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October 9, 2002

## VIA E-MAIL: director@fasb.org

Signed copy by Express Mail

Members of the Board Financial Accounting Standards Board 401 Merritt 7 Norwalk, CT 06856-5116 c/o: Ms Suzanne Bielstein

Ms, Suzanne Bielstein Director of Major Projects and Technical Activities

File Reference No. 1082-200

Re: Follow-up Response to Question Regarding

Not-For-Profit Entities; Roundtable Morning Session on Consolidation of Certain Special-Purpose Entities

## Dear Members of the Board:

Thank you again for the opportunity to participate in the morning session of the Open Roundtable held in your offices on September 30, 2002, regarding the Exposure Draft on "Consolidation of Certain Special-Purpose Entities" and comments submitted thereon. As you may recall, I was invited to participate on the basis of having submitted a Letter of Comment (No. 78 as logged by the FASB, dated August 30, 2002) on the Exposure Draft which focused on certain potential implications with respect to not-for-profit organizations and/or entities established by them to facilitate discharging the purposes for which they were established (as used herein, each an "NFP Entity.") I may have tipped my hand to rather broader interest than that during the course of the morning session discussions, but this letter will remain focused solely on issues unique to NFP Entities and the manner in which the Exposure Draft treats them.

As you may also recall, that topic actually came at the very end of the morning session when virtually all of the allotted time had already been used in productive discussions on other topics of perhaps wider interest. Given those time constraints, I may not have responded adequately to the question posed by Mr. Edward Trott as to whether the proposed Interpretation should apply to NFP Entities. Ideally (and in a nutshell), my reply would have been as follows:

- there are analytical bases upon which the Board could reasonably conclude that NFP Entities should not be covered, but
- (2) if the Board felt otherwise, it should at the very least craft actual definitions of SPEs and SOEs in a manner which would account for the fact that NFP Entities do have unique characteristics, and thus not automatically lump them into the SPE category (and not automatically exclude them from the SOE category) as the Exposure Draft does.

That may be all I need say on the matter, but this letter will provide additional detail on both components of such answer.

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## 1. Reasons to Exclude NFP Entities.

I was a bit surprised when this question came up. As indicated in my Letter of Comment and in my remarks at the Roundtable, I was under the impression from the press release issued by the FASB accompanying publication of the Exposure Draft that the Board had already determined that NFP Entities were not intended to be included within its coverage. My Letter of Comment was offered to note details of the provisions of the Exposure Draft which would need modification in order to reflect that determination properly. If that was not actually what the Board had determined, there are nonetheless reasons on which it could quite logically and properly base a conclusion that NFP Entities should be excluded and the proposed Interpretation revised accordingly.

It is useful to recall that, for the most part, the catalyst for the current process resulting in issuance of the Exposure Draft was the cumulative effect of press reports relating to corporate and/or accounting abuses which were facilitated by or otherwise actualized through an SPE. It is entirely possible that, when the legal and administrative process works it way through the situation, there will be a clear recognition that the existing accounting and legal framework was suitable for the situation but that no system would prevent intentional acts taken in violation of provisions in the applicable framework.

"Traditional" corporate enterprises are essentially left to self-governance and supervision. That is not true for NFP Entities. As a threshold matter, NFP Entities are subject to the oversight of, and supervision by, at least one very senior state official. That official typically has broad authority to exercise actual control of an NFP Entity upon showing in court that it is being operated in a manner which is inconsistent with purpose for which its existence has been recognized under the laws of such state.

Moreover, there is a second (and potentially even more powerful) level of supervision arising out the tax-exempt status for which NFP Entities are normally (but not immutably) organized: the Internal Revenue Service. The procedures which an NFP Entity must observe to secure and maintain that status is time-consuming and rigorous. Abuses occurring in that context would suffer very dire consequences both to the operations of the NFP Entity and to parties which had provided financial support to it. Perhaps more to the point, use

I am aware that both the FASB and the Staff of the SEC have over the years grappled with the question of whether the current 3% equity standard is sufficient and, if not, how an appropriate measure of adequacy would be crafted and applied. That is quite a separate matter from the issue of abuses identified in the press and elsewhere (see, e.g., Letter of Comment No. 36) and should not be confused with such abuses.

