

Letter of Comment No: 110
File Reference: 1082-200
Date Received: 09/03/02

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

Name	Bernd Vogt
Department	CF R 1
Phone	+49 89 636-34840
Fax	+49 89 636-34779
E-Mail	Bernd.Vogt@siemens.com
Our reference	BV/AC/GB
Date	29.08.2002

Comments on the Exposure Draft (ED) : "Proposed Interpretation – Consolidation of Certain Special-Purpose Entities, an Interpretation of ARB No. 51" (File Reference No. 1082-200)

Dear Sirs,

We appreciate the opportunity to express our views on FASB's Exposure Draft : "Proposed Interpretation – Consolidation of Certain Special-Purpose Entities, an Interpretation of ARB No. 51".

We welcome the Board's objective to provide specific guidance that exceeds the scope of SPEs involved with leasing or securitization. As pointed out by the Board itself, this will eliminate the necessity of extensive use of analogy when addressing issues of consolidation with respect to SPEs.

Our comments and concerns expressed in the following mainly focus on two areas: Conceptual Issues on the one side and Implementation Issues on the other side.

1. Conceptual Issues

One of the decisions taken by the Board outlines the specific intent that no general definition will be provided for SPEs. As preparers of financial statements we have regarded such decision with some level of skepticism during the project development phase. Therefore we find it helpful that the introductory section (paragraph 3) specifies which is the distinguishing attribute that would turn an SPE structure into a candidate to be analyzed under the provisions of this Interpretation. Still we believe that it would help to put more emphasis on a mutually exclusive definition of a SPE and a substantive operating enterprise (SOE).

The term **substantive operating enterprise** is crucial for scope exclusion purposes. The definition provided in paragraph 7 of the ED

"Substantive operating enterprise refers to an enterprise that is not an SPE. A substantive operating enterprise conducts business operations other than those performed for it by an SPE, has employees, and has sufficient equity to finance its operations without support from any other enterprise or entity except its owners. A substantive operating enterprise usually issues financial statements of its own."

does not make reference to the definition of a business as described in EITF 98-3 and used as

Corporate Finance Reporting

Leitung:
Charles Herflinger

Briefadresse:
Siemens AG
CF R 1
80312 München

Hausadresse:
Wittelsbacherplatz 2
80333 München
Telefon (089) 636-00

such in several other pronouncements. Comparing the definition of an “substantive operating enterprise” to that of a business under EITF 98-3 (in terms of inputs, processes applied to these inputs, and resulting outputs used to generate revenues) it becomes obvious that the substantive operating enterprise definition focuses more on the “input” side. We would suggest to consider whether an alignment with the EITF 98-3 definition, solely or in conjunction with some additional criteria (such as leverage level of the capital structure, etc.), would make sense.

The term **portion of a substantive operating enterprise** is also not clearly defined. We think it would be appropriate to indicate the meaning of this term in relation to terms such as “controlled business” or “controlled asset group” as used under EITF 01-2. We believe that clarifying guidance with respect to this scope exclusion would help applying the Interpretation.

A further area we would like to comment on refers to the variable interests that may arise in connection with **management contracts and contractual management arrangements** such as those covered under EITF 97-2. The ED does not clarify how the proposed Interpretation would affect the EITF 97-2 consensus guidance. With the adoption of the Interpretation in its current form two sets of guidance would exist, a risks-and-rewards model under this Interpretation and a control-based approach under EITF 97-2, both addressing the issue of consolidation with respect to contractual management arrangements. Individuals applying these two sets of rules to the same given situation may come up with different answers with respect to consolidation. We would deem it necessary to clarify the distinction between an EITF 97-2 situation and the new Interpretation for SPEs.

We assume that the Board will address the above mentioned conceptual issues at the latest during subsequent discussions within the broad FASB Consolidation Project, so that a uniform approach will be provided.

2. Implementation Issues

2.1. Sufficiency of Equity Investment

The Interpretation prohibits consolidation based on voting interests as long as the equity investment is not sufficient to allow the SPE to finance its activities without relying on financial support from variable interest holders. For an equity investment of 10% or less, insufficiency would be presumed. With an equity interest above 10%, an entity would first need to consider comparable substantive operating enterprises with similar risks.

