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MP&T Director—File Reference 1082-200
Financial Accounting Standards Board
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[VIA E-MAIL WITH COPY
BY FEDERAL EXPRESS]

Re: File Reference No. 1082-200
Exposure Draft of the Proposed Interpretation—Consolidation of Certain Special Purpose Entities, an Interpretation of ARB No.51 (the "Interpretation")

Ladies and Gentlemen:

Atlantic Financial Group, Ltd ("AFG") thanks you for the opportunity to provide our comments on the Interpretation.

AFG is a privately held limited partnership headquartered in Dallas, TX. AFG is directly (and occasionally through wholly-owned SPEs) the lessor for several billion dollars of "synthetic" and "credit-tenant" leases, in addition to providing real estate tax and financial consulting services. Our company was formed six years ago to engage in a variety of real estate-related activities, and we believe we would be considered a substantive operating enterprise ("SOE") based upon the Interpretation.

Considering the limited and fragmented accounting guidance available for transactions involving special-purpose entities ("SPEs"), it is helpful for the FASB to turn its attention to this area. Undoubtedly the Interpretation will improve reporting for activities other than leasing or securitizations, and will be directly responsive to the general sense of public concern over the recent accounting scandals involving both the lack of transparency with respect to reporting of transactions, and alleged self-dealing by major public companies with some of their top officers. The Interpretation should benefit reporting by eliminating most, if not all, inappropriate "orphan" SPEs.

However, with respect to leasing, we are concerned that the "cure" prescribed by the Interpretation for any perceived reporting deficiencies will create more problems than the "disease" it is intended to treat. The first section of this letter speaks to our contention that the Interpretation will be more effective if it excludes leases from the scope altogether. The second section draws from our experiences as a participant in the real estate leasing industry to suggest specific elements for the FASB to re-consider and/or clarify in the event the FASB elects not to exclude leasing from the scope.

Section One: Why the Interpretation would be more effective by excluding leases from its scope

A. The quality and consistency of lease reporting under the current rules is already being satisfactorily addressed through other FASB initiatives.

The FASB and EITF have made numerous modifications and additions to SFAS 13 since its effective date in 1977. While some may consider the collective standards to be less than ideal, they already address SPEs and they have the very significant merit of being well defined and understood by companies, analysts, investors, auditors and the SEC; that is, by the preparers and the informed readers of financial statements.

As a consequence, leasing transactions are currently originated and reported with efficiency, and there is a very high degree of uniformity in financial reporting, even with respect to the most complex structures including those involving SPEs. The current leasing guidelines already allow reporting that is useful in making business and economic decisions, and reporting which is representationally faithful and relevant.

To the extent "repairs" are considered necessary to the current lease reporting model, it seems they are being more satisfactorily addressed by means other than the Interpretation. More specifically, without arguing our views as to the merits or demerits of specific types of lease, it seems most of the recent public comments with respect to lease accounting have been aimed at accounting for synthetic leases, and these concerns are being effectively dealt with in other areas.

For example, in recent years some lessees in synthetic leases have been legitimately criticized for a lack of transparency in disclosures regarding residual guarantees, termination provisions, etc. However, the proposed new interpretation with respect to a guarantor's accounting and disclosure requirements for guarantees (the "Guarantee Interpretation") redresses these shortcomings, and they have already largely been eliminated in practice anyway as a result of significant public pressure for enhanced corporate disclosures. Despite well-reasoned objections to the initial recognition provisions from many (with whom we agree), the new guarantee rules will even apparently go so far as to record a portion of a lessee's guarantee obligations on the face of the balance sheet at lease inception.

As another example, minimum requirements for equity in lease-related SPEs have also already been addressed, and if there is consensus that the bar should be raised to a higher level, it could efficiently be accomplished by amending the current EITF standard to say, 5-10%, without causing an entire industry to re-evaluate, and continue to evaluate period after period, the many thousands of transactions with SPEs which are not causing any inadequate or ambiguous reporting.

While the FASB will eventually readdress lease accounting as its own project, there is no significant public or industry outcry to reconsider the reported ownership of the many legitimate SPEs that are used every day in routine industry transactions, regardless of whether such ownership is held by individuals or SOEs.

B. The "problem" SPEs are not in the leasing industry.

We agree the FASB should not allow existing leasing SPE standards to be the default reporting guidelines by analogy for transactions whose characteristics may be very different from leases, and the Interpretation will rightly provide an effective curb against the usage of SPEs for inappropriate deals similar to those that have made headlines this year.

However, there have been very few publicized problems dealing with SPEs in the leasing industry, and the infrequent exceptions have related to alleged non-compliance with existing guidelines versus any problems stemming from a lack of guidelines.

C. The Interpretation applied to leases has the potential to create the unintended consequences of significant inconsistencies, room for manipulation and greater confusion in financial reporting, not to mention great expense in application.

We have heard a number of comments from industry participants that the Interpretation will have unintended consequences in leasing transactions, and examples will undoubtedly be furnished in other comment letters.