Indeed, the Letter of Comment from Senator Levin outlining the abuses identified by his subcommittee in its Enron hearings (Letter of Comment No. 36) acknowledges his view that each category identified in those hearings evidenced violation of requirements existing at the time.

In most cases, that is the state Attorney General — directly with respect to a not-for-profit organization organized under the laws of such state, or indirectly though supervision of such organization with respect to any "Disregarded Entity" (as that term is used my Letter of Comment) created by it. Please note again that, as was the case with my Letter of Comment on this matter, this letter does not constitute a legal opinion on federal tax laws or on the laws of any state, much less a survey of state laws as applicable to formation and operation of NFP Entities. Please note also that, as used herein, the term "NFP Entity" covers both the not-for-profit organization and any such Disregarded Entity formed by it.

One of the Participants in the morning session of the Roundtable seemed to think that there were NFP Entities routinely using SPEs to conceal assets from potential donors in order to maximize fundraising. While I accept in theory that there may be NFP Entities thus suffering from such embarrassment of riches, I am equally certain that any such conduct would be of grave interest to the state official having statutory supervisory responsibilities over such NFP Entity.

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of an NFP Entity for personal gain (as was a clear component of the abuses in the "traditional" corporate world which came to light this year) would violate strict requirements of the IRS regarding private use of funds.

On those bases alone, the Board could reasonably conclude that the preventative nature of the proposed Interpretation would not add anything to existing oversight and supervision to which NFP Entities were subject. Application of it would instead present a significant obstacle to the efficient use of scarce resources for a public benefit. In that context, excluding NFP Entities from coverage of the proposed Interpretation (both as a potential consolidator and a potential consolidator) would be entirely appropriate.

## 2. Definitions / NFP Entities.

As noted during the morning session of the Roundtable, the problem for NFP Entities is that the "definitions" of SPE and of SOE as used in the Exposure Draft would potentially make all NFP Entities an SPE without any analytical basis for doing so. It seemed relatively clear, however, during the morning session that the Board was aware of the need to provide actual and specific definitions of those terms. Although the very last part of the discussions regarding NFP Entities occurred literally hours after that discussion, I assume the Board and Staff are aware of the ramifications of developing definitions of those terms which will be suitable for application in the context of an NFP Entity if those are not otherwise excluded from coverage. Conceptually speaking, there is no inherent reason why fully-functioning and tax-exempt NFP Entities should not be equally eligible for analysis as an SOE as are their counterparts in the "traditional" corporate community.

I hope that the foregoing follow-up is useful in addressing the issue raised during the morning session of the Roundtable and for which time was insufficient to address in this level of detail. As always, I remain available to discuss any questions or concerns which the Board or the Staff may have with respect to items covered in this letter. I believe Mr. Robert Uhl of Deloitte & Touche was the only other Participant in the morning session who also spoke on issues (of any nature) regarding NFP Entities so I am also copying him on this letter.

Very truly yours,

Steven K. Hazen

cc: Mr. Robert Uhl

See also, my Letter of Comment with respect to NFP Entities qualified as a tax-exempt organization in accordance with the provisions of Internal Revenue Code Section 509(a)(3) as a "supporting organization" with respect to another NFP Entity. Eliminating that vehicle as a potential source of support for NFP Entities serving societal needs would at the very least contradict the specific purpose for which the law was written in the first place. Surely, that cannot be the intent of a proposed Interpretation of ARB 51.

As a threshold, that could include components referencing formation under the laws of a U.S. jurisdiction containing specific provisions limiting scope of activities, as well as receipt (within a specified period following formation) of a determination letter from the IRS for tax-exempt status in conducting such activities.