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

**Letter of Comment No: 93
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I appreciate the opportunity to comment on the Exposure Draft (ED) of a Proposed Interpretation of ARB 51 on the Consolidation of Certain Special Purpose Entities. While I agree with the fundamental concepts of consolidating entities over which an entity exercises control and that the definition of control be broadened beyond voting percentages, I have three concerns:

- 1- The disclosures surrounding the financial troubles at Enron and other companies which used Special Purpose Entities (SPE) to create fictitious income or hide liabilities have convinced me that the inappropriate reporting was more a product of greed, lax governance processes, ineffective internal controls, fraud and poor auditing than to any defect in generally accepted accounting principles.**
- 2- The same financial engineers who reside in investment banks, law firms and accounting firms and wove the deceptive webs to evade the existing accounting rules will delight in an overly prescriptive interpretation because it will create new spinning opportunities, and**
- 3- An overly prescriptive interpretation could also result in significant unintended consequences and require the consolidation of certain SPE where there is no attempt to hide debt or create income.**

It would be a tragedy and a travesty if the perpetrators of Enron et al would succeed with an argument that the issuance of this interpretation proved that there was inadequate guidance in the existing literature. The concept of influence triumphing over voting percentages is evident in the accounting literature dealing with equity accounting. It is also becoming increasingly obvious that the manipulators did not qualify for non-consolidation under the present rules.

Notwithstanding the current situation, I agree that additional guidance is helpful and with the focus on the ability to exercise unilateral influence over the decision making process of the SPE. However, I am troubled by the excessive “rule based” criteria that are proposed because of the potential for unintended consequences. For example,

1- certain investment pools are deliberately constructed with various risk tranches to provide investors with product to satisfy different return expectations and risk tolerances. One of these tranches could be a subordinated debt instrument, which becomes a variable interest under Paragraph 6.

2- the limited use of derivatives could disqualify certain financial conduits from qualifying under Paragraphs 22 and 23. Derivatives have a logical and necessary role to hedge interest rate risk or asset exposure.

3-An investment manager could be required to consolidate a conduit SPE because it holds an immaterial investment in the vehicle.

4- Investors in a pool of assets delegate investment management decisions to a fiduciary operating as investment advisor/manager under arrangements that are essentially predetermined by the enabling documents and require approval of investment decisions by an independent party. The definition of sufficient discretion used in the final pronouncement should exclude such arrangements.

5- The ED suggest that even though a primary beneficiary may never benefit from the SPE assets and have no obligation to the creditors of the SPE, the primary beneficiary should consolidate such assets and liabilities in its financial statements. This contradicts the intent of the FASB’s accounting concepts.

6- the definitions of “sufficient discretion” and “market-based fee” are too ambiguous .

SUGGESTIONS:

The final interpretation should contain an overall safe harbor provision to either require or prohibit consolidation based on the substance of the situation regardless of form. Similarly, if the resulting financial statements are distorted and do not represent the economic circumstances, blind adherence to the rules should not be required.

Conceptually, control should be based on true ability to unilaterally direct the activities of the SPE and/or an obligation to provide ongoing financial support.

The final interpretation should make it clear that SPE that meet the following criteria should not be consolidated with the SPE advisor/ manager because there is no primary beneficiary. The criteria are: The SPE is a conduit formed solely to distribute risks and rewards among its investors. Its assets are purchased by the manager in the open market pursuant to restrictive rules and the debtors remains

obligated under the original terms and condition. The manager's investment decisions are subject to the approval of an independent trustee. The investors can remove the manager. The manager is not required to provide any future financial support to the SPE. Any investment by the manager in the SPE was acquired at the formation of the SPE on the same terms and conditions as similar securities. Such investments by the manager should be immaterial to both the manager and the SPE.

The Exposure Draft of the proposed interpretation of ARB 51 does not clearly and unambiguously exclude such an SPE from consolidation with the manager. This could result in the unintended consequence of consolidation of assets, which are not owned, and liabilities that are not owed.

Please feel free to contact me at 617-552-1933 or via e-mail at oreillyv@bc.edu with any questions or comments that you have.

Very Truly Yours

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