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February 15, 2012

Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

RE: Proposed Accounting Standards Update, “Principal versus Agent Analysis” (File Reference No. 2011-220)

Dear Technical Director:

We appreciate the opportunity to comment on the proposed Accounting Standards Update, *Principal versus Agent Analysis* (the proposed ASU). We support the Board’s objectives of improving the U.S. GAAP variable interest entity (VIE) consolidation requirements, providing guidance on how to evaluate whether a decision maker has a controlling financial interest in an entity, and eliminating inconsistencies in U.S. GAAP on how kick-out rights and participating rights affect consolidation evaluations.

However, we are concerned that the proposed ASU lacks sufficient discussion of the principles and objectives on which the qualitative principal-agent model is based for the model to be applied with an appropriate degree of consistency in practice. Prior to the issuance of ASU 2009-17, and FASB Interpretations 46R and 46, the principle for consolidation was clear in that an enterprise was required to consolidate another entity if it had control over the entity and other parties could not take that control away from the enterprise or participate in the enterprise’s decisions about how to operate the entity. With these amendments, consolidation evaluations have become less straightforward, and thus, we believe the Board should clearly articulate the current principle for consolidation. In addition, we believe it is imperative that the Board clarify certain aspects of the proposed ASU before it is issued in final form.

We note that while guidance on consolidation is a convergence initiative between the FASB and IASB, there remain differences between the Boards’ models generally, including, to some extent, between the FASB’s proposed principal-agent model and the requirements of IFRS 10. Accordingly, our comments are focused on the application of the FASB’s proposals in the context of the U.S. consolidation model and do not address the application of the IASB’s consolidation guidance for which we might have different points of emphasis.

As discussed in more detail in our responses to the Board’s specific questions on the proposed ASU, we believe the guidance in the proposed ASU could be simplified and enhanced if it were more objective and we have provided recommendations about improvements the Board could make to the final guidance in that regard. We believe that the principal-agent model should be revised to make substantive kick-out, liquidation, or participating rights determinative rather than merely a factor to consider. We also believe



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the Board should narrow the extent of the differences between the economic interests in the examples that lead to a conclusion that an enterprise is a principal versus those that lead to a conclusion that an enterprise is an agent.

Finally, we believe the Board should provide a scope exception to the proposed principal-agent requirements for entities that are required to comply or operate in accordance with requirements similar to those in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds. We believe the guidance in the proposed ASU may require decision makers of such entities to consolidate them in some cases and we understand that financial statement users prefer that these entities not be consolidated.

Our responses to the Board's specific questions are set forth in Appendix I and our other comments and recommendations on the proposed ASU are included in Appendix II. If you have any questions about our comments or wish to discuss any of the matters addressed herein, please contact Mark Bielstein at (212) 909-5419 or Kimber Bascom at (212) 909-5664.

Sincerely,

KPMG LLP

Appendix I

Principal versus Agent Analysis

Question 1: When determining whether a decision maker is a principal or an agent, the proposed amendments require the analysis to consider the decision maker's overall relationship with the entity and the other parties involved with the entity. This analysis would be based on a qualitative assessment. Do you agree with this approach? If not, why?

We agree that the evaluation of whether a reporting enterprise has a controlling financial interest in an entity should be based on the reporting enterprise's overall relationship with the entity and the other parties involved with the entity. However, we are concerned that the proposed ASU lacks sufficient discussion of the principles and objectives on which the qualitative principal-agent model is based for the model to be applied with an adequate level of consistency in practice. We believe the Board's basis for the principal-agent guidance is that when an enterprise has (a) the power to make the decisions that most significantly impact an entity's economic performance along with (b) an economic interest in the entity that is significant enough to incentivize the enterprise to use its power primarily on its own behalf (within the constraints of its fiduciary responsibilities, if any, to other parties involved with the entity), the enterprise should be required to consolidate the entity. However, this thought process is not clearly articulated in the proposed ASU.

In order for the principal-agent guidance to be applied consistently it is critical for the Board to link the elements of the thought process in the previous paragraph (i.e., power and economic interest) to each of the factors to consider in the principal-agent analysis. The final ASU should clearly explain which element of the underlying principle each of the factors relates to and why the factors are weighted in a particular manner. Specifically, the Board should explain the interaction between the three factors so that it is clear what facts and circumstances in combination should cause a shift in the analysis of whether an enterprise is a principal or an agent. In addition, the Board should either include more objective considerations in the guidance about how the factors in the principal-agent model should be applied or narrow the extent of the differences between the facts in the examples that lead to a conclusion that an enterprise is a principal versus those that lead to a conclusion that an enterprise is an agent.

