Leaseurope
Tél. (322) 771 21 08
Téléfax (322) 770 75 96
267, avenue de Tervuren
B - 1150 Bruxelles

European Federation of Equipment Leasing Company Associations
Fédération Européenne des Associations des Etablissements de Crédit-bail
Europäische Vereinigung der Verbände von Leasing-Gesellschaften

Ms. Suzanne Bielstein
Director of Major Projects and Technical Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

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Comments Regarding the Exposure Draft of the Proposed Interpretation for Consolidation of Certain Special-Purpose Entities, an interpretation of ARB No. 51
File Reference No. 1082-200

Dear Ms. Bielstein,

We have the honour and pleasure to enclose the official comments of Leaseurope to the Exposure Draft of the Proposed Interpretation for Consolidation of Certain Special-Purpose Entities, an interpretation of ARB No. 51.

Leaseurope is the European Federation of Leasing Company Associations, with about 30 National Leasing Associations as members covering more than 1,300 individual leasing companies in Europe. According to the latest 2001 Leaseurope statistics, the leasing companies represented by Leaseurope invested over 193 billion in real estate and equipment.

Although being a non-US Association, we would like to express our opinion on the above-mentioned interpretation and thus participate in your process, since US-GAAP standards have become more than just national accounting standards. While not being international standards, US-GAAP are very much internationally accepted, as well as the FASB, as one of the world's most influential standard setters and it is expected to have a major influence on the future of many international accounting standards.

We will not able to comment on all specific issues raised in the Interpretation as such an endeavour would require time-consuming analysis and in-depth understanding of US-specific regulatory and practical issues concerning the use of SPEs, which is currently not the case.

Let us express our general belief that leasing transactions, which make use of SPEs, have not been part of the latest accounting scandals. We think this is a good example of the validity and practicality of existing leasing rules (SFAS 13 and EITF 90-15 as well as related documents). However, we certainly agree that existing rules on leasing might need adaptating to new business and transactional developments, which are a different story and should not be confused with ad-hoc measures to prevent fraudulent accounting practices as it has been observed in the latest accounting scandals.

General

As mentioned previously, US-GAAP are considered internationally as the most accepted national accounting standards. Hence many companies in Europe do already apply US-GAAP, particularly when they are participating in the US capital market. With the European initiative to require capital market oriented companies to apply International Accounting Standards (IASs) by 2005 in their consolidated accounts, and the current efforts to have convergence of accounting standards across the world, US-GAAP are more than stand-alone national standards and will have a great impact on the future of international, and European accounting rules, in particular.

Let us point out from the outset that we are aware that the Consolidation project is a difficult and long-standing project in the US. Previous efforts to find new provisions in this area have been daunted by the complexity of the issue and the difficulty of finding suitable answers to practical questions. In light of the latest accounting scandals, an action by FASB on the issue of consolidation of SPEs seemed unavoidable. However, we still believe that FASB is aware that the quality for a new consolidation policy in the area of SPE consolidation should override the need to react quickly.

Having said that, we would like to express our support for the general thrust of the paper, i.e. to not provide a new consolidation standard but to keep the current main standard, i.e. ARB 51, guiding also the future consolidation policy, which is based on control ('controlling financial interest'). It is very important to note that control may only be exercised by one party, unless it is a joint venture. Hence, consolidation should only be done by this 'one' party. Clear rules will prevent such cases that the decision to consolidate has to be agreed upon with all different parties involved in an SPE, since each party involved must generally be reaching the same result, hence, understandable and distinguishable rules are a prerequisite.

Also, in the light of the latest accounting scandals and the corresponding press coverage, public awareness has been raised for issues previously being very complex financial settings and thereby only of interest to experts in that area. With rising public awareness, public opinion has been shaped and public perception of certain transactions has developed negatively. As such we very much welcome your statement in the Summary section that supports the notion of economic relevance of SPEs: *"Most SPEs serve valid business purposes, for example, isolating assets or activities to protect the interests of creditors or other investors or to allocate risks among participants."* Public perception of the term SPE is currently very negative. Hence, your statement will serve to correct this impression. We also agree with your statement that "the objective of this proposed Interpretation is not to restrict the use of SPEs but to improve financial reporting by enterprises involved with SPEs." By having improved financial reporting, which is understood by all interested parties, public confidence can be recovered and accounting will again play its role in gaining relevant information for decision-making.

Detailed comments to specific provisions:
We would like to comment on two areas that we see of particular importance in applying the Interpretation. The first one relates to the scope of the Interpretation, in particular par. 8c, and the second to par. 9b, one of the four conditions that indicate that the equity investment of the nominal owners of an SPE is sufficient to permit the SPE to finance its operations.

