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# EDISON ELECTRIC INSTITUTE

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Technical Director Financial Accounting Standards Board 401 Merritt 7 Post Office Box 5116 Norwalk, Connecticut 06856-5116

Submitted to: director@fasb.org

Re: Exposure Draft - Proposed Statement of Financial Accounting Standards

- Amendments to FASB Interpretation No. 46(R)

File Reference No. 1620-100

The Edison Electric Institute (EEI) is submitting these comments in response to the above-referenced Exposure Draft (ED). EEI is the association of U.S. shareholder-owned electric companies throughout the United States. EEI represents approximately 70 percent of the U.S. electric power industry, including companies that generate and transmit electricity and operate in electricity markets throughout the country.

We support the most significant provisions of the ED. We concur with the ED's requirement for the qualitative factor of control as a prerequisite to consolidation and with its explicit emphasis on using a qualitative rather than quantitative analysis of the primary beneficiary. We strongly believe that early adoption of the ED should be permitted with respect to variable interest entities (VIEs) that are not qualifying special-purpose entities (QSPEs), as it is critical that the FASB provide relief to non-financial institutions that are required under the FIN 46 quantitative model to consolidate entities over which they have no control by any standard. We also recommend that the definition of a significant variable interest be changed and that the provisions pertaining to ongoing assessments be clarified. These views and our responses to the FASB's specific questions are set forth below.

## Early Adoption for Non-QSPEs

We believe early adoption of the ED should be permitted for companies that have consolidated VIEs or could be required to consolidate VIEs without regard to control primarily as a result of a quantitative analysis of the absorption of expected losses and residual returns. We urge the FASB to permit companies to early adopt the new guidance so that a reporting enterprise's financial statements will reflect only those entities over which it has operational control. We recognize that consistency of application may be an overriding consideration for some enterprises – primarily financial institutions – that are in transition from the QSPE scope exception in FIN 46 or may need to renegotiate certain agreements. However, for enterprises that do not have QSPEs, but that are subject to the VIE consolidation requirements based on rules that are about to be changed, there is an overriding need to achieve the most meaningful presentation as soon as possible and thus to eliminate the requirement to consolidate entities over which they have no power or control. A delay such as that proposed in the ED would be counterproductive for these enterprises and their financial statement users.

As discussed in question 6 below, we also recommend that the transition provisions of the ED clarify that if deconsolidation is required as a result of implementation, a VIE should be derecognized from an enterprise's financial statements without regard to other derecognition principles such as those for the sale of real estate or extinguishment of debt.

### Definition of a Significant Variable Interest for Disclosure

We believe a variable interest should be considered significant for disclosure only if the interest is significant to the reporting enterprise. When assessing materiality, if the reporting enterprise determines that a variable interest could have a material effect on its own financial statements, then the reporting enterprise should be required to provide the disclosures. It is not practicable for a reporting enterprise to obtain the kind of detailed financial information necessary to fulfill the proposed disclosure requirements from entities that it does not control. The cost of obtaining such information would exceed its benefit when the variable interest is not significant to the reporting enterprise, especially if ongoing reconsideration is required as proposed.

### Responses to FASB Questions:

1. Question: 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?

Answer: We believe the proposed Statement, coupled with our suggested modifications outlined in this letter, would meet these objectives. Without the concept of control, consolidation analysis under FIN 46(R) can produce results that reduce the relevance and reliability of financial statements. While a significant financial interest may in many cases be accompanied by control, the variety of ownership and contractual structures is such that this is not always the case. In particular, in our industry we may be required by legal or regulatory mandates to enter into contractual arrangements that are financially significant but that do not and cannot give us operational control over the entities that are counterparties to our contracts. We believe that consolidating such entities does not reflect the substance of the arrangements with them, and we believe that the proposed Statement effectively addresses this issue by citing control as a prerequisite to consolidation.

2. Question: 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?

Answer: If the Board issues the proposed Statement in its current form, prohibiting early adoption, some companies will incur the costs of consolidating entities in 2008 and 2009, including information gathering and associated accounting and disclosures and audit costs, followed by the costs of deconsolidating those same entities in 2010. The Board could further reduce the costs of compliance with the requirements without significantly reducing the benefits to users of financial statements by allowing early adoption except in the case of existing QSPEs. We believe that there should be a dual effective date that would permit FIN 46(R), as amended by the ED, to be applied in fiscal years beginning after November 15, 2008, for all interests in entities, but that would delay evaluation for consolidation of QSPEs existing as of a specified date after the ED issuance date until fiscal years beginning after November 15, 2009.