We believe the guidance in the proposed ASU could be simplified and improved if it were more objective. This could be accomplished, for example, if the principal-agent model specified that an enterprise with power to direct the activities that most significantly impact an entity's economic performance would be considered a principal and would be required to consolidate the entity if any of the following conditions are met:

- a. The economic risks and/or rewards of interests held by the enterprise and parties acting on its behalf are disproportionately greater than those of other individual investors in substantive residual interests of the entity (which could include debt investors if the entity has no substantive equity interests),
- b. The interests held by the enterprise and parties acting on its behalf comprise a significant portion of the entity's most subordinate substantive residual interests, or
- c. The enterprise holds substantially all of the entity's economic interests, including senior interests.

The first condition above would require consolidation by an enterprise with decision making power that (together with parties acting on its behalf) holds an economic interest in an entity that is substantively subordinated to the interests of other investors, and the second condition would require consolidation by an enterprise with decision making power that (together with parties acting on its behalf) holds a *pari passu* economic interest in an entity that is significant in relation to the interests of other investors. The third condition would require consolidation by an enterprise with decision making power that (together with parties acting on its behalf) holds senior interests in an entity that represent substantially all of the



entity's economic interests. For purposes of the evaluation above, we believe an enterprise should not be considered to have power if other parties hold substantive kick-out, liquidation, or participating rights (also refer to our responses to Questions 3 and 4). In addition, we believe the guidance should require consideration of combined economic interests and decision making rights of separate parties where one party is acting on behalf of one or more other parties. We believe the related party tiebreakers in ASC 810-10-25-44 could be used to identify the party within such groups that is required to consolidate the entity.

As an alternative to the recommendation in the previous paragraph, we believe the Board could significantly improve the VIE consolidation guidance by revising the requirements on kick-out, liquidation, or participating rights (consistent with our previous recommendation) and revising the requirement in ASC paragraph 810-10-25-38A(b) to take probability into consideration consistent with the requirement in ASC paragraph 810-10-55-37(c). That is, kick-out, liquidation or participating rights could be considered substantive in the evaluation of ASC paragraph 810-10-25-38A(a) even if they require more than a single party to exercise them. The Board could further provide guidance on how to evaluate the impact that dispersion of kick-out, liquidation, or participating rights has on their substance. (This guidance would also impact the condition for determining whether an entity is a VIE in ASC paragraph 810-10-15-14(b)(1).) Under this approach, an enterprise would be the primary beneficiary of a VIE if it has (a) the power to direct the activities that most significantly impact the entity's economic performance, and (b) a variable interest that exposes the enterprise to significant variability of the VIE. The principal-agent guidance for non-VIE partnerships and similar entities could be modeled on the revised ASC paragraph 810-10-25-38A. We believe this approach would be simpler than the ASU's proposals, would retain the general framework of ASU 2009-17 in which the primary beneficiary of a VIE must have both power to direct the relevant activities of the VIE and a significant economic interest in the VIE, and would be more objective than the principal-agent model in the proposed ASU.

Question 2: *The evaluation of a decision maker's capacity would consider the following factors:*

- a. *The rights held by other parties*
- b. *The compensation to which the decision maker is entitled in accordance with its compensation agreement(s)*
- c. *The decision maker's exposure to variability of returns from other interests that it holds in the entity.*

Are the proposed factors for assessing whether a decision maker is a principal or an agent appropriate and operational? If not, why? Are there any other factors that the Board should consider including in this analysis?

We believe the factors above generally are appropriate for purposes of evaluating whether a decision maker is a principal or an agent. However, as indicated in our previous response, we believe the factors are not sufficiently operational without a clearer articulation of the principle and objectives of the principal-agent model and a comprehensive discussion that explains the linkage between the principle and objectives and each of the factors. In addition, we believe when substantive kick-out, liquidation, or participating rights are held by parties that are not acting on behalf of the decision maker that the decision maker should be considered an agent. That is, we believe the existence of substantive kick-out, liquidation, or participating rights should be determinative in the principal-agent analysis rather than being merely a factor to consider. We also believe the Board needs to comprehensively define a decision maker for purposes of the guidance or dispense with the term and require any party with power to direct the activities that most significantly impact an entity's economic performance to perform the principal-agent analysis. Consistent with the guidance in the VIE subsections of ASC Subtopic 810-10, we believe a variety of factors other than the rights held by other parties may affect whether an enterprise has the power to direct the activities that most significantly impact an entity's economic performance.



The Board should include language in the Codification similar to the language in paragraph BC20 of the proposed ASU indicating that liquidation rights should be evaluated in the same manner as kick-out rights. In addition, the Board should make clearer that the discussion of liquidation rights as protective rights (ASC paragraphs 810-10-25-10, 25-41F, and 25-105) relates to the right of other parties to block the reporting enterprise's decision to liquidate the entity rather than the right of other parties to require the entity's liquidation.

