

November 17, 2008



Mr. Russell G. Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

RE: Exposure Draft - Amendments to FASB Interpretation No. 46(R)

Dear Mr. Golden:

The Accounting Standards Executive Committee of the American Institute of Certified Public Accountants (AcSEC) has reviewed the Exposure Draft on Amendments to FASB Interpretation No. 46(R) (the proposed Standard or the Exposure Draft) and is pleased to provide you with our comments.

We believe the proposed Standard makes improvements in the operationality of a complicated standard that has posed numerous implementation issues since its inception.

However, we understand that the International Accounting Standards Boards (IASB) is currently working on a project on consolidation that is on a "fast track," and plans to publish an Exposure Draft in the fourth quarter of 2008. The goals of the IASB project are very similar to the FASB's ultimate goals – to revise the definition of control when it is not evidenced by a majority ownership of voting common stock; to allow the same control criteria to be applied to all entities; and to require enhanced disclosures about consolidated and nonconsolidated entities. As the FASB will also issue a joint Standard with the IASB in the future, we believe it would be too burdensome to ask companies to implement two sets of accounting changes dealing with the same topic within a very short time frame. AcSEC believes that it would be better to require companies to make a single change to a converged accounting standard, rather than implementing this proposal and then undertaking a second implementation effort when a converged consolidation standard is issued shortly thereafter.

Substantial costs will be incurred to implement these standards. Preparers will incur costs to learn the new standard, train employees, collect significant amounts of data not collected today, change reporting and consolidation systems and make changes to systems and control structures to reflect the new requirements. Auditors will need to update practice aids, policies, tools and train employees on the new standard. Users will experience a similar learning curve. Therefore, we think it is unreasonable to ask entities to apply two sets of accounting changes within what we expect to be a



short time frame.

AcSEC also recommends that the FASB issue the standard on amendments to FASB Interpretation No. 46(R), Consolidation of Variable Interest Entities (FIN 46(R)), concurrently with the standard on amendments to FASB Statement No. 140, Transfers of Financial Assets and Extinguishments of Liabilities (FAS 140). We believe that the two standards complement each other, since they both address what should be recognized on the balance sheet. Therefore, we would be opposed if FASB delayed one of the proposed standards and issued the other.

Although AcSEC encourages the FASB to delay the issuance of this proposed Standard until a joint solution with the IASB can be achieved, we support the issuance of FSP FAS 140-e and FIN 46(R)-e, Disclosures about Transfers of Financial Assets and Interests in Variable Interest Entities. The FSP would provide greater transparency to financial statement users about a transferor's continuing involvement with transferred financial assets and an enterprise's involvement with variable interest entities before a final joint standard on consolidation can be finalized.

AcSEC recognizes that FASB may decide to continue with the project despite our views. Therefore, we recommend the following revisions to improve the standard.

#### **Continuous Reassessment**

AcSEC does not support the change to require continuous reassessment of the status of an entity as a variable interest entity (VIE). The requirement to continuously reassess whether an entity is a VIE would potentially sweep many more entities into the scope of FIN 46(R) than would otherwise be required under the "by design" provisions of paragraph 5. For example, many investors in separate entities that previously did not have to reassess whether they were the primary beneficiary, because the entities were not VIEs in the absence of the reconsideration events specified in the current FIN 46(R), will now have to reassess their conclusions continuously even when the design of the entity has not changed. We believe that this is inconsistent with the "by design" concept in FIN 46(R). Furthermore, we believe that the requirement for ongoing assessment to determine whether an entity is a VIE is impractical from an operational standpoint. Many companies in the financial sector have involvements with hundreds or thousands of entities and continuously reassessing each of these to determine whether any have become VIEs or have ceased to be VIEs would be very burdensome. We feel the assessment to determine whether an entity is a VIE should only be performed at inception by evaluating the design of the entity and then the evaluation should only be reconsidered periodically based on certain reconsideration events or triggers as currently outlined in paragraph 7 of FIN 46(R).

AcSEC supports the change to eliminate to concept of reconsideration events for consideration of whether an enterprise is a primary beneficiary of a VIE. However, operationally we believe that



assessment should be performed at each interim and annual reporting period, rather than continuously. If an enterprise determines that there has been a change in whether it is the primary beneficiary, it should then consider when the change occurred and reflect the consolidation or deconsolidation at that date. If the enterprise cannot determine when the change occurred, it should then assume that the change occurred at the beginning of the period. This model would be similar to that used for FAS 133 hedge effectiveness testing and seems to be operational.

