

October 29, 2008

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LETTER OF COMMENT NO. 4

Russell G. Golden, CPA Technical Director FASB 401 Merritt 7 PO Box 5116 Norwalk, CT 06856-5116

Re: September 15, 2008 Exposure Draft (ED) of a Proposed Statement of Financial Accounting Standards, Amendments to FASB Interpretation No. 46(R) [File Reference No. 1620-100]

Dear Mr. Golden:

One of the objectives that the Council of the American Institute of Certified Public Accountants (AICPA) established for the PCPS Executive Committee is to act as an advocate for all local and regional firms and represent those firms' interests on professional issues, primarily through the Technical Issues Committee (TIC). This communication is in accordance with that objective. These comments, however, do not necessarily reflect the positions of the AICPA.

TIC has reviewed the ED and is providing the following comments for your consideration.

GENERAL COMMENTS

TIC is supportive of many of the proposed amendments in the ED, with the exception of the enhanced disclosures for nonpublic entities. The renewed emphasis on the qualitative approach and the new requirement for ongoing assessments are preferable and should address many of the observed abuses related to qualified special purpose entities and also provide certain benefits to financial reporting for nonpublic entities.

However, TIC believes this ED presents the perfect opportunity to also re-examine the effectiveness of FIN 46(R) in the private company environment. It is the ideal time to add specific implementation examples that would enhance the understandability of the standard and to consider additional revisions to FIN 46(R) that are needed to address the two major





issues faced by private entities:

- The cost/benefit issues created when certain private entities are required to consolidate certain leasing variable interest entities (VIEs), even though most lenders and other financial statement users do not find this presentation useful; and
- Diversity in practice that has resulted from varying interpretations of FIN 46(R) when an individual is a significant variable interest holder of one or more commonly owned affiliates.

TIC therefore recommends that the FASB consider a new FIN 46(R) exception to address these issues. TIC has developed a proposal based on the unique needs of users of private company financial statements. It also addresses some of the concerns expressed in the May 23 and July 18, 2008, FIN 46(R) recommendation letters to the FASB from the Private Company Financial Reporting Committee.

TIC suggests adding the following specific language to paragraph 4 of Fin 46(R):

j. A nonpublic enterprise that meets the definition of related parties in paragraph 16 and is engaged primarily in a leasing transaction that otherwise would be accounted for in accordance with FAS 13 shall not be subject to this interpretation but shall instead follow the guidance in FAS 13, paragraph 29, with respect to accounting for leases with related parties. This exemption would not apply if related party leasing arrangements were coupled with other variable interests unrelated to leasing.

In providing this particular scope-out for nonpublic entities, the Board will remove what appears to be the major point of contention in applying this Interpretation to nonpublic entities. Lenders generally need and rely on financial statements of the separate components of related party leasing affiliates; consolidated financial statements often serve no practical purpose. The ultimate accounting for these transactions would then be left to the outcome of the current project with respect to lease accounting and will likely result in a classification of the lease as a capital lease in the issuing entity's financial statements. This will then accomplish the goal of providing the users of the financial statements the benefit of understanding the balance sheet impacts of the related party leasing transactions.

TIC believes this small change will enable greater acceptance of the interpretation and reduce the currently increasing numbers of GAAP exceptions related to this standard. Additionally, this would retain the requirements to consolidate other VIE transactions such as real estate developments or securitization transactions entered into by nonpublic entities





that should be consolidated to provide users with the requisite information on formerly off balance sheet transactions.

If the Board does not agree to the limited scope exception suggested above, TIC believes it would be helpful to provide examples to mitigate diversity in practice in the accounting for related party leasing transactions under the interpretation. In particular, the examples should illustrate how the impact of capital levels in the related party VIE would or would not affect the accounting.

The specific comments below present TIC's proposal in greater detail and the Committee's responses to the questions posed by the Board in the ED.

TIC has also requested an invitation to the November 6, 2008 public roundtable meeting to represent the views of regional and local practitioners and their clients regarding this ED.

SPECIFIC COMMENTS

1. Will the proposed Statement meet the project's objectives to improve financial reporting by enterprises involved with variable interest entities and to provide more relevant and reliable information to users of financial statements?

Yes. TIC supports the FIN 46(R) amendments in the ED, with the exception of requiring enhanced disclosures for nonpublic entities. In particular, TIC believes that ongoing assessment is a conceptually better model for determining the appropriate deconsolidation point for entities that no longer meet the definition of a variable interest entity (VIE). However, TIC does not see the benefit of the enhanced disclosures for most private entities, as discussed under Question 8 below.

2. What costs do you expect to incur if the Board were to issue this proposed Statement in its current form as a final Statement? How could the Board further reduce the costs of applying these requirements without significantly reducing the benefits to users of financial statements?