Question 3: *The proposed Update would require judgment in determining how to weigh each factor in the overall principal versus agent analysis. Do you agree that the proposed amendments, including the related implementation guidance and illustrative examples, will result in consistent conclusions? If not, what changes do you recommend?*

We do not believe the proposed ASU provides adequate guidance on how to weigh the factors in the principal-agent analysis to be applied with a sufficient level of consistency. As discussed in our response to Question 1, we believe it is critical for the Board to explicitly address the linkage between the principle and objectives of the principal-agent model and each of the factors to consider. The Board also should explain the interaction between the factors so that it is clear what facts and circumstances in combination should cause a shift in the analysis of whether an enterprise is a principal or an agent. In addition, the Board should either include more objective considerations in the guidance about how the factors in the principal-agent model should be applied or narrow the extent of the differences between the facts in the examples that lead to a conclusion that an enterprise is a principal versus those that lead to a conclusion that an enterprise is an agent.

In evaluating exposure to variable returns from other interests, the proposed ASU would require a decision maker to consider whether the magnitude of, and variability associated with, its economic interests makes it more likely that the decision maker is a principal. It is unclear how the analysis of the magnitude of an enterprise's economic interests would ever result in a different outcome under the principal-agent analysis than the analysis of the variability of the enterprise's interests. In assessing variability, a reporting entity inherently must consider magnitude and subordination. This also seems to be the theme in the examples provided in the proposed ASU. The Board should explain the interplay between variability of an enterprise's interests and the absolute size of its interests in the principal-agent analysis.

We do not believe economic interests should be given more weight in the principal-agent analysis than substantive kick-out, liquidation, or participating rights and thus, disagree with the Board's conclusions in paragraph BC19 of the proposed ASU and the evaluation of Case D in paragraph 810-10-55-3AD, which states that a fund manager with a 20 percent subordinated interest is considered a principal even though it is subject to substantive kick-out rights held by a board of directors of seven members. While we agree that an enterprise with a significant subordinated economic interest in an entity may be motivated to use its relationship with the entity primarily for its own benefit, we believe that the presence of substantive rights that give other parties the ability to preclude the enterprise from taking such actions are more relevant than the enterprise's motivations. We believe it would be inconsistent with the Board's conceptual framework to conclude otherwise. It would be more appropriate in our view for a fund manager to be required to consolidate a fund in the circumstances described in Case A (paragraphs 810-10-55-3B through 55-3K) than for a fund manager to be required to consolidate a fund in the situation described above in Case D. This is because we view power as a prerequisite to a controlling financial interest. That is, even though a party may have a significant economic interest in an entity (and many valid reasons for wishing to use its relationship with the entity primarily for its own benefit), if it does not have the unilateral right to take those actions then it cannot have a controlling financial interest and consolidated financial statements would be misleading to the enterprise's investors. Accordingly, we believe that when an enterprise is subject to substantive kick-out, liquidation, or participating rights, the enterprise should not be considered a principal.



Question 4: *Should substantive kick-out and participating rights held by multiple unrelated parties be considered when evaluating whether a reporting entity should consolidate another entity? If so, do you agree that when those rights are held by multiple unrelated parties, they should not in and of themselves be determinative? If not, why? Are the guidance and implementation examples illustrating how a reporting entity should consider rights held by multiple unrelated parties in its analysis sufficiently clear and operational?*

We believe that substantive kick-out, liquidation or participating rights held by multiple unrelated parties should be considered in evaluating whether an enterprise is required to consolidate another entity. As discussed in our responses to Questions 1–3, we believe that when an enterprise is subject to substantive kick-out, liquidation, or participating rights held by parties that are not acting on its behalf, the enterprise should not be considered a principal. That is, the existence of substantive kick-out, liquidation, or participating rights should be determinative in the principal-agent analysis rather than being merely a factor to consider. We agree that the dispersion of kick-out, liquidation, or participating rights may affect their substance. In addition, although we agree that redemption rights should not generally be considered in evaluating whether an enterprise is required to consolidate an entity, we believe that redemption rights should be evaluated in the same manner as liquidation rights when the circumstances are such that they function as liquidation rights. For example, if a decision maker owns 10 percent of an entity’s equity interests and another investor that has a redemption right owns the remaining 90 percent of the entity’s equity interests, the redemption right may require liquidation of all of the entity’s assets if it is exercised (e.g., if the entity’s assets are real estate properties). In that situation, we believe the redemption right should be evaluated as a liquidation right. This is consistent with our understanding of the application in practice of the current requirements of ASC Subtopic 810-20.

