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Director, TA&I-FSP Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

## Proposed FASB Staff Positions on Certain Issues Related to FASB Interpretation No. 46

We appreciate the opportunity to comment on the six proposed FASB Staff Positions (FSPs) addressing several issues on FASB Interpretation No. 46, Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51 (the Interpretation). Overall, we believe the proposed FSPs provide limited but helpful guidance for preparers and auditors by clarifying several general misconceptions of the Interpretation's provisions. But we also believe more helpful guidance could be provided in some of the proposed FSPs, and we believe the conclusion in one proposed FSP is inconsistent with the Interpretation itself. Our comments are organized by each specific proposed FSP.

### Applicability of the Interpretation to Not-for-Profit Organizations

We are concerned with the precedent that would be set if the proposed FSP is finalized because we believe it amends the Interpretation by expanding the Interpretation's scope. This proposed FSP's provisions would be more helpful if the Board specifically stated that it would not object to any not-for-profit entity analogizing to the Interpretation's provisions in addressing consolidation issues. Given the lack of authoritative guidance in this area, we believe the Interpretation's consolidation model represents appropriate literature to be considered by not-for-profit entities in certain circumstances.

#### Fees Paid to Decision Makers

We agree that the Interpretation requires all gross fees paid to a decision maker to be included in the calculation of the entity's expected residual returns. We believe the final FSP should explicitly state that the variability in fees paid to a decision maker should not be included in the calculation of the entity's expected losses and expected residual returns. For example, assume the present value of the gross fees (computed by (1) determining the fee to be paid to the decision maker in each potential cash flow scenario, (2) multiplying the fee to the decision maker in each scenario by the scenario's respective probability of occurrence, and (3) summing the probability-weighted fees computed for each scenario) is calculated to be \$100. Those gross fees will have variability because there will be scenarios that will produce fees paid to the decision maker that are greater than or less than \$100. This variability gives rise to expected losses and expected residual returns on the gross fees.

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We have numerous operational concerns about the method of including the variability in the fees in the expected loss and expected residual returns calculation. For example, by including the variability in the fee along with the gross fee in the expected residual returns calculation, the decision maker's expected residual returns could be greater than the fee itself, which we believe is inappropriate. Using the previous example, assume the present value of the gross fees paid to the decision maker is \$100, and the expected losses and expected residual returns on that fee is \$8. By including the variability in the fee in the decision maker's expected residual returns calculation, the decision maker's total expected residual returns are \$108, which is greater than the fee itself.

We do not believe this result is logical. Given the Board's reaffirmation of its previously stated conclusion in this area, we believe the proposed FSP should specifically state that the gross fees paid to a decision maker should be included in calculating that decision maker's expected residual returns. In addition, we believe the proposed FSP should also state that the variability in those fees is not to be considered in the expected losses or expected residual returns calculation. Such a statement would assure that the fees are not double counted in the analysis. Attachment A includes language that the Board may want to consider in drafting the final FSP.

#### Silos

We do not agree with the conclusion in the proposed FSP that a silo is not created if the interests in the specified assets and related claims cannot be reported separately without accounting allocations. Paragraph 13 of Interpretation states that a silo is created "if the specified assets ... are essentially the only source of payment for specified liabilities or specified other interests" (emphasis added). This language is consistent with the proposed FSP, which states that a silo is created when it is "effectively separate from the remainder of the entity." We believe this language is clear that "essentially all" does not mean "solely," as the provision prohibiting accounting allocations suggests.

We understand the Interpretation to indicate that a silo exists whenever essentially all of the expected losses and expected residual returns are allocable to a liability holder or other interests that look solely to these assets, and essentially none of the expected losses or expected residual returns of their assets are borne by, or inure to, other variable interest holders in the entity. Practice is evolving to believe that a silo would be created, for example, when a lessor has financed an asset to be leased with nonrecourse debt that is at least 95 percent of the asset's cost and the lessee has a fixed price option to purchase the asset. The Board should be aware that if the proposed FSP is finalized in its current form, there will rarely be silos.

We would be pleased to discuss any of these specific concerns with you, the Board members or other staff, at your convenience.

Very truly yours.

Ernst + Young LLP

# Fees to Decision Makers and Certain Guarantors

### (Excerpted from our Client Summary)

Determining whether a VIE has a decision maker is essential in identifying the VIE's primary beneficiary because all fees paid to the decision maker (including market-based fees) are required to be included in the expected residual return calculation. While expected losses and expected residual returns generally are based on the concept of expected variability, we believe the fees to be included in the expected residual return calculation are gross fees. Neither the variability in those fees nor the expenses incurred to provide the service should be included in the calculation. That is, when estimating cash flows, the fees paid to the decision maker for each possible outcome should be determined. (These fees reduce the cash flows that are to be allocated to the variable interest holders in computing their expected losses and expected residual returns.) These fees are then multiplied by the probability of occurrence and discounted to present value at the rate on default risk-free investments. This amount represents the present value of the fees, and is to be included in the expected residual return calculations. Because these fees are gross, and the rest of the calculation is based on variability in potential returns, in structures where no one party has a majority of the entity's expected losses, the decision maker may be required to consolidate the VIE because it has a majority of the expected residual returns.