

Letter of Comment No: 122  
File Reference: 1082-200  
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Director of Major Projects and Technical Activities  
Financial Accounting Standards Board  
401 Merritt 7, P.O. Box 5116  
Norwalk, Connecticut 06856-5116

Re: Proposed Interpretation – Consolidation of Certain Special –Purposes Entities  
File Reference No. 1082-200

Gentlemen;

While I understand that urgency to provide guidelines and interpretations for Special Purpose Entities (SPE) due to the recent use of such entities by Enron, I believe this interpretation could be used or more appropriately misused by accountants and corporate executives. The designation of only one entity as the primary beneficiary of the future benefits of the Special Purpose Entity would be misleading. Consolidation of all the assets, liabilities and results of operations of the SPE only on the primary beneficiary would result in an overstatement of its respective financial statement while all other beneficiaries of the SPE would still continue to exclude their respective share of the SPE. Those entities which have misused SPE's to hide certain assets, liabilities and results of operations would only have to structure the arrangement so they are not the primary beneficiary.

I believe a better alternative method would be the "proportionate consolidation" as discussed in the Discussion Memorandum (paragraph 114) issued by the FASB on September 10, 1991, an analysis of issues related to Consolidation Policy and Procedures. Proportionate consolidation would require all entities to consolidate their respective share of the special purpose entity. As a result no one entity could "hide" its assets and obligations by utilizing a special purpose entity.

Illustration:

Company A purchased \$600,000 of equipment and Company B purchased \$400,000 of equipment. For the next five years each company has leased, borrowed or traded use of each other's equipment when needed. At the end of the fifth year the equipment was completely depreciated with a zero book value but Company A still owed \$300,000 on a note for the equipment and Company B owed \$200,000 on a similar note. As both companies used the equipment, they agreed to establish a Special Purpose Entity to own the equipment and transferred the equipment to the SPE along with the related debt. ABC Company was the only stockholder in the SPE, and invested \$50 in capital to purchase the corporate license.

Company A and B guaranteed that the equipment value to be equal to the debt during the next five years and leased back the equipment. The lease payments were equal to the amortization of the loan principal and interest payments plus an administrative fee for Company ABC.

Utilizing the Interpretation of Consolidation of Certain Special-Purpose Entities, Company A recognized a gain of \$300,000 on the transfer of the equipment and eliminated the \$300,000 in debt. As Company A is required to consolidate the SPE, the gain on the sale is eliminated. The remaining \$200,000 of assets of the SPE and \$500,000 of liabilities are reported on Company A's consolidated balance sheet.

Company B however, is not required to consolidate the SPE and is therefore able to recognize a \$200,000 gain of the asset sale and eliminate the debt on its balance sheet.

  
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