We recommend that the Board provide specific guidance on how to evaluate the impact that dispersion of kick-out, liquidation, or participating rights has on their substance. The Board should indicate, for example, whether it views the effect of dispersion of such rights on their substance to be a matter of difficulty of exercise or likelihood of exercise. We do not believe likelihood of exercise in isolation is an appropriate basis on which to evaluate the substance of such rights. If there are mechanisms in place to ensure that the parties that hold the rights can exercise them if they desire to do so, have the ability to obtain timely information with which to reach a decision about whether to exercise the rights, and do not face barriers that would serve as a deterrent to their exercise, we believe the likelihood of exercise is not relevant to the substance analysis. Likelihood of exercise could be influenced by a variety of factors that are unrelated to the substance of kick-out, liquidation, or participating rights, including whether the holders of the rights also have other rights (e.g., withdrawal rights), and the nature of the entity’s assets and operations. We also observe that technology has reduced the difficulty of exercising kick-out, liquidation, or participating rights that are held by a large number of unrelated parties.

The guidance in the proposed ASU illustrating how a reporting enterprise considers kick-out, liquidation, or participating rights is not sufficiently clear and will likely lead to an undesirable level of diversity in practice. For example, in Case E (paragraphs 810-10-55-3AN through 55-3AX), the kick-out rights held by the debt holders do not overcome the conclusion that the fund manager is acting in a principal capacity because the debt of the entity is widely dispersed and the disparity between the decision maker’s subordinated equity interest and the AAA-rated debt holders diminishes the relevance of the kick-out rights (paragraphs 810-10-55-3AN through 55-3AX). It is unclear how these kick-out rights would be evaluated if they were held by pro-rata equity holders rather than debt holders, and, how “widely held” is interpreted such that the kick-out rights are not substantive.

We also note that Case D (paragraphs 810-10-55-3AD through 55-3AM) is the only example where investors have substantive rights to remove the fund manager (through the rights of the fund’s board of directors). Although we agree with the conclusion that the fund manager is acting in an agent capacity,



the Board's views in paragraph BC19 (that kick-out rights held by a small number of parties could overcome the decision maker's economic interest in the principal-agent analysis) are not well articulated. In addition, we disagree with the Board's conclusion that if the fund manager's 20 percent interest were subordinated, the manager would be considered a principal even if it was subject to substantive kick-out rights.

The Board should clearly explain the interaction between kick-out, liquidation or participating rights and the other principal-agent factors to consider so that it is clear what facts and circumstances in combination should cause a shift in the analysis of whether an enterprise is a principal or an agent.

Question 5: *The proposed Update would not include a criterion focusing on the level of seniority of a decision maker's fees when evaluating the decision maker's capacity. Do you agree that the seniority of the fee relative to the entity's other operating liabilities that arise in the normal course of the entity's activities should not be solely determinative of a decision maker's capacity? If not, why?*

We agree that subordination of the decision maker's fees should not be determinative in evaluating whether the decision maker is acting as a principal or an agent. However, as discussed in our response to Question 3, we do not believe economic interests should be given more weight in the principal-agent analysis than substantive kick-out, liquidation, or participating rights. Paragraph BC27 of the proposed ASU indicates that "The Board believes that although a portion of the decision maker's fee may be subordinate to the entity's senior interest holder, this portion of the fee may represent compensation for the decision maker using its power as an agent for the subordinated interest holders." Although we agree that a decision maker may be acting as an agent when it has a subordinated fee, given the Board's conclusions in paragraph BC19 and the evaluation of Case D of the proposed ASU when the fund manager holds a subordinated equity interest, we believe the Board needs to better explain the reason for the differences in how subordinated fees and subordinated equity interests affect the evaluation of whether a decision maker is a principal or an agent.

Question 6: *The evaluation of a decision maker's capacity places more emphasis on the decision maker's exposure to negative returns (for example, an equity interest or a guarantee) than interests that only expose the decision maker to positive returns. When performing the principal versus agent analysis, should the assessment differentiate between interests that expose a decision maker to negative returns (or both negative and positive returns) from interests that expose the decision maker only to positive returns? If not, why?*

As discussed in our response to Question 1, we believe the Board's basis for the principal-agent guidance is that when an enterprise has (a) the power to make the decisions that most significantly impact an entity's economic performance along with (b) an economic interest in the entity that is significant enough to incentivize the enterprise to use its power primarily on its own behalf (within the constraints of its fiduciary responsibilities, if any, to other parties involved with the entity), the enterprise should be required to consolidate the entity. If our understanding of the Board's basis for the principal-agent guidance is correct, we believe the Board needs to link the proposals on weighting exposure to negative returns differently than exposure only to positive returns back to that basis. While we agree that exposure to losses may be a stronger financial motivator than the opportunity for positive returns, it is not clear to us that the difference is significant. As a result, we believe the Board needs to provide more guidance about the degree of emphasis that should be placed on exposure to losses.

We also believe the Board should consider including implementation guidance about how a decision maker should evaluate its exposure to negative returns when it receives an equity-based performance fee. For example, at formation of the entity, a decision maker may be entitled to receive an annual performance fee in the form of equity interests (rather than cash). It is unclear whether the decision maker's exposure to variability would impact the principal-agent analysis each time it receives an equity-

based performance fee, even though it was contemplated at the formation of the entity. The Board should consider clarifying this in the final ASU.