The costs of compliance with the Statement would be further reduced if the Board provides the clarification we suggest in our response to Question 6 below pertaining to ongoing assessments. Under our proposed revision, companies would not be required to perform comprehensive VIE and primary

beneficiary assessments automatically each reporting period, but rather only whenever events or circumstances indicate that a change in the VIE or primary beneficiary status may have occurred.

3. Question: 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?

Answer: We fully support the use of a principles-based, qualitative approach to determine the primary beneficiary of a VIE. On the whole, the principles in paragraphs 14-14B are clear and operational. However, we believe the principles could be further clarified by incorporating the consideration of probability in the assessments of whether a reporting enterprise has an implicit financial responsibility to ensure the VIE operates as designed. In evaluating whether an enterprise has an implicit financial responsibility (e.g., to protect reputation risk), we believe that the reporting enterprise should consider the likelihood of its acting on the event (e.g., based on historical experience or management commitment) and, where reasonably predictable, the likelihood of the event occurring. We believe that if the likelihood of the event occurring and the reporting enterprise acting on the event are both low, then the reporting enterprise should not be considered to have an implicit financial responsibility.

We believe the Board should also extend the principles-based, qualitative approach proposed in the Statement to the business scope exception provisions contained in paragraph 4.h. Specifically, we suggest removing the quantitative criterion contained in paragraph 4.h(3) which precludes the application of the business scope exception if "The reporting enterprise and its related parties provide more than half of the total of the equity, subordinated debt, and other forms of subordinated financial support to the entity based on an analysis of the fair values of the interests in the entity." Removing this quantitative provision would be consistent with the overall principles-based approach in the proposed Statement.

4. Question: 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.

Answer: We believe that the examples provided are helpful in illustrating many of the provisions of paragraphs 14 – 14B. However, we believe that the principles in the Statement would be clarified if the following aspects of the Statement were also included as additional examples:

- An illustration of the determination of the primary beneficiary, if any, when multiple interest holders each have the power to direct matters that impact different activities;
- One or more examples illustrating fact patterns that result in the conclusion that a qualitative assessment is inconclusive, and thus that a quantitative analysis is necessary to determine the primary beneficiary;
- An example of the provision in paragraph 5 illustrating "changes in facts and circumstances" that would merit reconsideration of an entity's status as a VIE.

Finally, we believe that an additional example would be helpful to illustrate a circumstance in the utility industry where a power purchase agreement, which subjects the enterprise to the risks and rewards of a VIE, does not provide the enterprise with control over the VIE and therefore consolidation is not required. We note that the comment letter of Northeast Utilities dated October 29, 2008 has just such an example and we fully support the incorporation of this example into the final Statement.

5. Question: 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 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?

Answer: We believe that the quantitative method should be available in the event that the qualitative method fails to conclusively identify the primary

beneficiary of a VIE. In some situations, it may not be possible to determine qualitatively whether the right to receive benefits or the obligation to absorb losses could potentially be significant to the VIE. In those situations, the ability to utilize quantitative analysis would be needed.

6. Question: 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 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?

Answer: We believe the proposed Statement's language pertaining to the requirement to perform "ongoing assessments" is potentially contradictory and could result in conflicting applications by preparers and auditors. We request that the Board clarify the requirement for ongoing assessments to indicate that they are not intended to be performed automatically and comprehensively each reporting period, but rather only whenever events or circumstances indicate that a change in the VIE or primary beneficiary status may have occurred. We support the performance of continual monitoring of variable interests and potential variable interests to determine if any events or circumstances have changed which would trigger a full assessment, and we believe that such continual monitoring is, in fact, a current requirement of FIN 46(R). However, that monitoring should not result in a requirement for routine documentation of the absence of such an event.

The potentially ambiguous language contained in paragraph 2.a. of the proposed Statement notes that "This Statement requires 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." Taken in isolation, this language could be interpreted as requiring an automatic, comprehensive evaluation and corresponding documentation for each VIE or potential VIE on a continual basis, regardless of whether any events or circumstances have changed to cause such an evaluation to be performed. We do not believe that an "ongoing assessment" needs to be performed automatically, even in the absence of any changes in events or circumstances. Rather, we believe that the principle underlying this requirement can be achieved if companies apply an "events-and-circumstances" approach as indicated by the following wording of the proposed amendments to paragraph 5 of FIN 46(R):

An entity shall be subject to consolidation during a reporting period (not limited to the end of a reporting period) according to the provisions of this Interpretation if, by design, or as a result of changes in facts and circumstances, the conditions in a, b, or c, exist.... [Emphasis added]

Further, the Board stated in paragraph B8 that "these ongoing assessments should not be limited to the end of each reporting period but, rather, should occur when circumstances warrant a change in an entity's status as a variable interest entity or an enterprise's status as a primary beneficiary."

