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Letter of Comment No: File Reference: FSPFIN46-F

December 16, 2003

Director, Technical Application and Implementation Activities Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856

Re: Proposed FASB Staff Position

We are pleased to respond to Proposed FSP No. FIN 46-f, "Evaluating Whether as a Group the Holders of the Equity Investment at Risk Lack the Direct or Indirect Ability to Make Decisions about an Entity's Activities through Voting Rights or Similar Rights under FASB Interpretation No. 46, Consolidation of Variable Interest Entities" (the "Proposed FSP").

While we agree with the Proposed FSP's conclusion that the evaluation of whether the holders of the equity investment at risk control the entity's activities should be based on the extent to which that investment provides the holders as a group the ability to make decisions about the entity's activities, we believe the final FSP should:

- reconcile the condition in paragraph 5(b)(1) of Interpretation 46 to "participating rights" discussed in EITF Issue No. 96-16, "Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights"
- not include any discussion of other conditions in paragraph 5 of Interpretation 46
- be effective and provide for transition that is consistent with the effective date and transition provisions in the proposed modification of Interpretation 46 and FSP No. FIN 46-6, "Effective Date of FASB Interpretation No. 46, Consolidation of Variable Interest Entities"
- either not include the exhibit or be modified to incorporate our comments in the first two
 points above.

The remainder of this letter discusses further each of the comments above.

Participating Rights

We agree with the FASB staff's observation that it would not be possible, nor do we believe it would be desirable, to create a list of decisions that an equity group must be able to make in order to determine whether that group lacks the characteristic in paragraph 5(b)(1). However,

the EITF considered a similar problem in Issue 96-16. Rather than concerning itself with what rights the majority owner should have in order to be able to consolidate, the EITF focused on the rights held by the minority owner that could preclude the majority owner from exercising control.

We believe the Proposed FSP's guidance would be more useful if it reconciled the condition in paragraph 5(b)(1) to participating rights discussed in Issue 96-16. Because Issue 96-16 was focused on identifying when a majority shareholder does not control the investee's activities and because the condition in paragraph 5(b)(1) is focused on the inability of the possible VIE's shareholders to control its activities, we believe there is symmetry between the two issues.

The primary benefit of focusing on the rights contained in Issue 96-16 is that most preparers and auditors are familiar with, and used to applying, that model. If participating rights are important enough to preclude a majority owner from consolidating its subsidiary, it would seem that those rights would have a significant impact on the entity's success and would therefore be consistent with the guidance in the Proposed FSP. For example, concluding that the equity group likely possesses the characteristic in paragraph 5(b)(1) if it has the ability to make decisions that have a significant impact on the success of the entity appears to be a different way of stating that no other interest holder holds rights that would be considered participating rights under Issue 96-16. However, we were not sure that was the FASB staff's intent and believe clarification would be helpful.

Discussion of Conditions Not Directly Related to Paragraph 5(b)(1)

We believe the sole focus of the final FSP should be on whether the equity investors in an entity have the right to direct its activities when holders of interests not classified within equity provide the holder of that interest the right to participate in determining the entity's activities. We are concerned with the Proposed FSP's implication that, because the holders of the equity investment at risk are exposed to the entity's expected losses and are entitled to its expected residual returns, they must have the ability to direct its activities. The last sentence in the first paragraph of the conclusion states:

In those situations [where both the equity group and parties outside the equity group have voting or similar rights], emphasis should be placed on the ability of the equity group to make decisions that have a significant impact on the success of the entity as well as the extent to which the equity group absorbs expected losses and receives expected residual returns of the entity. [Emphasis added]

We do not understand why the equity group's obligation to absorb expected losses and receive expected residual returns is relevant to the evaluation of whether the equity holders as a group have the ability to control the entity's activities. While it may be reasonable to assume that the holders of the equity investment at risk would want the ability to control the entity's activities when those conditions are present, the presence of those factors does not automatically lead to a conclusion that they will have that ability.

We note that footnote 3 to paragraph 5(b)(1) of Interpretation 46 states:

Enterprises that are not controlled by the holder of a majority voting interest because of minority veto rights as discussed in EITF Issue No. 96-16, "Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights," are not variable interest entities if the shareholders as a group have the power to control the enterprise and the equity investment meets the other requirements of this Interpretation. [Emphasis added]

The discussion in footnote 3 is clear that each condition in paragraph 5 should be evaluated separately and that no condition is dependent on any other condition. If the FASB staff did not intend to imply that the inability of the equity group to control the entity's activities could be overcome by the equity group's obligation to absorb losses and right to receive residual returns, we believe the discussion of those other conditions should be removed from the Proposed FSP to avoid any possible confusion that may result.

