



August 30, 2002

Letter of Comment No: 82
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Ms. Suzanne Bielstein
Director of Major Projects and Technical Activities
Financial Accounting Standards Board
401 Merritt 7
P. O. Box 5116
Norwalk, CT 06856-5116

Subject: File Reference No. 1082-200

Dear Ms. Bielstein:

The IMA's Financial Reporting Committee wishes to express its views on the proposed Interpretation of ARB No. 51 (the "Interpretation"), Consolidation of Certain Special Purpose Entities. The FRC agrees on the need for revised guidance on consolidation of SPEs and supports the concept of variable interests as a surrogate means to assess when SPE's should be consolidated. That said, we believe the requirements are incredibly complex and difficult to apply. We think these problems would lessen if the proposed requirements were modified to provide a clearer connection between the overall concept and the Interpretation's requirements and our recommendations for changes in the variable interest rules were adopted. The FRC also supports the existing accounting model for derecognition of financial assets under FAS 140 and believes that the Board needs to ensure that proposed Interpretation does not undermine that standard. That can be accomplished by developing a workable approach to the definition of financial SPE's. Our detailed comments are provided below. We welcome the opportunity to assist the Board in clarifying the final Interpretation as the Board proceeds to a final document.

Substantive Operating Entities -- The FRC agrees that the an SPE that is consolidated by a substantive operating entity should be outside the scope of the ED. However, we think it should be clear that the test of whether an entity is an SOE should consider the size and resources of the SOE in relation to its ability to support all of the SPEs that it consolidates. Some have interpreted the definition to mean that a small private entity conducting substantive

but limited operations could become the “parent” of a portfolio of nominally capitalized SPEs engaging in much larger financing transactions and, thereby, cause all of those SPEs to be excluded from the scope of the Interpretation. We are confident that this was not the Board’s intent and support additional clarification in the final Interpretation.

Variable Interests -- We believe that variable interests often serve as a surrogate for voting equity in circumstances where the activities of the entity are significantly limited. The FRC therefore agrees that an analysis of variable interests is the appropriate means for assessing whether an SPE should be consolidated. However, we have significant concerns with the way the proposed Interpretation defines variable interests and requires them to be analyzed. In general, we believe that the requirements for analyzing variable interests to make consolidation decisions should parallel the analysis of voting interests. The Board appears to support this view based on the comments in paragraph B11 of the exposure draft. That paragraph identifies two attributes that are indicative of a “parent-subsidiary” relationship: (1) the parent’s responsibility or willingness to provide financial support (and suffer losses if the subsidiary does not generate profits) and (2) the ability to realize a rate of return that is limited only by the nature of the assets held by the entity and the parent’s ability to use those resources effectively. However, the definition of variable interests in paragraph 18 seems to focus solely on the first attribute. We believe that this will lead to significant implementation problems and, more importantly, faulty consolidation answers. Our specific concerns follow:

- We do not agree that contingent obligations such as guarantees are variable interests. We also do not believe that the requirements should focus exclusively on potential losses. Voting equity represents an existing financial interest that has both risks and rewards. Variable interests, either singly or in combination, must provide that same potential. We would not expect a document that interprets ARB51 to move beyond assessments of an existing financial interest and require consideration of a contingent interest as well. Such a change is, in our view, an amendment of the existing standard. If the Board chooses to continue in this direction, the final standard should be issued as an amendment and afforded the extended due process that would be requisite for such a fundamental change. We therefore believe that the Board should focus on the entire distribution of returns – both positive and negative – and should exclude contingent arrangements from the definition of variable interests unless they are related to an existing financial interest. If the consolidation model is to be changed to take into account contingent arrangements and notions of effective control, those matters should be addressed in a separate project that covers situations involving limited scope and regular entities.
- We disagree with the requirement to consolidate when the holder does not have a majority of the variable interests. The requirement to analyze the variable interests of others to determine whether it holds significantly more than other variable interest holders is neither operational nor conceptually supportable under the theory that this interest is a surrogate for equity. Similar to our previous point, there should be symmetry between this requirement and an analysis based on voting interests, where consolidation is generally required if a majority of the voting equity is owned.