Question 7: *A reporting entity would be required to evaluate whether there has been a change in the decision maker's capacity by considering whether there has been a change in the purpose and design of the entity. For example, the purpose and design of the entity may change if the entity issues additional equity investment that is at risk to the decision maker. Do you agree with this proposed requirement? If not, please specify when this relationship should be reassessed and why.*

Although we agree with reassessment, we believe that reassessment triggers will be difficult to identify within a judgment framework. Without a more objective principal-agent model, we believe a reporting enterprise will likely have difficulty differentiating a change in purpose and design from a re-evaluation of a previous judgment. The Board should consider developing additional implementation guidance about how to evaluate whether a change in purpose and design has occurred for purposes of the principal-agent model. We also note that the proposed reassessment requirement for the principal-agent analysis is inconsistent with the primary beneficiary reconsideration requirement, which is assessed continuously as facts and circumstances change. We recommend this inconsistency be addressed by requiring a reassessment of the principal-agent analysis as facts and circumstances change.

In addition, as discussed in our previous response, it is unclear whether receipt of an equity-based performance fee would be considered a change in purpose and design that would require reconsideration of the principal-agent analysis each time the decision maker receives its fee in the form of an equity interest. It is also unclear when kick-out, liquidation or participating rights should be reconsidered under the proposed ASU (e.g., as the number of investors change).

Question 8: *The Board decided to include the principal versus agent assessment as a separate analysis within the overall consolidation assessment, rather than replacing the current guidance for evaluating whether a decision-making arrangement is a variable interest (and accordingly, a principal) with the revised principal versus agent analysis. The Board believes that if an entity's fee arrangement does not meet the definition of a variable interest (for example, a nominal performance-based fee), the decision maker should not be required to continue the consolidation assessment. Do you agree? If not, why?*

We believe it is likely if the Board proceeds with a separate principal-agent model that the only function of the current guidance in ASC paragraph 810-10-55-37 for evaluating whether a decision-making arrangement is a variable interest in a VIE would be to establish when an agent is required to consider the VIE disclosure requirements because its fee is a variable interest. We do not believe the guidance in ASC paragraph 810-10-55-37 is necessary or will save decision makers any significant effort in the evaluation of whether to consolidate an entity over which they have decision-making rights if the Board proceeds with a separate principal-agent model. Decision makers with no interests in an entity other than their fee are likely to be able to easily perform the principal-agent analysis. We believe the guidance would be less complex and easier to understand if the Board simply were to indicate that a decision maker that is an agent is not subject to the VIE disclosure requirements of ASC 810-10, while the ASC 810-10 primary beneficiary disclosure requirements apply to a decision maker of a VIE that is a principal.

Question 9: *The Board expects the proposed principal versus agent guidance may affect the consolidation conclusions for entities that are consolidated as a result of the decision maker having a subordinated fee arrangement (for example, collateralized debt obligations). However, the Board does not otherwise expect the proposed amendments to significantly affect the consolidation conclusions for securitization entities, asset-backed financing entities, and entities formerly classified as qualifying special-purpose entities. Do you agree? If not, why?*



We agree that the proposed ASU may affect previous consolidation conclusions where the decision maker has a subordinated fee. Previous consolidation conclusions for securitization entities, asset-backed financing entities, and entities formerly considered qualifying special-purpose entities may also be impacted if the entity is a VIE under ASC paragraph 810-10-15-14(b)(1). That is, if an entity is a VIE because the decision maker has the right to make the decisions that most significantly impact the entity's economic performance and does not receive that right from an equity-at-risk investment, under the guidance in the proposed ASU the decision maker may be an agent, and therefore, the entity may no longer be a VIE. The proposed guidance on consideration of kick-out, liquidation, and participating rights may change previous consolidation conclusions for some special-purpose entities (both VIEs and non-VIEs). Furthermore, we believe that some consolidation conclusions may change based on the discussion in paragraph BC19 which places more emphasis on the decision maker's other economic interests.

Question 10: *Update 2010-10 was issued to address concerns that some believe that the consolidation requirements resulting from Statement 167 would have required certain funds (for example, money market funds that are required to comply with or operate in accordance with requirements that are similar to those included in Rule 2a-7 of the Investment Company Act of 1940) to be consolidated by their investment managers. The amendments in this proposed Update would rescind the indefinite deferral in Update 2010-10 and would require money market funds to be evaluated for consolidation under the revised guidance. The Board does not intend the application of the proposed Update to result in money market funds being consolidated. Do you agree that the application of the proposed Update will meet this objective? If not, why and what amendments would you recommend to address this issue?*

We believe the proposed ASU may require sponsors of entities that are required to comply or operate in accordance with requirements similar to those in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds (collectively MMFs) to consolidate MMFs in which the sponsor has an implicit obligation to absorb credit losses. Cases F (ASC paragraphs 810-10-55-3AY through 55- 3BK) and C (ASC paragraphs 810-10-55-122 through 55- 133) suggest that implicit variable interests may affect consolidation conclusions. Although we believe the sponsor would have been a principal in Case F even without the implicit variable interest described in that Case (a point we believe the Board should clarify), we believe the guidance in Cases C and D (ASC paragraph 810-10-55-3AM) suggests that if the sponsor has an implicit variable interest that is a significant subordinated interest, that fact would be weighed heavily in reaching the conclusion that the sponsor is acting as a principal. As a result, we believe the guidance in the proposed ASU may require many sponsors of MMFs to consolidate those MMFs.