We believe in all cases that the costs of moving to an ongoing assessment model will be higher than those under the existing FIN 46(R). In particular, the enhanced disclosures are more extensive and more granular in nature than existing disclosures. The cost increases will range from nominal to significant, depending on the number, nature and complexity of the potential VIEs under consideration. Therefore, entities with many VIEs will bear the





highest cost burden.

In some cases, the additional cost will have proportional user benefits. As noted above, the new reconsideration provisions are more representationally faithful, since a better mechanism would be provided to deconsolidate certain previously consolidated VIEs that no longer meet the qualitative criteria. The additional cost is also justified when off balance sheet risk is high, as is frequently seen within the construction business.

However, for single-owner entities with leasing affiliates, the disclosures are very burdensome with little or no user benefit. TIC believes that the level of disclosure necessary for full transparency should be different for complex structured investment vehicles v. simple, tax-driven VIE structures in the private company environment. Research performed by the PCFRC has shown that the primary users of private company financial statements (i.e., lenders) do not need the level of disclosure that is present in the existing FIN 46(R) standard, much less the enhanced disclosures proposed in the amendments. Therefore, TIC believes disclosure relief can effectively be adopted without compromising user benefits.

3. The Board decided to adopt a more principles-based approach to determine the primary beneficiary of a variable interest entity. Do you believe the principles in paragraphs 14–14B of Interpretation 46(R), as amended by this proposed Statement, are sufficiently clear and operational?

Yes. The qualitative analysis described in the ED is already being followed in practice.

4. The Board concluded that it would be helpful to provide examples of the application of the principles in this proposed Statement. Do you believe that the examples in Appendix A clearly indicate how the principles in paragraphs 14–14B of Interpretation 46(R), as amended by this proposed Statement, would be applied? If not, please articulate what additional information or guidance is necessary, considering the basis for the Board's conclusions.

The examples in the ED generally relate to structured financial entities. TIC believes there may be more complexities in applying paragraph 14A(a) to operating entities when powers are shared or divided. For instance, certain construction ventures, not meeting the definition of a joint venture, designate one party as being unilaterally responsible for certain aspects of a project, and the second party being unilaterally responsible for other, equally significant aspects, generally based on each party's particular expertise. Accordingly, determination of the primary beneficiary is complicated and could benefit from additional examples.





Another common example is the business owner that purchases real estate in a separate entity and leases it to the related operating company. This business model is one of the more common scenarios among private companies. As discussed in our General Comments above and in Question 7 below, TIC believes such businesses should be excluded from the scope of FIN 46(R) and should follow the related party leasing provisions (paragraph 29) of FASB Statement No. 13. The existing FASB guidance on related party leases will provide suitable guidance until a converged international standard on leases has been finalized.

If the Board does not scope out such VIE relationships, the amended standard should include new examples that will eliminate existing diversity in practice. Implementation issues frequently arise when a natural person is the common business owner of a related party leasing VIE. The methodology for determining the primary beneficiary of a VIE is confusing to many because defining which party, the owner or the operating entity, is the most closely associated with the VIE often involves considerable judgment. Additional complexities include entities with at-will leases, operating leases and capital leases. The level of outside financing also adds complexity. Examples include those entities with no outside financing to substantial outside financing. Responsibilities for property improvements will also add to the complexity. If an individual is the primary beneficiary, some say the operating entity should consolidate because the primary beneficiary/lessor is a natural person, rather than an entity. Others say none of the entities should be consolidated whenever the individual is the primary beneficiary in a commonly controlled group of entities. TIC strongly believes this diversity in practice needs to be resolved with specific guidance that provides clear indicators as to when consolidation would and would not be required. The current example of a leasing arrangement with a potential VIE rarely occurs in practice and accordingly provided little benefit.

Another illustrative example should include the accounting for a thinly capitalized VIE that over time becomes fully capitalized based on its own operations. The example should illustrate the decision process involved in the deconsolidation of the VIE.

5. This proposed Statement retains the quantitative analysis for situations in which an enterprise cannot determine whether it is the primary beneficiary through the qualitative analysis in paragraph 14A of Interpretation 46(R), as amended by this proposed Statement. In Appendix A, each example either identifies a primary beneficiary or concludes that no primary beneficiary exists through a qualitative analysis. The Board may consider removing the quantitative analysis for determining whether an enterprise is the primary beneficiary of a variable interest entity. Do you believe that the quantitative analysis is necessary based on the proposed amended guidance for determining the primary beneficiary? Do you believe that the quantitative





analysis would be performed in many situations? Why or why not?

