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new york state society of

NYSSCPA

certified public accountants

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August 30, 2002

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

By email: director@fasb.org

Re: File Reference 1082-200

Exposure Draft: Proposed Interpretation, *Consolidation of Certain Special-Purpose Entities*

Dear Ms. Bielstein:

The New York State Society of Certified Public Accountants, the oldest state accounting association, represents 30,000 CPAs that will implement the provisions proposed in the captioned exposure draft. NYSSCPA thanks FASB for the opportunity to comment on its exposure draft.

The NYSSCPA Financial Accounting Standards Committee deliberated the exposure draft and prepared the attached comments. If you would like additional discussion with the committee, please contact Steven Rubin, chair of the Financial Accounting Standards Committee, at (212) 492-3799, or Robert Colson, NYSSCPA staff, at (212) 719-8350.

Sincerely,

Jo Ann Golden
President

new york state society of

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**NEW YORK STATE SOCIETY OF
CERTIFIED PUBLIC ACCOUNTANTS**

COMMENTS ON FASB EXPOSURE DRAFT

Proposed Interpretation, *Consolidation of Certain Special-Purpose Entities*

File Reference No. 1082-200

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August 19, 2002

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**NEW YORK STATE SOCIETY OF
CERTIFIED PUBLIC ACCOUNTANTS**

FINANCIAL ACCOUNTING STANDARDS COMMITTEE

COMMENTS ON FASB EXPOSURE DRAFT

**Proposed Interpretation, *Consolidation of Certain Special-Purpose
Entities***

File Reference No. 1082-200

General Comments

We generally support the Board's desire to provide timely guidance on the accounting for special-purpose entities (SPEs), particularly in light of the increasing number of recent well-publicized events in which the accounting for SPEs has been so prominently featured.

Furthermore, we generally support the Board's goal of requiring the assets, liabilities, and results of activities of an SPE to be included in a business enterprise's consolidated financial statements when the business enterprise has a controlling financial interest in the SPE, regardless of whether that interest results from ownership or other means.

Nonetheless, as discussed below, we believe the Proposed Interpretation is unclear in a number of areas and, if those areas are not clarified, the final Interpretation will be difficult to understand and implement and, therefore, could be ineffective, unworkable, and result in inconsistent application.

Specific Comments

Introduction

The Introduction should clarify and emphasize, in plain English, the Board's rationale for the proposed accounting requirements. Some of the Board's rationale is presented in the "summary" that precedes the Interpretation section, but not in the Interpretation section itself. We suggest that the Introduction include language such as the following:

There is an assumption that, given the nature of an SPE, its future economic course is limited and pre-defined. If there is no party that clearly controls the SPE through means of ownership, which is often the case, it is assumed that there is control by one of the parties on whom the SPE's future economic course depends. While the identity of that

one party is not always readily apparent and is not always readily discernible, that party, once identified, should account for its involvement with the SPE in a manner substantially similar to the accounting that would result if the party controlled the SPE through means of ownership. This Interpretation sets forth the accounting by the controlling party and provides guidance on how that party may be identified.

Definitions of Terms and Scope

The Board should clarify the following concepts that are critical to the application of the proposed accounting requirements to ensure that they are well understood and consistently applied.

SPE. The ED never defines an SPE, although it refers to how an SPE functions. Paragraph 3 of the Introduction should be expanded to provide a definition of an SPE. The definition should address the various separate legal forms that an SPE entity could take and whether a separate legal structure is even necessary for an SPE. For example, the definition should clarify whether a group of assets owned through joint tenancy or through tenancy in common would constitute an SPE.

Variable Interests. Paragraph 7(b) defines variable interests, and paragraphs 18 and 19 list examples of types of variable interests. However, how these variable interests function in practice is still not clear. The final Interpretation should provide an appendix giving a substantial number of illustrations, in plain English, of transactions and descriptions of the resulting gains and losses reportable between an SPE and various types of variable interest holders.

Primary Beneficiary. Paragraph 7(c) defines primary beneficiary, and paragraphs 13, 16, 20 and 21 provide guidance on how a variable interest holder should determine whether it is the primary beneficiary. It is unclear how a variable interest holder can make this determination without actually consulting with other variable interest holders. The ED also does not address the possibility of two or more variable interest holders determining that each is the primary beneficiary.

Therefore, Footnote 5 on page six should be expanded to require a holder of a significant variable interest to make a *reasonable* search for information regarding the status and actions of other variable interest holders.

Furthermore, additional guidance is also needed on how variable interests of a dissimilar nature may be reduced to a common unit of measurement to enable the variable interest holders to make the primary-beneficiary determination.