We suggest that the final Statement indicate that, while assessments are not required to be performed automatically for all VIEs or potential VIEs each reporting period, companies are required to continually monitor VIEs or potential VIEs for changes in events or circumstances and to document their assessments whenever changes in facts and circumstances indicate that a change in the status of a VIE or primary beneficiary may have occurred. We believe the application of the events and circumstances approach is consistent with well-established practices contained in other standards where significant judgment is involved, such as determining when to test a long-lived asset for recoverability based upon the occurrence of a triggering event rather than automatically every reporting period.

We disagree with the requirement to reassess the application of FIN 46(R) based upon the occurrence of actual operating losses. The classification of an entity as a voting or variable interest entity is made at inception based upon the design of the entity and the contractual relationships between the variable interest holders. We believe that reassessments of that classification should be based upon the same considerations. For example, companies should continuously monitor existing VIEs and potential VIEs for changes in events or circumstances (e.g., changes in contractual documents) that relate to:

- The entity's purpose and design,
- The power to direct matters that most significantly impact the activities of a VIE, and
- The right to receive benefits from the VIE (or absorb losses) that could potentially be significant to the VIE.

In contrast to these factors, we believe that an approach that requires monitoring of ongoing operating performance is inconsistent with the "by design" principle of FIN 46(R). Additionally, we do not believe that this

approach is workable in practice. The ability to obtain the necessary information is questionable when the variable interest initially was determined not to be significant, and the level of judgment required to determine when operating losses have changed the status of the entity or the relationships between the parties is so subjective as to be unworkable and will likely result in significant diversity in application.

We believe that the ED should also clarify that, if it is determined through an assessment that consolidation of a previously consolidated VIE is no longer required, then deconsolidation is required without regard to other derecognition principles such as those for the sale of real estate or extinguishment of debt. We recommend that this deconsolidation guidance also be incorporated into the ED's transition provisions.

7. Question: 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.

Answer: We believe the proposed Statement should be applied by all entities.

8. Question: 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?

Answer: We believe that a number of the disclosure requirements appear reasonable except that, as discussed above, the definition of a significant variable interest for disclosure should be changed. A variable interest should be considered significant for disclosure if the interest is significant to the reporting enterprise. If an enterprise does not have control of a VIE, it is unlikely to be able to obtain the VIE's financial information necessary to determine its maximum exposure to loss or other disclosures. We believe that existing disclosure requirements for commitments, contingencies and guarantees are adequate to address exposure to loss under contractual arrangements that are not significant to the reporting entity. In circumstances where a variable interest is significant to the reporting entity, the additional disclosures may be useful.

9. Question: 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?

Answer: We believe that there may be circumstances in which the elements of a consolidated VIE should be permitted to be classified separately from other elements in an enterprise's financial statements. For example, in order to clearly represent the enterprise's financial position, the restricted nature of a VIE's assets or the nonrecourse nature of its debt or other liabilities may be best portrayed through separate balance sheet line item presentation rather than in combination with the enterprise's other assets or debt. The need for separate classification is particularly evident under the current guidance of FIN 46(R) in the circumstance where a reporting enterprise may not control a consolidated VIE and the VIE's debt is nonrecourse to the reporting enterprise would control a consolidated VIE, separate classification may not always be justified. Because of the complexities involved in establishing disclosure rules, we believe it would be more appropriate to address this topic as part of the longer-term FASB project on consolidation.

### Conclusion

In summary, EEI supports the ED and urges the FASB to permit early adoption for non-QSPEs. We also recommend changing the definition of a significant variable interest and clarifying the provisions pertaining to ongoing assessments. We hope you will also find our other comments useful in finalizing the ED's provisions.

Even if there are delays in finalizing some of the provisions of the proposed Statement, EEI urges the FASB to move forward soon with guidance that precludes consolidation in circumstances where there is no control as defined in any of the relevant standards (including ARB 51, FAS 140 and FIN 46(R)). As utility companies subject to legal and regulatory mandates to enter into significant contractual arrangements that do not and cannot give us operational control over our contract counterparties, we believe consolidation does not reflect the substance of our arrangements and should be discontinued at the earliest possible date. We urge the FASB to issue guidance, effective at the earliest possible date, that results in no consolidation and permits deconsolidation in circumstances where the reporting enterprise does not possess control.

EEI appreciates the opportunity to provide comments on this important ED. If you need additional information or have any questions about these comments, please contact me or EEI Director of Accounting David Stringfellow at 202-508-5494 or dstringfellow@eei.org.

Respectfully submitted,

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