## **Troubled Debt Restructurings**

AcSEC approves of rescinding the exception from reconsideration for troubled debt restructurings. However, we believe that investors/lenders that are not the primary beneficiaries should be exempt from the proposed disclosure requirements. Consider the following fact pattern – consistent with its normal business objectives, a financial institution makes a loan. Through no fault of the lender, a borrower experiences some financial difficulties and agrees to modify the loan. The loan modification is accounted for as a troubled debt restructuring. As a result, the borrower may now meet the criteria to be a VIE and the loan may now be considered a variable interest. It may be qualitatively clear that the lender or investor does not have any power to direct the activities of the borrower and therefore is not the primary beneficiary. Thus, consolidation of the borrowers would not be required. However, the determination of whether the borrower is a VIE is important, because the proposed Standard contains significant required disclosures for VIEs which the reporting enterprise holds a variable interest in, but does not consolidate. As passive investors or lenders, the investors/lenders may not have access to the data needed to make these increased disclosures. For this reason, we believe that they should be exempt from the proposed disclosure requirements.

# Qualitative Assessment

AcSEC supports the Board's proposed move to a more qualitative model for determining which entity is the primary beneficiary of a variable interest entity, because it is more consistent with the concepts governing consolidation and recognition of assets and liabilities in other GAAP. The Board also should consider requiring a qualitative approach for purposes of determining whether an entity is a VIE as described in paragraph 9. Paragraph 5(b) of the Exposure Draft seems effectively to require companies to do a quantitative analysis of expected losses and expected residual returns to determine whether an entity is a VIE. AcSEC recommends that the FASB provide examples of situations where a qualitative assessment could be used to assess when the total equity at risk is not sufficient to permit the entity to finance its activities without additional subordinated support. A quantitative analysis should only be required if the qualitative analysis is deemed inconclusive. This would be consistent with the proposed method used for determining the primary beneficiary.

#### **Power**



The concept of "power" is new in U.S. GAAP and we feel that this concept is not described clearly enough in the proposed statement. It is unclear whether the concept of "power" focuses on day-to-day decision making or whether "power" is held by the entity that makes long-term strategic decisions. We believe that Example 8, which describes two unrelated parties owning a hotel, does not sufficiently address this question, because the example assumes that all significant decisions are jointly decided by Company A and Company B. However, consider a situation where the hotel operator (Company A) makes all the day-to-day decisions on behalf of the entity (i.e., hiring, training, reviewing and overseeing staff members; meeting with customers, contractors, and suppliers, etc.), whereas Company B makes long-term strategic decisions on behalf of the entity (i.e., building a new hotel wing). It is unclear to us in this type of scenario which Company would be considered the primary beneficiary. Therefore, we believe that the Board needs to better develop the concept of power. Similarly EITF Issue No. 04-5, Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights, places little emphasis on "protective rights" to determine which entity should be consolidated, but rather focuses more on "participating rights." We believe that FASB should strengthen its definition of power by incorporating a discussion of "protective" and "participating" rights to be consistent with existing GAAP. Additionally, more examples would be helpful in this regard.

The IASB exposure draft on consolidation deliberately moves away from the notion that control is only achieved through the power to govern the operating and financial policies of an entity. For example, entities with very detailed and defined founding and governing documents or operating within a strict legal framework might only be able to perform a limited range of activities and might have significantly limited decision making authority; therefore, ascribing control to any party would be meaningless. We would suggest that FASB also move in this direction to clarify that the entity that controls long-term strategic decisions has the "power" and, if a decision is made according to the governing documents, it would not be considered to be evidence of "power." Such a clarification would promote the convergence efforts by FASB and IASB. Furthermore, paragraph B23 in the Basis for Conclusions states that the Board concluded that the matters that are most significant to a VIE are generally matters that most significantly impact the entity's economic performance. Entities that have control over long-term strategic decisions can most significantly impact the economic performance, not those entities that make day-to-day decisions on behalf of the entity. We believe that this concept should be clarified in the Exposure Draft.

## **Mutual Funds**

Under the proposed Standard, we believe that mutual fund investment managers may be required to consolidate the mutual funds they manage, since they have the power to direct matters that most

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significantly impact the activities of the mutual fund and share in the returns of the funds through the fees that they earn. However, the mutual fund investment managers make decisions primarily for the benefit of investors in accordance with their fiduciary responsibilities. Therefore, we feel that it would not be useful or informative for mutual fund managers to consolidate all of the underlying investments of the mutual funds that they manage. We recommend that the final standard be clear about whether or not mutual fund investment managers would consolidate funds they manage.