Effective Date and Transition

The Proposed FSP would require a reporting enterprise to apply its guidance as of the beginning of the quarter in which the final FSP is posted to the FASB website. Assuming the final FSP is posted before December 31, 2003, a reporting enterprise would be required to apply the final FSP as of October 1, 2003. However, FSP FIN 46-6 deferred the effective date for applying Interpretation 46 until the end of the first interim or annual period ending after December 15, 2003. For a calendar year company, the deferral would result in the guidance in Interpretation 46 being applied on December 31, 2003. We believe the effective date of the proposed FSP should be consistent with the Interpretation 46's effective date, as modified by FSP FIN 46-6.

Exhibit

We believe the guidance in the exhibit should not be included in the final FSP. We believe the conclusions reached in the exhibit are difficult to reconcile to and, in some instances, appears to be inconsistent with, the conclusion in the Proposed FSP that the condition in paragraph 5(b)(1) is met if the owner(s) of the equity interests in an entity do not have the ability to make decisions that significantly impact the entity's success. For example, the ability of the franchisor to determine the location of the franchisee's operation, approve the products that the franchisee may sell, and approve the franchisee's marketing plan would all presumably have a significant impact on the franchise's operations. However, the exhibit to the Proposed FSP appears to ignore the importance of these participating rights in concluding that the franchisee has control over decisions that significantly impact the franchise's success. However, the franchisee's ability to make decisions primarily affects the hours of operation and the retention of management personnel. Those rights, while important, will generally have less of an impact than the decisions that the franchisor either controls or over which the franchisor has approval (or veto) rights.

Further, we are concerned that the FASB staff comment that "there is an important distinction between having the ability to make decisions that have a significant impact on the success of a franchise and having the ability to make decisions to protect the franchisor's brand" implies a bright line separating those two. However, as reflected in the EITF's discussion on Issue 96-16, all participating rights could be viewed as protective rights. Accordingly, if the exhibit is to be retained in some form, we believe comments such as this should not be included or should be modified to explicitly state the FASB staff's views.

Finally, if the FASB staff decides to retain the exhibit as an example of how the guidance in the final FSP would be applied, we believe the comments discussed in the first two sections of this letter should be incorporated into the discussion of that example. Of particular importance, we believe the guidance in Issue 96-16 should be considered in determining whether the rights of the franchisor are protective or participative.

Other Comments

We note that many franchisees have raised concerns that their franchises will be deemed to be VIEs and, if so, that the franchisor will be deemed to be the primary beneficiary. Those concerns primarily relate to circumstances where the franchisor is a public entity. In those circumstances, franchisees are concerned about the increased costs inherent in becoming a "subsidiary" of a public company, such as the costs to comply with the provisions of the Sarbanes-Oxley Act and its related implementation rules, in particular those related to controls over financial reporting. In addition, franchisees of both public and private franchisors are concerned they may be required to change auditors (so the franchisor's auditor will qualify as the principal auditor). However, if the franchise is deemed to be a VIE and the franchisor its primary beneficiary, we believe the concerns raised by franchisees, while valid, should not be a factor in determining whether (or how) the guidance in Interpretation 46 should be applied.

The reason most franchisees have voiced a concern is because:

- 1. Franchisors typically have participation rights, as defined in Issue 96-16. Because of the lack of guidance on how paragraph 5(b)(1) should be applied, franchisees have, for the most part, concluded the franchise is a VIE.
- 2. While franchisees generally make a significant investment in the franchise and are obligated to absorb expected losses and entitled to receive expected residual returns, it is likely the franchisee would be considered a "de facto agent" of the franchisor because of restrictions on the ability of a franchisee to sell, transfer, or encumber its interest in the franchise operation without the franchisor's approval. In applying the guidance in paragraph 17 (before considering changes discussed by the Board at its December 10, 2003 meeting), it is not clear that the franchise operations are more closely associated with the franchisee than the franchiser as both parties benefit from the arrangement. Accordingly, unless the franchisee is permitted to analyze whether it is a principal or agent based on the guidance in EITF Issue No. 99-19, "Reporting Revenue Gross as a Principal versus Net as an Agent," and EITF Issue No. 96-19, "Debtor's Accounting for a Modification or Exchange of Debt Instruments," the franchisor would be required to consolidate as it is the "de facto principal."

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Accordingly, we request the Board carefully consider those concerns in its redeliberations of the Exposure Draft of the proposed modification of Interpretation 46.

We would be pleased to discuss any of our comments with the Board or the FASB staff. Please direct your questions or comments to Joe Graziano at (732) 516-5560, or Jeff Ellis at (312) 602-8991.

Very truly yours,

Grant Thornton LLP