As it was not the Board's intention to require consolidation of MMFs, we suggest that MMFs be excluded from the scope of the proposal. We do not believe the Board's objective can be met through illustrative examples that are contradictory to the principal-agent model or by placing more weight on substantive kick-out, liquidation, or participating rights, because sponsors of many entities that are required to comply or operate in accordance with requirements similar to those in Rule 2a-7 of the Investment Company Act of 1940 for registered MMFs may not be subject to such rights.

Interests Held by Related Parties

Question 11: *For purposes of applying the proposed principal versus agent guidance, the proposed amendments would require a reporting entity to include the decision maker's direct and indirect interests held in an entity through its related parties. Do you agree with the requirement that a decision maker should include its proportionate indirect interest held through its related parties for purposes of applying the principal versus agent analysis? Why or why not?*

We do not believe the requirement to consider only interests held directly by an entity and those held indirectly through interests in related parties will be operational in the principal-agent model. Instead, we



believe that the guidance should require consideration of economic interests and decision making rights of related parties that are acting on behalf of the enterprise (also refer to our response to Question 1) in evaluating whether the enterprise is a principal or an agent.

In addition, the Board should give further consideration to the related party guidance in the non-VIE subsections of ASC Subtopic 810-10. Otherwise, an enterprise and its related parties could structure their involvement with an entity so that the entity would not meet the condition in ASC paragraph 810-10-15-14(b)(1) (because none of the related parties are individually considered a principal) and thereby avoid consolidation of the entity in their individual financial statements. The following example is included for the Board's consideration:

Enterprise A holds all of the decision making rights over Limited Partnership, while Enterprise B holds all of the economic interests in Limited Partnership. Enterprises A and B are under common control, and neither party has an interest in the other. Under the proposed ASU, neither Enterprise A nor Enterprise B would be considered a principal, such that Limited Partnership would not be considered a VIE under ASC 810-10-15-14(b)(1). Assuming that Limited Partnership does not meet any of the other conditions that would cause it to be a VIE, it would be evaluated for consolidation under the Consolidation of Partnerships and Similar Entities subsections of the proposed ASU, and neither Enterprise A nor Enterprise B would be required to consolidate it (although their mutual parent would). We note that either Enterprise A or Enterprise B would consolidate Limited Partnership if it were a VIE because of the related party guidance in ASC paragraphs 810-10-25-42 through 25-44.

In the example above, we believe it may be appropriate for Enterprise A or Enterprise B to consolidate Limited Partnership, even if it is not a VIE. In other situations, however, parties under common control may hold all of the decision making rights and economic interests of an entity that is not a VIE and it may be appropriate for the entity not to be consolidated by any one of those parties. We believe this would be the case if, in the example above, Enterprise A and Enterprise B each held half of the economic interests of Limited Partnership and shared all of the decision-making rights over Limited Partnership equally. We believe the Board should give further consideration to the types of involvements that parties under common control may have with an entity that is not a VIE in developing further guidance on the impact that interests held by related parties of an enterprise should have on the enterprise's evaluation of whether to consolidate the entity. An alternative we believe the Board could consider is revising the guidance in ASC paragraph 810-10-15-14(b)(1) to indicate that if a significant portion of the equity-at-risk is held by an affiliate of a decision maker that is an agent, the condition in that paragraph would be met and the entity would be a VIE.

We note that the proposed ASU would eliminate the related party exceptions in ASC paragraph 810-10-55-37 for employees and employee benefit plans of the decision maker. However, there is no discussion in the proposed ASU about the reason why the Board decided to make this change. We recommend that the Board discuss with financial statement users whether this change would provide more useful financial information from their perspective. We question the benefit of a decision maker consolidating a fund it manages for an employee pension plan when the fund holds investments in securities issued by unrelated parties and substantially all of the fund's investment interests are held by the employee pension plan. If the Board decided to retain this change in the final ASU the Board should provide its rationale for the change.