TIC believes that many entities already have interpreted FIN 46(R) to allow for a qualitative analysis. Although we don't anticipate a significant need for a quantitative analysis for the types of VIEs that TIC members see most often, we don't believe there is harm in leaving that option available for certain situations where a qualitative analysis does not produce a clear result. The quantitative analysis may also prove useful if some preparers try to structure transactions to circumvent the spirit of the standard.

6. For the reasons stated in paragraphs B6-B15 of this proposed Statement, the Board decided to require ongoing assessments to determine whether an entity is a variable interest entity and whether an enterprise is the primary beneficiary of a variable interest entity. Do you agree with the Board's decision to require ongoing assessments? If not, please provide reasons (conceptual or otherwise) as to why you disagree with these requirements considering all of the proposed amendments in this proposed Statement.

We agree that the ongoing assessment methodology is preferable to the previous methodology that was based on specific reconsideration events. This amendment will provide a more appropriate assessment of a VIE and its relationship with the primary beneficiary on an ongoing basis and will more quickly identify those VIEs that should be deconsolidated.

7. Do you believe that any exceptions to this proposed Statement should be made for private or not-for-profit entities? If so, please articulate the conceptual basis and reasons for the exceptions.

Yes. As discussed in the general comments section above, TIC believes a nonpublic enterprise that meets the definition of related parties in paragraph 16 and is primarily engaged in a leasing transaction that otherwise would be accounted for in accordance with FAS 13 should be excluded from the scope of FIN 46(R), as amended. Alternatively, such entities should instead follow the guidance in FASB Statement No. 13, paragraph 29, with respect to accounting for leases with related parties.

Such VIEs are usually established for legal and tax considerations. Current and prospective lenders make credit decisions based on a separate analysis of the financial capacity of the primary operating entity, as well as each legal entity that comprises the borrowing group. Therefore, bankers need and rely on the separate financial statements of each component; consolidated financial statements have no practical use for their lending models. Further,





TIC believes the leasing standards (capital vs. operating) are more appropriate than FIN 46(R) to address the risks and rewards of entities involved primarily in leasing activities. (The exemption would not apply if related party leasing arrangements were coupled with other variable interests unrelated to leasing.)

For commonly controlled leasing entities, off balance sheet risk is more appropriately handled through related party disclosures. The current disclosure requirements in FASB Statement No. 57, Related Party Transactions, No. 5, Accounting for Contingencies, FASB Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, and AICPA Statement of Position 94-6, Disclosure of Certain Significant Risks and Uncertainties, provide financial statement users with enough information to evaluate the reporting entity and its activities with VIEs.

The benefits of TIC's proposal go beyond cost/benefit issues. If the consolidation issues identified above could be resolved, TIC believes the currently increasing number of qualified opinions due to FIN 46(R) GAAP departures could be reduced.

One additional amendment should be made for not-for-profit organizations (NPOs). TIC believes the last sentence of paragraph 4a, which is not changed by the current ED, should be deleted. This sentence implies that using NPOs "in a manner similar to a variable interest entity" would be an attempt to circumvent the spirit of FIN 46(R). This is generally not the case within TIC's constituency. Designating NPOs as general partners in an LLC is for substantive business and tax structuring reasons. TIC members have not seen NPOs being used for abusive purposes. Therefore, these entities should not be penalized by being brought into the scope of FIN 46(R). The scope-out for NPOs in paragraph 4a of the standard should be without exception.

8. Financial statement users indicated that the information disclosed in accordance with Interpretation 46(R) about an enterprise's involvement or involvements with variable interest entities and the associated risks are often insufficient and untimely. Do you believe the disclosure requirements in this proposed Statement address those concerns?

Our experience is that financial statement users of most private company financial statements are more concerned about identifying and then evaluating VIEs on a stand-alone basis. Therefore, we do not believe that the additional proposed disclosures will address the needs of most users of private company financial statements. For entities within our constituency, TIC believes existing related party disclosures are meeting users' needs.





9. Should the elements of a consolidated variable interest entity be required or permitted to be classified separately from other elements in an enterprise's financial statements?

We believe this may be considered beneficial by certain financial statement users. Certain financial statement users find the consolidated financial statements lack understandability, particularly when credit and other decisions must be analyzed on an entity-by-entity (standalone) basis. We are aware that many users of financial statements already request consolidating and / or separate company financial statements, to allow analysis on an entity-by-entity basis.

However, TIC believes this is an issue that should be deferred until the Boards are ready to tackle convergence on this topic. In the interim, separate classification of the elements of consolidated VIEs should be permitted but not required. Such detail could be presented in the notes to the financial statements.

TIC appreciates the opportunity to present these comments on behalf of PCPS member firms. We would be pleased to discuss our comments with you at your convenience.

Sincerely,

Stephen Bodine, Chair

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PCPS Technical Issues Committee

cc: PCPS Executive and Technical Issues Committee