# **Kick-Out Rights**

We disagree with the proposed requirement that kick-out rights only be considered substantive when a single enterprise has the ability to exercise them unilaterally. EITF Issue No. 04-5 states that kick-out rights are substantive if they can be exercised by a vote of a simple majority of the limited partners. The final Standard should also consider the guidance in EITF Issue No. 96-16, Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights. The SEC Advisory Committee on Improvements to Financial Reporting (CIFR) has recommended that GAAP should be based on a presumption that similar activities should be accounted for in a similar manner. Therefore, the guidance in FIN 46(R) on kick-out rights should be consistent with that in EITF Issue No. 04-5. Particularly, in the case where a small number of parties have the ability to exercise kick-out rights with a simple majority vote, we believe the kickout rights should be considered substantive.

## Examples

We believe that examples are very important to illustrate how to apply the new concepts in the Exposure Draft in practice. However, we are concerned that the fact patterns in the examples are too simplistic and do not substantially enhance readers' understanding of how the FASB intends the guidance to be applied. For example, we believe that the FASB should include examples of more complex situations where the qualitative analysis fails to determine who the primary beneficiary is and entities would have to resort to the quantitative analysis. As discussed above, we believe FASB should also provide examples of situations when a qualitative assessment could be used to assess whether an entity is a VIE.

#### **Transition**

AcSEC believes that the same transition provisions provided when FIN 46(R) was issued should apply to the proposed Standard also. Those provisions required that the consolidating enterprise initially measure the assets, liabilities, and noncontrolling interests of the variable interest entity at their



carrying amounts. If determining the carrying amounts is not practicable, the assets, liabilities, and noncontrolling interests of the variable interest entity should be measured at fair value. Any difference between the net amount added to the balance sheet of the consolidating enterprise and the amount of any previously recognized interest in the newly consolidated entity shall be recognized as the cumulative effect of an accounting change. We are unaware of any significant practice issues for either preparers or users under this transition method.

This method is necessary to avoid being forced into a mixed attribute accounting model and more complicated disclosures of loan loss reserves among others. For example, consider the case where a company's unsecuritized credit card receivables portfolio is accounted for at historical cost, with a related allowance for loan losses. As a result of the new consolidation guidance, certain securitized credit card receivables would be recorded at fair value upon adoption of the amendments to FIN 46(R) and no allowance would be established at the effective date. Therefore, the total managed credit card receivables portfolio would now have two different bases of accounting, which would be confusing to users of financial statements trying to understand the loan loss statistics and the allowance coverage relationship to the loan portfolio. We believe that requiring a different (i.e., fair value) method of accounting would not be justifiable, because effectively there has been no change in economics. In this example, the company would be required to consolidate the credit card receivables only because the consolidation rules changed, not because the economics changed resulting in the company's becoming the primary beneficiary. Therefore, the basis of accounting should not have to change.

One of CIFR's recommendations was that FASB use a single measurement attribute for each type of business activity presented in the financial statements. Forcing companies into a mixed attribute accounting model for one managed book would clearly contradict that recommendation. Furthermore, those companies that prefer to account for consolidated VIE assets and liabilities at fair value can choose to elect the fair value option.

We also are uncertain what to do in transition with servicing rights and interest-only strips, previously accounted for separately when the underlying assets are now consolidated. The Board needs to clarify in the final Standard whether the provisions of EITF Issue No. 02-9, "Accounting for Changes That Result in a Transferor Regaining Control of Financial Assets Sold," should be applied in transition to the amended standard

### **Enhanced Disclosures**

We believe that the elements of a consolidated variable interest entity should be required or permitted to be classified separately from other elements in an enterprise's financial statements. Because the assets of a variable interest entity can in certain cases only be drawn upon to settle the claims of the

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VIE's liability holders, we believe that it is important to separate variable interest entities from voting interest entities. Furthermore, we think that such a classification would be helpful to financial statement users, the company's investors and creditors, to see those assets that are restricted and not available to cover the company's other liabilities, especially since the Board decided not to apply the "linked presentation" accounting model.

AcSEC has already provided its comments on the enhanced disclosures in its comment letter on the Proposed FSP FAS 140-e and FIN 46(R)-e, which are applicable to this proposed standard as well.

We also believe that the recognition, measurement and disclosure requirements in this proposed standard should apply equally to both public and private companies.

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We thank the Board for its consideration and would welcome the opportunity to discuss our comments further with Board members and their staff.

Very truly yours,

Jay D. Hanson Chair, AcSEC Linda B. Bergen James W. Bean Co-chairs, FASB Statement No.140 and FIN46(R) Task Force