Evaluation of Partnerships and Similar Entities

Question 12: *The amendments in this proposed Update would require a general partner to evaluate its relationship with a limited partnership (or similar entity) by applying the same principal versus agent analysis required for evaluating variable interest entities to determine whether it controls the limited partnership. Do you agree that the evaluation of whether a general partner should consolidate a partnership should be based on whether the general partner is using its decision-making authority as a principal or an agent?*

If the Board accepts our recommendation that the decision maker be considered an agent when substantive kick-out, liquidation or participating rights are held by parties that are not acting on the decision maker's behalf, we support the objectives in the proposed ASU because it would require consolidation evaluations for VIEs and non-VIE partnerships and similar entities to be more consistent. However, we have concerns about how this guidance would be applied for certain partnerships and similar entities and believe it is imperative for the Board to provide examples illustrating the application of the principal-agent model to limited partnerships and similar entities.

We agree that a general partner's consolidation analysis should be based on whether it is acting as a principal or an agent. However, we question the statement in paragraph 810-10-25-82 that "the general partner is the limited partnership's decision maker." We believe there may be circumstances in which a general partner is not the limited partnership's decision maker. For example, if a limited partner has a unilateral kick-out right over the general partner, we believe the limited partner should perform the principal-agent analysis. Accordingly, we believe paragraph 810-10-25-82 should be modified to indicate that the general partner is usually the limited partnership's decision maker, however there could be circumstances in which it is not. In addition, it is unclear whether a general partner is also the limited partnership's decision maker if the limited partnership is evaluated under the VIE consolidation subsections of ASC 810-10. The Board should conform the analysis of whether an entity is a decision maker of partnerships that are VIEs to the analysis of whether an entity is a decision maker of partnerships that are not VIEs. As indicated in our response to Question 2, we believe the Board should comprehensively define a decision maker or eliminate the term and require any party that has the power to direct the activities that most significantly impact an entity's economic performance to perform the principal-agent analysis.

The limited existing guidance in U.S. GAAP on how limited partners should evaluate whether to consolidate a limited partnership is included in the real estate Topic in ASC paragraph 970-323-25-8, which the proposed ASU would revise as follows:

If the substance of the partnership arrangement is such that the general partners are not in control of the ~~major operating and financial policies of the partnership~~ activities that most significantly impact the limited partnership's economic performance, a limited partner may be in control. An example could be a limited partner holding over 50 percent of the total partnership interest. A controlling limited partner shall be guided in accounting for its investment by the principles for investments in subsidiaries in Topic 810. Noncontrolling limited partners shall account for their investments by the equity method and shall be guided by the provisions of Topic 323, as discussed in the guidance beginning in paragraph 970-323-25-2, or by the cost method, as discussed in the guidance beginning in paragraph 970-323-25-5, as appropriate.

Because the relevance of this guidance is not limited to the real estate industry, the Board should consider moving it from ASC Topic 970 to ASC Topic 810. Moving the guidance into ASC Topic 810 would make it applicable to all entities, thereby reducing the likelihood of diversity in practice. We also recommend revising the example to include an assessment of the limited partner's relationship with the general partner as well as the level of ownership held by the limited partner.



ASC paragraph 810-10-25-95(d) would require a general partner to “consider its maximum exposure to losses of the limited partnership, which would include guarantees of the partnership’s obligations (through a contract or a legal requirement) that may be inherent in a general partner’s ownership interest.” A general partner typically has unlimited liability with respect to the overall operations of the limited partnership. It is unclear how a general partner’s unlimited liability would be assessed under the proposed ASU when the limited partnership is structured so that the general partner would not incur losses that are in excess of its capital balance (e.g., because the general partner’s interest is held through a “blocker” entity). Paragraph B7 of ASU 2010-10 indicates that “a general partner’s unlimited liability with respect to its interest in a limited partnership that has general recourse obligations would not be deemed to expose the reporting entity (general partner’s investor) to losses of the partnership that could potentially be significant to the partnership, if the general partner has no assets other than its interest in the limited partnership and the partnership’s creditors have no recourse to assets of the financial reporting entity (general partner’s investor).” The Board should clarify whether it intends for a general partner to evaluate its unlimited liability similarly to the Board’s conclusions in ASU 2010-10.

The proposed ASU would eliminate the guidance in ASC 810-10 on participating rights relating to activities that occur in the ordinary course of business. This suggests that the Board believes the decisions made in the ordinary course of business for a partnership or similar entity that is not a VIE may be different than the decisions that most significantly impact the entity’s economic performance. Accordingly, an enterprise will need to re-evaluate participating rights in partnerships and similar entities, and different consolidation conclusions may result. The Board should clarify whether it expects the decisions that most significantly impact a non-VIE entity’s economic performance to be different than the decisions made in the ordinary course of business and, if so, why. If the Board believes decisions made in the ordinary course of business for an entity that is not a VIE are equivalent to the decisions that most significantly impact the entity’s economic performance, the Board should retain the guidance in ASC 810-10 relating to evaluating whether rights relating to decisions made in the ordinary course of business are substantive.

