to circumvent the provisions of this Interpretation.

Issue 6. In principal, we do not object to the clarification as described in paragraph 3.c. of the exposure draft that identifies a VIE as an entity where the holders of the total equity investment do not possess the characteristics of a controlling financial interest. However, it would have been useful if the exposure draft provided specific examples of arrangements that might be used to circumvent the original requirement that gave rise to the need for clarification.

Furthermore, the exposure draft does not provide any explanation for the Board's decision to drop the words "if they occur" from subparagraphs (b)(2) and (b)(3) of

paragraph 5 and deleting footnote 4. We are concerned that this deletion may allow some enterprises to circumvent the provisions of the Interpretation. There may be situations in which enterprises have an obligation to absorb unlimited losses over a specified threshold that might not get picked up in a determination of expected losses because of the probability assessments used. If so, dropping “if they occur” may give a green light to enterprises to avoid treating interests structured in this way as VIEs. At a minimum, the exposure draft should have explained specifically why the Board adopted this language (and the related footnote) in the first place. If the phrases and footnote are no longer deemed to be important, the exposure draft should also explain why.

Issue 7. We do not object to the additional wording in the last statement of paragraph 5 and the modification of footnote 6 to make them more effective in identifying arrangements in which the voting interests are not aligned with income interests.

Issue 8. We generally do not object to the proposed clarification that an entity’s expected losses and expected residual returns should be based on the expected variability in the entity’s long-term return on variable interests. However, there may very well be circumstances when significant changes in short-term performance should prompt a reassessment of long-term expected losses and expected residual returns. The proposed clarification may make it less likely that such reassessments will occur on a timely basis.

While we support the notion as proposed in paragraph 9A that qualitative assessments be carefully considered in assessing the entity’s expected losses and equity investment at risk, we are concerned that the Board is again proposing to substitute a “rules-based” standard for a “principles-based” standard by specifying that such a qualitative assessment be performed and that it be determined that a reasonable conclusion cannot be reached solely on this qualitative assessment before requiring the calculation to determine whether the amount of equity invested in the entity exceeds the estimate of the entity’s expected losses. It seems to us that both qualitative and quantitative methods should be used in such determination and that preparers and auditors should consider all of the available evidence in determining whether an equity investment below 10% of assets is sufficient. Thus, the proposed modification would appear to open the door to a determination of sufficiency in many more cases where the expected losses exceed the equity investment.

Issue 9. We do not object to the proposed clarification that paragraph 11 of Interpretation 46 does not exempt development stage enterprises from the requirements of paragraph 5(b).

Issue 10. We do not object to the notion of clarifying the guidance for determining which variable interest holder will absorb a majority of the expected losses, receive a majority of expected returns or both. We also understand that it makes sense to remove potential inconsistencies that can create confusion about how to apply the Interpretation. Nevertheless, as noted in our response in the second paragraph of Issue 6 above, we are concerned that the elimination of the phrase *if they occur* might allow some financing

entities to circumvent the provisions of this Interpretation and therefore would prefer to see a clear explanation in the exposure draft about why the Board decided to drop it.

Issue 11. We do not object to the provisions related to a reconsideration of whether an entity is a VIE whenever the design or ownership interests in the entity change sufficiently.

Issue 12. We do not object to the provisions that require an enterprise that holds a variable interest in a VIE to reconsider whether it is the primary beneficiary whenever the design or ownership interests change sufficiently.

Issue 13. We do not have sufficient understanding of the significance of the proposed clarification concerning the creation of a de facto agency relationship under paragraph 16(d)(1) of Interpretation 46 to offer an opinion. That clarification would recognize a de facto agency relationship, if the approval rights on the sale, transfer or encumbrance of interests effectively constrain the interest holder's ability to manage the economic risks or realize the economic rewards of its interests.

Issue 14. We do not have sufficient understanding of the significance of the proposed clarification concerning the change in guidance in paragraph 17 of FIN 46 on determining which party in a related party group is the primary beneficiary by giving primacy to the objective of identifying the party with activities most closely associated with the entity as the primary beneficiary.

Issue 15. We do not object to the recognition of goodwill when an enterprise becomes a primary beneficiary of a VIE that is a business (or the recognition of an extraordinary loss, for a VIE that is not a business). However, we are not sure that there is always a clear distinction between those entities that are businesses and those that are not. As a result, some companies will be able to achieve a desired accounting objective by redefining the entities activities. In any event, the Interpretation should include a footnote disclosure requirement for the balance sheet, income statement and cash flow effects of VIEs recognized and derecognized during the period, whether through purchase of interests or reclassifications. This should include separate disclosure of the amount of goodwill (or extraordinary loss) recognized (or derecognized) along with other parameters of the transaction(s).

Issue 16. We do not object to the clarification that the effects of intercompany eliminations on the variable interest entity's net income or expense should be attributed to the primary beneficiary in the consolidated financial statements. However, the net effect of intercompany transactions should be disclosed in a footnote and reporting enterprises should be encouraged to provide comparative consolidating financial statements that identify VIEs separately from other assets and liabilities.

Issue 17. We do not support the deletion of paragraphs B1-B10 of Appendix B of Interpretation 46. Generally, we found these paragraphs to be useful in helping to identify types of VIEs and that paragraph B1 helped to make it clear that these

descriptions are not complete, that each situation is different and that the analysis must be based upon specific facts and circumstances. While we understand that some preparers and auditors found some of the descriptions to be inaccurate or confusing, we believe that the appropriate solution is to clarify or correct them, not drop them. In order to facilitate understanding of the Proposed Interpretation and the eventual complete modified interpretation, the Board and staff should have taken the time to make these corrections before issuing the exposure draft, rather than proposing to address them in a future FASB Staff Position.

Concluding Remarks

Given the complexity of the topic and the short comment period, we have offered some comments based upon our understanding of the issues, which may be limited in some cases. Generally, we believe that the Board has no choice but to grant exceptions in certain cases (i.e. lack of information, healthcare organizations and master trusts). In other cases, we are concerned that the proposal will make it easier to circumvent the provisions of this Interpretation (for example, in the clarification of the process for determining the sufficiency of the equity investment). We are also concerned that there are disclosure issues that need to be addressed in order for users to have adequate information about the impact of VIEs on the consolidated financial statements. (e.g., impact of purchases/sales and recognition/derecognition of variable interests, impact of these changes on goodwill and extraordinary losses, and the impact of intercompany transactions between VIEs and the enterprise on the financial statements). The Board should address these disclosure issues as quickly as possible to give guidance for the 2003 annual financial statements. Nevertheless, there are many issues that still remain that have not been addressed in this exposure draft and can probably best be addressed in a new project on consolidated financial statements, which we urge the Board to add to its agenda as soon as possible.

We thank the Board for the opportunity to comment on this issue. If the Board or staff have any questions about our comments or want us to clarify our positions, please call Steve Percoco at 732-499-4300.

Sincerely,



Stephen P. Percoco
Vice Chair
The Committee for Improved Corporate Reporting