Paragraph 8c:

> *"No enterprise shall be deemed to be the primary beneficiary of a subsidiary, division, department, branch, or other portion of a substantive operating enterprise even if it is otherwise similar to an SPE that would be subject to the requirements of this Interpretation. For example, a subsidiary of a substantive operating enterprise that acts as the lessor for a leveraged lease, direct financing lease, or sales-type lease shall not be consolidated with any enterprise other than its parent.*

As already mentioned above, we agree with your efforts to prevent double consolidation that goes hand in hand with the strategy to keep ARB 51 as the general standard, and the application of which leads to results that must be consistent with applying interpretative statements. We also support your comments in Appendix B, B18 that derecognition of assets, liabilities or whole entities should not be confused with the consolidation issue of SPEs.

In any case, let us point out that the term substantive operating entity is actually used twice in the interpretation:

1. when an SPE is consolidated by a substantive operating entity (presumably based on voting rights), the Interpretation would not be applicable (par. 8);
2. when an SPE is not consolidated by a substantive operating entity but the SPE itself is a substantive operating entity, than consolidation shall be based on voting rights (para. 9).

We are not sure whether the use of the same notion for different entities and purposes is appropriate. Does no. 1 above need to be tested against the criteria in par. 9, i.e. in order to determine whether the entity that consolidates the SPE is a substantive operating entity or does it depend on other factors, e.g. that it usually issues financial statements of its own, has own employees, has no activities related to one other party only, is involved in multiple transactions, has true operating income, and the like.

Hence, it might be useful to include a general definition of an SPE in line with the notions mentioned in the Introduction, par. 2 and 3 in particular, in the Definition of Terms – section of the Interpretation, in order not to have to apply par. 9 also to interpret par. 8c, i.e. whether the mother company that consolidates an SPE is a substantive operating entity.

Furthermore, par. 8c mentions specific leasing transactions as examples. We propose not to mention them in par. 8c, since it might create a wrong perception of its basic concept, i.e. to avoid double consolidation. Since par. 8c is a conceptual issue and because the whole interpretation relates to SPEs in general, and not only leasing SPEs, the specific examples should be moved to the Appendices.

Paragraph 9b:

> *"The amount of equity invested is sufficient to allow the SPE to finance its activities without relying on financial support from variable interest holders. That is, the investment is large enough to enable the SPE to conduct its activities or finance its activities without direct or indirect assistance from holders of variable interests. Generally, that means that the equity investment should be greater than or equal to the expected future losses of the SPE at all times during the SPE's existence*

We understand that par. 9b attemps to implement a condition based on principles, while somehow par. 12 brings the analysis down again to a percentage test. A similar problem has been observed with applying EITF 90-15 and the 3%-notion, which was not regulated as being a fixed level but instead as being only an indication. However, practice seems to have applied the 3% very strictly and not only in leasing transactions but also on other SPE constructions.

Somehow we have the impression that the provisions are in part circular and also contradictory. First of all par. 9b refers to the expected future losses as the level for the sufficiency test. Par. 11 then states that an amount of equity is sufficient, if it compares with the respective amount *invested in substantive operating enterprises with similar assets and liabilities, similar activities, and similar risks of that information is available.* Further on in par. 11 it is said that *if no information about comparable substantive operating enterprises is available, the enterprise shall determine whether the equity invested in the SPE is greater than or equal to expected future losses.* Thereby, the general sufficiency test in par. 9b is downgraded and becomes the alternative to a comparison that will anyway be applicable only rarely, since similar activities and similar risks, in particular, are just the distinguishing factors between an SPE and a substantive operating company.

We are further wondering, what the real need for the 10% level, mentioned in par. 12, is. There seems to be a slight confusion, whether 10% is seen as a minimum or not. It is not clear whether an equity investment of less than 10% could be sufficient in case the comparison with another comparable entity would lead to that result, or the future expected losses would be below 10%.

An equity investment below 10% of the SPEs total assets is presumed to be insufficient. To overcome this presumption, one needs pervasive evidence that a comparable entity also needs less than 10%; in case no information on a comparable entity is available (we assume this will quite often be the case; see above), different from par. 11, the recourse to the expected losses, which might also be below 10% of total assets, is not proposed as an alternative.

Furthermore, also an equity investment of 10% or more is not presumed to be sufficient, unless it allows the SPE to finance its activities without relying on financial support from variable interest holders. Here, par. 12 refers back to the very general notion in par. 9b, which itself is explained in par. 11-12. Hence, there is a circular sufficiency test that will be difficult to apply.

Further confusion is raised by Appendix B, par. B9:

> *The Board intended that presumption to apply in one direction only; that is, an equity investment of less than 10 percent is presumed to be insufficient, but an equity investment of 10 percent is not presumed to be sufficient.*

Actually, the 10% of total assets itself, offering an operational measurement for the sufficiency test, will never be the appropriate level itself, since it needs to be tested against either the comparable figure in a substantive operating entity or the level of expected losses.

We therefore suggest rethinking the above-mentioned prescriptions in the Interpretation, in order to provide consistency and to offer a clear testing procedure, which will also be practical.

We hope that you find our comments helpful and we remain at your disposal for any questions related to the above or further information you might need.

Yours sincerely,

Dr. Thomas Schröer
Chairman of Accounting and Taxation Affairs Committee

Marc Baert
Secretary General