



December 1, 2003

Mr. Robert E. Herz
Chairman, Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Dear Bob,

The Committee on Corporate Reporting ("CCR") of Financial Executives International ("FEI") wishes to share its views on the Financial Accounting Standards Board's (the "Board") proposed modification of FASB Interpretation ("FIN") No. 46, *Consolidation of Variable Interest Entities* (the "Proposed Modification"). FEI is a leading international organization of 15,000 members, including Chief Financial Officers, Controllers, Treasurers, Tax Executives and other senior financial executives. CCR is a technical committee of FEI, which reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations. This document represents the views of CCR and not necessarily the views of FEI.

CCR appreciates the Board's ongoing efforts to address concerns over implementation issues related to FIN 46. The Proposed Modification and recent FASB Staff Positions ("FSP") address several of the conceptual issues that have been identified, and the delay of the original implementation date has given preparers and their auditors additional time to further analyze and understand key provisions of FIN 46. To further that process, FEI has offered to sponsor a teleconference with our members in mid-December that would allow the Board time to explain the changes embodied in the modification and the FSPs in advance of the required effective date.

We note that considerable tension persists between the desire of some in the auditing profession for explicit prescriptions and prohibitions, which are focused on preventing abuse when applying the provisions of FIN 46, and the very real need for a common sense approach, which utilizes the appropriate exercise of judgment to ensure that entities that were never intended to be consolidated are in fact not consolidated. It is impossible for any of us to anticipate all potential fact patterns that might arise, but we believe it is in the best interest of all parties to avoid the unintended consolidation of entities in financial statements. For example, we are aware of circumstances in which municipal bond insurers would be required to consolidate trusts that issue the insured debt. Given that the insurer received a fixed, market-based premium for the insurance provided, we would likely all agree that the

issuing entity should not be consolidated, and the final statement must either provide a scope exception to prevent this type of occurrence or allow for that judgment to be made.

As preparers and auditors continue to implement FIN 46, the Board continues to address a number of significant implementation issues. In addition to the eleven proposed or final FSPs the Board has issued on this subject, CCR has sent specific implementation issues for the Board's consideration under separate cover (which are not repeated in this letter). FIN 46 is having broad implications to the preparer community in part because of the new economic unit concept utilized and the Board's efforts to adopt a principles-based standard. Many of the issues encountered in implementation have surfaced only recently because audit firms have been releasing and modifying their implementation guidance that preparers look to when implementing FIN 46. Certain of our CCR members have learned that audit firms are providing their implementation guidance based on non-public discussions with the Board. We believe it is critical that significant issues be resolved in an open forum, such as through the EITF, where due process exists. Should the significant number of implementation difficulties and expected post-implementation concerns result in the Board continuing its practice of private discussions with the audit firms, we reluctantly suggest the Board develop an implementation working group to respond to implementation and ongoing accounting concerns raised by this new standard. Such a working group, if required, should be comprised of Board members, FASB staff, preparers and auditors, should operate in full 'sunshine', and should remain in existence until the volume of implementation issues subsides. We would ideally want to avoid the formation of a separate implementation group because of the lack of 'sunshine' with the last implementation group (DIG) and because we believe it would perpetuate the rules-based environment that runs counter to the current direction of financial reporting and standard setting.

As we approach the finalization of this Proposed Modification and related FSPs, we are concerned that feedback from some in the auditing profession, coupled with the remaining short timeframe until implementation (e.g., these proposals will likely be finalized in mid-December, with an December 31, 2003 effective date), may result in changes to the final modification to FIN 46 that preparer's will not see or have adequate opportunity to provide comments. We recognize the Board's strong desire to implement final rules with an effective date of December 15, 2003, however, we respectfully request that any material modifications to the Proposed Modification are re-exposed for public comment to allow for a balanced dialogue and hearing around significant changes.

In addition, we believe that the Proposed Modification and the related FSPs should be consolidated in one comprehensive document. This will make it easier for preparers to see the interactions of the various proposals to facilitate a more complete understanding of FIN 46.

ADDITIONAL IMPLEMENTATION ISSUES

One of the modifications to paragraph 5 (a) is the inclusion of equity investors as one of the parties who would cause the equity investment to be insufficient to finance the entity's activities if the investors also provided subordinated financing. CCR believes that this provision should not include those situations where all the equity investors provide

subordinated financing in the same percentage as their equity ownership and the entity would otherwise not be a VIE.

For example, consider a simple structure in the form of a project corporate joint venture whereby all of the equity investors contribute equity capital consistent with their ownership percentage (and the equity capital is well over 10% of the assets). Further assume that it is anticipated that upfront project financing is arranged from a third party bank that will be drawn down as the project progresses. There are no guarantees or other arrangements and the economic interests of the equity investors are equal to their voting rights. In other words, this entity is not a VIE.

Now assume the same facts except that the entity will be additionally required to make cash calls from its equity investors. These cash calls will be required in the same percentage as the equity holdings but they will be in the form of advances rather than equity investments. The reasons for this structure could vary but might include strategies such as tax optimization or the facilitation of investment repatriation from undeveloped countries. CCR believes that the subsequent advances by the equity holders should not result in the entity becoming a VIE. The relationship of the equity investors to the other potential beneficiaries has not changed. The only changes have been to increase exposure by all the equity investors as a group and the relationship of the equity investors to themselves as lenders. This should not cause an entity to become a VIE.

Another implementation issue is that FIN 46 implicitly assumes that the investor who is the primary beneficiary controls the VIE. However, this presumed level of control is not always present. The primary beneficiary of the VIE does not necessarily have the ability to make decisions that have a significant impact on the success or failure of the VIE. Likewise, the primary beneficiary might not have the ability to apply governance and oversight to the VIE in a manner similar to voting-controlled subsidiaries. We believe that, similar to quantitative aspects which are used in the determination of whether or not an entity is a VIE, qualitative aspects, such as the ability to make decisions or apply governance, must be considered in the determination of whether or not VIE should be consolidated by the primary beneficiary.

The FASB is proposing an FSP on identifying variable interests and computing expected losses under FIN 46. Once the proposed FSP is exposed, we will review the proposed FSP and may provide additional comments.

In conclusion, while we believe that additional time and discussion would allow us to more fully flesh out all of the remaining implementation issues, we also recognize the need to bring this project to a close. The decision as to when a standard is ready to be made effective is a difficult one that involves significant judgment and weighing competing interests. That said, the credibility of financial statements will be severely damaged if the required adoption is followed by a large number of restatements due to misapplication of FIN 46. We therefore respectfully request that before reaching a final decision, you fully consider the state of readiness of preparers and auditors to implement the guidance, as amended, in an appropriate way.

We appreciate the Board's consideration of these important matters and welcome the opportunity to discuss any and all related matters. If you have any questions regarding this letter, please feel free to call me at (989) 636-1541.

Sincerely,

A handwritten signature in black ink that reads "Frank H. Brod". The signature is written in a cursive, flowing style.

Frank H. Brod
Chair, Committee on Corporate Reporting
Financial Executives International