Given the rather complicated process of making comparisons to other substantive operating enterprises, we would like to point out that a risk exists that auditors and preparers of financial statements may tend to regard the 10% threshold as sufficient and thus the Interpretation’s intended rationale might not be achieved. We believe that a process easier to implement would result in a reduced probability that people will tend to turn to the “bright line”.

In addition, since the required comparable information may not be available, many enterprises would be required to proceed with the next step and determine whether the equity invested in the SPE is greater than or equal to the expected future losses. We suggest the Board should provide additional implementation guidance on how to apply the probability-weighted model under SFAC 7 with respect to expected future losses and, as indicated, without considering possible gains. With respect to the restriction that only losses should be included in the assessments, especially businesses with a seasonal/cyclical pattern of results could face a situation where expected future losses may be greater than the current equity investment despite the entity being profitable on the long run. We therefore think that the use of business plans could be preferable to the suggested

approach at this stage of the assessment. We would suggest to retain the losses-focused model only for the next step of the exercise, namely with respect to the identification of variable interests.

Evaluation of sufficiency of equity may also be complicated by insufficient information and poor communication among the parties involved. Although each party will have to assess its own relationship with a certain SPE and its holders of financial interest, this assessment will have to use assumptions about the SPE itself and about the SPE's activities. These assumptions will have to be accepted and, moreover, used by the other parties involved with the same SPE. We think this approach is hard to implement.

Some countries already have measurement indicators (for tax and other purposes) with respect to what represents a sufficient equity investment. Has the Board considered admitting these criteria for the evaluation of sufficiency of equity under this Interpretation?

2.2 Identification of Variable Interests / Primary Beneficiary

Identification of variable interests may be subject to a high degree of subjectivity. We welcome the Board's description in paragraph 18 of the situations that may lead to the existence of variable interests. However, we consider this description being not specific enough and eventually hard to operationalize. We suggest the Board should provide some guidance of how to determine expected future losses for those described situations leading to variable interests, especially when the entities involved are also equity holders in the SPE.

With respect to the **determination of the primary beneficiary** we consider that the guidance proposed in paragraph 13c:

"...if other parties provide financial support, the enterprise is the primary beneficiary if it provides a majority of the financial support or a significant portion of the total financial support that is significantly more than any other party"

would in the present form be difficult to implement. This would be especially the case for entities having similarly high variable interests with respect to a certain SPE structure. We suggest the Board offers clear criteria to identify those situations where no primary beneficiary may be identified, namely where the SPE effectively disperses risks.

We would also like to point out that the **dominant risk concept** when used for the identification of the primary beneficiary uses information that has already been considered in assigning probabilities to the expected future losses. Therefore, due to a lack of additional differentiating information the dominant risk concept may not produce the desired results.

2.3. Other Issues

Some **Asset-Backed SPEs** have several transferors of assets. Paragraph 17 describes the separation of such SPEs into separate SPEs. Our understanding is that the number of primary beneficiaries of these SPEs equals the number of contributors of assets. We suggest to explicitly address such a situation in the Interpretation and to explain in more detail the requirements to meet the condition "substantially restrict an enterprise's rights and obligations to specifically identified assets of an SPE".

The requirement in paragraph 14 with respect to how much effort should be spent to produce the necessary evidence according to the Interpretation is difficult to operationalize. We suggest the Board should offer a positive definition of which evidence should be considered (such as commonly available information, etc.).

The requirement to provide comparable information in order to justify the market based character of a fee is also hard to operationalize. We would suggest to include some guidance to this aspect.

The provision under paragraph 15 e with respect to related parties is hard to operationalize and implement. It would be helpful if further guidance could be given to this aspect.

We think the Board should provide additional determination and disclosure guidance with respect to variable interests belonging to the other parties to the SPE and also with respect to disclosures that will have to be made by an administrator.

If you have any questions about our comments or wish further to discuss any of the matters addressed herein, please contact Elisabeth Schmalfuß at +49 (89) 636-33528, (email: elisabeth.schmalfuss@siemens.com) or Guido Biendarra at +49 (89) 636-34068, (email: guido.biendarra@siemens.com).

Very truly yours,

Bernd Vogt