As a single example of the potential for inconsistencies and confusion in reporting with respect to real estate leases, consider a hypothetical group of 20 year, credit tenant, bond-net real estate leases of retail stores originated in 2001. Assume that the leases are off-balance sheet for the single-tenant lessee, and the lessor for each property is a SPE that borrowed 97% of the funds needed to acquire the properties. The SPEs are disregarded for tax purposes, since they are trusts owned 100% by a SOE unrelated to the lender or the lessee. The SOE is unrestricted, within reason, in its ability to sell its interest in each SPE subject to the existing debt.

Since the owner of the SPEs is a SOE, the Interpretation will initially apply and the lender will record its interest in the transaction as a loan. Now assume that the SOE sells its ownership interest in one of the SPEs ("Sale 1") to an individual investor/developer in 2002. Assume the buyer is motivated by the desire to temporarily accomplish a like-kind exchange (Section 1031) for tax purposes until he develops a new property, at which time he intends to market the original replacement property and close a second exchange ("Sale 2").

The transaction will fall under the Interpretation's scope at the time of Sale 1 (a time not within the lender's or lessee's control). Based upon the example in Appendix 2 of the Interpretation, it is likely that due to the remaining high leverage, and the extended time before the new non-SOE owner would benefit from the property's residual value, the lender would be the Primary Beneficiary. Upon closing of Sale 1, the lender would be required to eliminate its loan in consolidation, converting its former note receivable to a consolidated direct financing lease or operating lease. Depending upon the lessor's classification, the lender might be required to depreciate the consolidated asset.

Thereafter, at each reporting period the lender would be required to make the subjective judgment as to whether it had reached the crossover point where the investor's (or lessee's) variable interests exceeded its own, at which time it could de-consolidate. If Sale 2 occurred prior to the crossover (again not within the lender's or lessee's control), the lender could deconsolidate if the buyer for Sale 2 was a SOE, but not otherwise.

Assume each property follows a similar pattern; with 10+ individual sales occurring at irregular intervals over the life of the loan and lease, none controlled by the lender or lessee. Lastly, assume each lender will have many similar groups of transactions, since we believe the fact pattern described in the example is common in the credit tenant lease ("CTL") business.

The potential for inconsistency is great. Lenders will initially record virtually identical transactions differently, depending upon whether the borrower is a SOE or an individual, and a SOE to one lender and its auditors may not be a SOE in the view of another lender and its auditors (see Section 2 of this letter). Lenders and auditors for similar transactions will determine different crossover points regarding the lenders' status as Primary Beneficiaries, and the assets of their enterprises will be subject to periodic reclassification for circumstances beyond their control. Some lenders and their auditors will argue that SPEs have sufficient equity to finance their activities, others will say that the 10% presumption for required equity has not been overcome.

Without modification to the Interpretation, a reader of a lender's financial statements might see reclassifications quarter by quarter, while the lender's fundamental economics have not changed at all. The reporting as a result of the Interpretation will be more confusing and inconsistent (and expensive) than the current reporting model, and it will be less useful for making business and economic decisions and for comparing comparable companies.

Eliminating the scope exception for SOEs is not a good solution. This would eliminate one potential for inconsistency in reporting between similar transactions, but it would also create more significant confusion since many assets would likely be consolidated and reported as owned by two different enterprises under two separate accounting theories. Since borrowers, lenders and lessees are unrelated in typical leasing transactions, there will be no way to ensure only one party consolidates each entity. Eliminating the SOE exception would draw thousands more routine lease transactions under the scope, since it is not unusual for secured non-recourse debt borrowed by SOEs such as REITS, leasing companies, etc. to be isolated in wholly-owned SPEs. Lastly, eliminating the SOE scope exception would potentially open the door for pro-rata consolidation, a concept that the FASB has on other occasions carefully considered and rejected. That is, we believe some companies and their auditors might view lease transactions funded with non-recourse debt loaned directly to a SOE to be sufficiently isolated to be considered "virtual" SPEs "embedded" within the SOE and thereby subject to the Interpretation (notwithstanding paragraph B18—see Concluding Remarks below).

Eliminating the 10% presumption for SPEs with respect to the sufficiency of equity would be a better solution for eliminating the types of inconsistencies discussed in the example, but this would come at the potential cost of eliminating some of the significant benefits to be derived from applying the Interpretation to problematic non-leasing transactions.

Eliminating the lender from consideration as the Primary Beneficiary (unless the lender had upside potential) might eliminate most problematic elements when considering lease transactions, but again it would come at the potential cost of eliminating some of the significant benefits to be derived from applying the Interpretation to problematic non-leasing transactions.

The best solution is to eliminate leases from the scope of the Interpretation for the reasons described in section 1A above.

Section Two: Specific Elements for the FASB to consider if it continues down the current path

A. More clarification is needed as to what constitutes a SOE.

The Interpretation states "a substantive operating enterprise refers to an enterprise that is not an SPE." We read the Interpretation as implying that an entity is either a SOE or a SPE, that is, that the categories are not only mutually exclusive, but that there is also no third undefined and un-addressed category. It would be helpful for the FASB to explicitly state whether this is the case. If so, then there will be greater likelihood for consistency in applying the Interpretation, because there is already a general understanding of what constitutes a "SPE" from previous accounting literature as well as common usage of the term in corporate transactions. Coupled with the general SOE description, there would reasonable opportunity for consistency in judging the preponderance of evidence to determine which camp a given entity would fall into. If there is the possibility of a third category, then the definition of a SOE would benefit from much greater elaboration.

