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Mr. Lawrence W. Smith
Director of Technical Application and Implementation Activities
Financial Accounting Standards Board
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Proposed FASB Staff Positions FIN 46-e re: FASB Interpretation No. 46, Consolidation of Variable Interest Entities

Dear Mr. Smith:

Our comments on proposed FASB Staff Position (FSP) FIN 46-e, Effective Date of FASB Interpretation No. 46, Consolidation of Variable Interest Entities, for Certain Interests Held by a Public Entity, are discussed below. In addition, the Appendix to this letter provides suggested changes to enhance the clarity of the FSP.

We support the issuance of this FSP, given the complexity and issues surrounding implementation of FIN 46. Further, we believe the Board should provide a broad deferral of the effective date of FIN 46 for all entities until the first interim or annual period beginning after December 15, 2003. We believe a broad deferral will reduce the current level of uncertainty in financial reporting given the fundamental aspects of the Interpretation for which interpretive guidance is still evolving, including the analysis of whether an entity is a VIE and of what party is the primary beneficiary of a VIE.

In addition, we believe the Board should clarify or modify several aspects of the proposed FSP. First, the fourth condition to qualify for the deferral is unnecessary and likely not operational. The aspects of the Interpretation that are presently under consideration for further clarifying guidance from the FASB are sufficiently pervasive that most entities that meet the other three conditions to qualify for the deferral will not have reached conclusions about whether they are involved with a VIE or whether they are the VIE's primary beneficiary. Accordingly, we recommend that the Board delete the fourth condition required to qualify for the deferral. Second, the Board should clarify its intent with respect to the requirement that the entity's assets be predominantly nonfinancial. Many operating entities outsource substantial portions of their operations or



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lease substantially all of their nonfinancial assets under operating leases so that their only GAAP assets are liquid assets such as cash and trade receivables (i.e., financial assets). We believe that the Board intended for the deferral to apply to such operating entities and recommend that the second condition be clarified to so indicate. Finally, many entities that meet the definition of a business in ETTF Issue No. 98-3, Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business, were created to undertake a narrow and well-defined objective. We do not believe the Board intended to exclude such operating entities from qualifying for the deferral under the third condition and believe that it would be helpful for the Board to clarify that condition accordingly. Alternatively, the Board may wish to define the third condition as entities that were not previously subject to the requirements of EITF Issue No. 90-15, Impact of Nonsubstantive Lessors, Residual Value Guarantees, and Other Provisions in Leasing Transactions, or No. 96-21, Implementation Issues in Accounting for Leasing Transactions involving Special-Purpose Entities, or EITF Topic No. D-14, Transactions involving Special-Purpose Entities.

If you have questions about our comments or wish further to discuss any of the matters addressed herein, please contact John Guinan at (212) 909-5449 or Kimber Bascom at (212) 909-5664.

Very truly yours,

KPMG LLP

KPMG's Comments on Proposed FASB Staff Positions FASB Interpretation No. 46, Consolidation of Variable Interest Entities

Proposed FSP FIN 46-e—Effective Date of FASB Interpretation No. 46, Consolidation of Variable Interest Entities, for Certain Interests Held by a Public Entity

The Board directed the FASB staff to issue this FASB Staff Position (FSP)¹ to (a) defer the effective date for applying the provisions of Interpretation 46 to interests held by a public entity² in certain variable interest entities or potential variable interest entities and (b) require an entity that defers the application of Interpretation 46 in accordance with this FSP to make certain disclosures.

A public entity need not apply the provisions of Interpretation 46 to interests held in a variable interest entity or potential variable interest entity until the end of the first interim or annual period ending after December 15, 2003 (as of December 31, 2003, for an entity with calendar year-end quarters), if all of the following four-conditions are met:

- 1. The public entity acquired its interests in athe variable interest entity or potential variable interest entity before February 1, 2003
- The assets of the variable interest entity or potential variable interest entity are predominantly nonfinancial³
- 3. The variable interest entity or potential variable interest entity was not specifically created by or for the public entity to undertake a narrow and well-defined objective or was not previously subject to the requirements of EITF Issues No. 90-15, Impact of Nonsubstantive Lessors, Residual Value Guarantees, and Other Provisions in Leasing Transactions, No. 96-21, Implementation Issues in Accounting for Leasing Transactions involving Special-Purpose Entities, or EITF Topic No. D-14, Transactions involving Special-Purpose Entities.
- 4.The determination of whether the entity is a variable interest entity or whether the public entity is the variable interest entity's primary beneficiary has not been completed as of the issuance of the financial statements for the interim or annual period beginning after June 15, 2003.

¹ The Board directed the FASB staff to issue this guidance in the form of an FSP rather than an FASB Technical Bulletin. Although the delay of an effective date is identified as one of the uses of a Technical Bulletin, procedures for issuing an FSP provide for ease of distribution, for retrievability, and for the expansion of the exposure period from the 15 days provided for by Technical Bulletins to 30 days.

² The term public entity is defined in paragraph 395 of FASB Statement No. 123, Accounting for Stock-Based Compensation.

³ Nonfinancial assets are assets other than financial assets as defined in paragraph 364 of FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. Financial assets are cash, evidence of an ownership interest in an entity, or a contract that conveys to a second entity a contractual right (a) to receive cash or another financial instrument from a first entity or (b) to exchange other financial instruments on potentially favorable terms with the first entity.

⁴ The application of this condition of the deferral requires judgment. The intention of this condition is to exclude from the scope of this deferral entities that generally were considered to be special purpose entities before Interpretation 46 was issued.

Examples of variable interest entities or potential variable interest entities to which this deferral may be applicable if all of the conditions in this FSP for deferral are met are (a) suppliers to the public entity, (b) franchisees or dealers of the public entity's products, and (c) borrowers from the public entity that have been subject to a troubled debt restructuring event. The deferral is not intended to apply to a variable interest entity or potential variable interest entity that would commonly have been considered a special-purpose entity, such as (a) a lessor for a single party lease(s), (b) an entity specifically created to acquire nonfinancial assets from the public entity (other than franchisees or dealers), (c) an entity designed to hold financial assets, and (d) an entity designed to convert nonfinancial assets to financial assets.

Disclosures

A public entity that defers the application of Interpretation 46 to variable interests in one or more variable interest entities or potential variable interest entities under the provisions of this FSP shall disclose the following information about such entities:

- a. The number of entities to which the application of Interpretation 46 is being delayed and the reason for the delay
- b. The nature, purpose, size (if available), and activities of the entity(ies) and the nature of the public entity's involvement with the entity(ies)
- The public entity's maximum exposure to loss because of its involvement with the entity(ies)
- d. The amount of income, expense, purchases, or sales, or some other measure of activity between the public entity and the entity(ies) for all periods presented. However, if that information is not readily available for prior periods that are presented in the financial statements for which this requirement applies, the information for those prior periods is not required.

These disclosures are required in the public entity's financial statements issued between the original effective date of Interpretation 46 and the date the public entity issues financial statements applying Interpretation 46 to those interests subject to deferral under this FSP.

Effective Date

The guidance in this FSP is effective for financial statements issued after the final FSP is posted to the FASB website.