Effective Date and Transition

Question 13: *Do you agree with the proposed transition requirements in paragraph 810-10-65-4? If not, how would you propose to amend those requirements, and why? Please provide an estimate of how long it would reasonably take to implement the proposed requirements.*

We generally believe the proposed transition requirements will be well understood because they are consistent with the transition requirements of ASU 2009-17. However, we believe the proposed ASU will likely result in significant cost and effort to implement because a reporting enterprise will need to reconsider:

- All VIE conclusions affected by the analysis of ASC 810-10-15-14(b)(1),
- All primary beneficiary conclusions,
- The impact on consolidation of participating rights held by noncontrolling shareholders of non-VIE corporations,
- The impact of kick-out, liquidation, or participating rights on consolidation of all non-VIE partnerships, and
- All consolidation conclusions for entities that qualified for the indefinite deferral in ASU 2010-10.

A reporting enterprise will need to re-document its consolidation evaluations based on the requirements of the principal-agent ASU regardless of whether the conclusions change. Accordingly, we believe the cost and time reasonably required for a reporting enterprise to implement the proposed ASU could be significant. Paragraph BC40 indicates that the Board does not expect the proposed ASU to affect



consolidation conclusions, other than for entities that qualify for the indefinite deferral in ASU 2010-10. If the Board does not anticipate significant changes in consolidation conclusions, we recommend the Board consider prospective application, except for companies that are subject to ASU 2010-10.

Question 14: *Should early adoption be permitted? If not, why?*

We do not believe early adoption should be permitted because it would negatively impact comparability.

Nonpublic Companies

Question 15: *Should the amendments in this proposed Update be different for nonpublic entities (private companies or not-for-profit organizations)? If the amendments in this proposed Update should be applied differently to nonpublic entities, please provide a rationale for why.*

We believe that the amendments in the proposed ASU should be the same for both public and nonpublic entities. However, we recommend that the Board consider a delayed effective date for nonpublic entities, particularly if the transition requirements in the proposed ASU are finalized in their current form.



Appendix II

This appendix provides certain observations and recommendations that we believe would enhance the clarity of the proposed ASU.

- The amendments to “With Cause” in the Master Glossary should also include fault or nonperformance of the decision maker as a situation in which the investors have the ability to dissolve the entity or remove the entity’s decision maker.
- ASC paragraph 810-10-15-3(c) states that a reporting entity that has a contractual management relationship with another entity that is not within the scope of the VIE subsections would apply the guidance in the Consolidation of Entities Controlled by Contract subsections. The Board should clarify that only not-for-profit entities would apply the guidance in the Consolidation of Entities Controlled by Contract subsections as entities that are controlled by contract would meet the criteria to be VIEs.
- ASC paragraph 810-10-15-14(b)(1) should also refer to 810-10-15-14(b)(2)-(3) when referring to entities that are not VIEs if the holders of the equity investment at risk have the power to control and the equity investment meets the other requirements in ASC paragraph 810-10-15-14 (the proposed ASU only references 810-10-15-14(a) and 810-10-15-14(c)).
- We believe the proposed deleted text in ASC paragraph 810-10-15-14(c)(2), which explains the reason for the condition in ASC paragraph 810-10-15-14(c), should be retained at the end of ASC paragraph 810-10-15-14(c).
- The proposed ASU would eliminate the guidance in ASC paragraph 810-10-25-13(e) about noncontrolling rights and the impact of these rights on the presumption that the majority owner would consolidate. We are unclear as to why this guidance is no longer relevant.
- ASC Paragraph ASC 810-10-55-3BJ should be clarified to indicate whether the sponsor’s implicit obligation is a necessary element in reaching the conclusion that the sponsor is using its decision making authority in a principal capacity.
- Paragraph BC15 indicates that the Board believes that when a decision maker is an agent, the other interest holders are likely to introduce additional measures that may limit the decision maker’s authority. We recommend that this guidance be included in the authoritative changes to the codification in the final ASU.
- We recommend that the Board consider eliminating the guidance in ASC paragraph 810-10-55-39 that indicates that a lease may be a variable interest. Given the direction of the Board’s joint project with the IASB on accounting for leases, under which all leases other than short-term leases would be considered obligations of the lessee, we believe that guidance may no longer be appropriate or consistent with the general guidance on variable interests under which an obligation of an enterprise to another entity generally is precluded from being considered a variable interest in the entity (e.g., an obligor’s debt obligation to a trust issuing trust-preferred securities is not considered a variable interest in the trust under ASC paragraph 810-10-55-32). There has been ongoing confusion in practice about how to evaluate whether a lessee has a variable interest in the lessor and, if so, how to



evaluate whether the lessee has the power to direct the activities that most significantly impact the lessor's economic performance. If the lessee's only involvement with the lessor is the lease itself, we believe it is appropriate for the lessee not to consolidate the lessor, particularly if the lessee is required to recognize a liability for the lease.