In addition, the guidance in paragraph 20, which requires the relative size of variable interests to be determined by comparing expected future losses, is not helpful if

future losses are not expected or if a variable interest is not subject to expected future losses.

Finally, the final Interpretation should require contemporaneous documentation of the factors used in making primary-beneficiary determinations, similar to requirements in SFAS 133 for contemporaneous documentation, at inception, of factors to support hedge accounting.

Nominal Equity Interests. Paragraphs 9 to 12 of the ED, which discuss the requirements for consolidation to be based on voting interests, require clarification. An illustration tracking an equity investment, and the relevant measurements, over the life of an SPE should be provided in an appendix, along with flowcharts.

Additionally, the ED contains conflicting language concerning the 10% minimum equity interest requirement. Paragraph 12 indicates that the presumed 10% minimum can be overcome “if there is persuasive evidence that an equity investment of less than 10% of total assets is comparable to the equity of businesses that are not SPEs and that engage in similar transactions with similar risks.” This conflicts with paragraph B-9, which states: “The Board apparently 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.” There should be no exceptions to the 10% minimum investment requirement.

Moreover, one of the requirements listed in paragraph 9(e) for an equity investment to qualify for consolidation based on voting interests is that “the equity investment was not provided directly or indirectly by the SPE or other parties with variable interests...” “*indirectly*” needs further clarification, supplemented by illustrations. For instance, would the investment by a company whose major customer is a variable interest holder constitute an indirectly provided equity investment solely because of its desire to maintain or strengthen the business relationship?

Another aspect of the paragraph 9(e) requirement that needs clarification is the Board’s conceptual rationale of why, in principle, two equity interests that provide for the same degree of control would be treated differently depending on how the interests were obtained.

Other Aspects of Proposed Interpretation

- Paragraph 8(c) appears to provide an unintended “loophole” to continue synthetic lease transactions. A lessee that has the risks and rewards associated with the leased asset should be required to consolidate the underlying asset and related debt, and a lessor that has no risks and rewards associated with the leased asset should be required to de-recognize the underlying asset and related debt (e.g., if residual and loss guarantees or title transfer to lessee are provided by the lessee).

- Paragraph 15 could be interpreted to require an enterprise with an insignificant variable interest in an SPE to consolidate the SPE merely because it belongs to a group of entities each of which also has an insignificant variable interest in the same SPE, but whose individually insignificant variable interests add up to a significant variable interest on a group-wide basis. In this case, it appears that what is recorded by the consolidating entity is disproportionate to what it would, in due course, realize by virtue of its insignificant variable interest. The Interpretation should clarify, through illustration or otherwise, what entries, if any, would be recorded on the books of the various related entities. We believe that this may be a case of sufficiently diversifying risk and reward and, therefore, that consolidation may not be appropriate.
- It is unclear why the disclosure proposed in paragraph 24 should be limited only to SPE assets that collateralize SPE liabilities. It seems reasonable to require an enterprise to disclose all SPE assets since there is an absence of legal ownership in such assets despite the appearance of ownership implied by consolidation.
- Consideration should be given in paragraph 19 to whether the non-controlling interests should include just the nominal equity interests or the other variable interests as well.
- Appendix B, paragraph B-18, states that “the Board believes that it is not appropriate to address de-recognition in this interpretation.” We disagree. Since consolidation is based on fine, complex measurements, rather than discrete business-combination transactions, it appears that the issue of consolidation vs. de-consolidation could arise many times during the life of an SPE.
- Due to the complexity of the proposed accounting requirements, we believe the final Interpretation should provide appendices with a substantial number of illustrations on the application of the requirements.

Board’s Approach to SPE Project

- **Brief Comment Period.** Despite our support of the Board’s desire to provide timely guidance, we are dismayed that the Board chose such a relatively brief comment period (only two months) to elicit views on a proposal that represents a major change to the accounting literature that, in turn, is expected to lead to a major change in practice for a relatively large number of companies.
- **Interpretation Rather Than Standard.** We do not agree with the Board’s determination that an Interpretation, rather than a Standard, is the appropriate type of pronouncement for the accounting requirements being proposed.

There is a general understanding that the stated purpose of an Interpretation is to clarify or elaborate on an accounting requirement contained in an existing Standard, while the stated purpose of a Standard is to create a new accounting requirement or to change an accounting requirement contained in an existing Standard.

Based on that general understanding, we observe that this ED clearly changes an accounting requirement in an existing Standard (ARB 51) and, therefore, we conclude that the ED should result in a Standard, not an Interpretation.