Difficulties in applying the proposed approach become evident when the variable interests are tranching, widely dispersed and publicly traded. In those circumstances, it may not be feasible for an entity to perform the analysis required by the proposed interpretation. Similar issues arise with respect to derivative arrangements with the SPE. We recommend that consolidation be limited to circumstances in which a party holds a majority of the variable interests.

- We do not support analysis of variable interests based on expected values in accordance with Concepts Statement No. 7. Assigning probabilities to potential outcomes, particularly for event-oriented contingencies, is highly subjective and difficult enough in these circumstances for one's own interests. Requiring variable interest holders to make such assessments with respect to the loss expectations of other variable interest holders in order to determine whose expected losses are greater will inevitably produce subjective and arbitrary results and will further encourage inconsistent application of the Interpretation. As a result, this approach is likely to produce inconsistent consolidation answers across companies and, potentially, for the same company over time. We therefore believe that the requirements should focus on most likely scenarios of outcomes that include both gains and losses.
- We do not agree with the explicit requirement to assess variable interests each reporting period. If the Board does not change its proposed requirement for a holder of a significant variable interest to determine whether its interest is significantly greater than those of other variable interest holders, the standard would become incredibly burdensome and difficult. We understand the concern behind this requirement and if the Board decides proceed with the proposed approach, we would not object to a requirement to reassess variable interests if there are indicators that may suggest a change in the primary beneficiary of an SPE. This would seem to be a reasonable compromise that appropriately balances costs of assessing a multitude of variable interests and the benefits of consolidation.

Financial SPEs – We agree with the Board's conclusion that SPE's that effectively diversify risk among numerous entities, such that no one party carries a disproportionate share, should not be consolidated by any of its beneficiaries. We do not believe that the rule-based approach proposed in paragraphs 22 and 23 of the Interpretation will have the desired effect. It is difficult to relate those requirements back to the concept of not consolidating entities that effectively diversify risks and we are concerned that many of these entities may not actually meet the criteria. It perhaps would be more productive to drop those paragraphs and augment the variable interest requirements with examples that demonstrate how these financial SPE's would satisfy those requirements. We believe that the changes we propose above to the variable interest rules would make it more likely that SPE's that effectively diversify risk would not be consolidated.

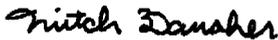
Transition -- The FRC notes that the proposed transition is unusual for a new standard that changes the boundaries of a reporting entity – APB 20 normally requires retroactive restatement of all periods presented. We recognize that the Board may view this as a practical expedient and necessary because some companies that would not be in a position to restate prior year results. On the other hand, other companies have this data readily available and may wish to restate because that approach provides better information to investors for purposes of analysis post-adoption. We would therefore suggest that the Board permit, but not require, companies to retroactively restate.

In the event the Board decides to stay with the transition guidance in the draft, it should address how the fair value recognition should work, whether minority interests should be recognized for variable interests held by other parties, and what the subsequent accounting should be for the SPE assets and liabilities.

Effective Date -- The FRC is quite concerned that it will be not be feasible for companies to adopt the Interpretation as of the beginning of the fiscal period beginning April 1, 2003. For calendar year companies, that timetable would be very difficult to meet and it is not clear that an interim period would be an appropriate time to make wholesale changes to the financial statements. We believe investors will be in a better position to understand the changes if they are implemented in the fiscal fourth quarter so that the full annual financial statements would be provided along with the change. This also would allow companies more time to understand and apply these requirements.

We appreciate your consideration of our comments and welcome the opportunity to discuss these issues with the Board at its convenience. If you have questions regarding this letter, please feel free to contact me at (203) 373-3563.

Sincerely,



Mitchell A. Danaher
Chair, Financial Reporting Committee
Institute of Management Accountants