For example, one of the elements requiring greater clarification in the abbreviated definition of a SOE is the statement that a SOE "has sufficient equity to finance its operations without support from any other enterprise or entity except its owners." In footnote 4 to paragraph 9B, the FASB makes it clear that a bankrupt SOE is still not to be considered a SPE, however, could a company with negative net worth be considered a SOE? We believe it could, citing Amazon.Com, Inc. as an example. While the company has significant negative GAAP equity, its market capitalization is $5.5 billion, and it appears to have sufficient equity to finance its operations. Could an established track record of financing operations without support from any other enterprise or entity except its owners be a sufficient indicator of an entity's ability to do so in the future? Questions like these should be addressed.

Principles-based guidance is better than a set of rules, but the FASB should not default its responsibility to clarify the definition of a SOE. If it fails to provide clarification, as a practical matter the technical partners of the small group of remaining national accounting firms will in all likelihood develop informal rules, guidelines and flowcharts for determining SOEs anyway. It would be better for the FASB to provide a reasonable level of detailed guidance than to delegate its responsibility to a smaller group of individuals who will be relatively disadvantaged in their decision making by the inability to conduct the same open, formal process used by the board, who may unintentionally make judgments contrary to the board's intent, and who have a relatively more difficult task in preserving both the appearance and fact of their independence from those affected by their decisions.

B. The 10% equity threshold presumption in the voting interests model as discussed in paragraph 12 of the Interpretation should be deleted.

Consistent with the comments in Section 1 of this letter, we believe many CTLs are financed using SPEs owned by individuals with less than 10% equity, and that the reporting related to these transactions is appropriate. However, the ability to access reliable and persuasive data regarding transactions with similar risks financed by SOEs may be difficult or impossible to obtain since SOEs may be private, or the information may not be segregated from the other activities of public SOEs. As a consequence some auditors reviewing some CTLs may not allow them to overcome the presumption, even though application of the Primary Beneficiary concept will lead to the undesirable results outlined earlier in this letter.

C. In the voting interest model, guarantees should not be treated differently from other similar contractual obligations.

We continue to be puzzled that residual guarantees are considered differently in the Interpretation from other contractual lease obligations that accomplish the same result. More specifically, whether a lessee pays low rents and guarantees a higher residual value, or whether it pays higher rents so that the lessor's residual value may be amortized to a lower level, the cash outflows and risks of the lessee are the same (actually they may be potentially lower in the first example) and the effect in reducing risk to the lessor is the same. However, in Appendix A2 the variable interests would be viewed quite differently if a lessee provides a contingent guarantee of residual values versus an obligation with identical present value to the lessee that reduces the lessor's risk by an identical amount via higher payments of rents instead.

We believe SFAS 13 deals appropriately with this concept by treating guaranties the same as other contractual promises to pay in evaluating classification based upon minimum lease payments. SFAS 13 will cause the lessee to capitalize a lease if such contractual inflows of either type exceed 90% of fair market value at inception. If guarantees of residual values are to be considered variable interests, then commitments to pay rents equating to a similar present value should also be considered; in any event it makes no logical sense to treat the two obligations so differently.

Concluding Remarks

The comments in the preceding sections reflect our thoughts regarding the potential broad effects of the Interpretation on reporting in the industry in which we practice.

From a narrower perspective, please know that we operate a business independent from our lessors and lenders, and report the ownership of all of our assets on the face of our audited balance sheet. We rarely use SPEs because we prefer if possible to avoid even the appearance of control by our lessees or lenders. From following the FASB's actions over a long period of time, including listening to deliberations and reading minutes of board meetings, we are confident that it is not now, and has not been, the FASB's intent to cause parties to consider proportional consolidation of assets of assets directly owned and reported by unrelated parties, even if they have a contractual relationship through a lease and the reporting party has made use of non-recourse debt.

In our view, Paragraph B18 of the Interpretation makes this point with crystal clarity, however, based upon conversations with a technical partner in one of the national accounting firms, we believe this understanding is not yet universally shared. That is, it appears some may choose to consider a SOE with extensive leasing activities relative to its other activities effectively a SPE, even if the SOE's other activities are by themselves significant. Following this view, each individual lease within such an entity might be considered a sub-SPE subject to dis-aggregation and/or proportional consolidation. In order to avoid misinterpretation by us, this national firm, or any other readers of the Interpretation, we strongly encourage further clarification related to these background comments, and consideration of moving language similar to paragraph B18 directly into the body of the text.

Thank you for the opportunity to express our views.

Very truly yours,

ATLANTIC FINANCIAL GROUP, LTD.

By: Atlantic Financial Managers, Inc its sole general partner

By: _____
Stephen Brookshire
President