Please note that the comments expressed herein are solely my personal views.

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- File Reference No. 2011-220  
- Consolidation (Topic 810)  
- Principal versus Agent Analysis

Dear Sir,

Thank you for giving us the opportunity to comment on your Exposure Draft: Consolidation (Topic 810); Principal versus Agent Analysis.

The proposals would change the way reporting entities evaluate whether to consolidate variable interest entities\(^1\). The amendments in this proposed Update would rescind the indefinite deferral in Update 2010-10 and would require all variable interest entities to be evaluated for consolidation under the revised guidance. The revised guidance would clarify whether a decision maker is using its power as a principal or an agent. This analysis affects the determination of whether the entity is a variable interest entity and, if so, whether a reporting entity should consolidate the entity being evaluated.

I generally support the proposals, which are an improvement compared with current practice. It is important that a decision maker’s capacity is evaluated under a qualitative model that is based on all the facts and circumstances of the arrangement in order to prevent structuring opportunities, and inappropriate consolidation or non-consolidation outcomes\(^2\). However, the key principal versus agent analysis and evaluation should focus on:

- the rights held by other parties  
- the compensation to which the decision maker is entitled in accordance with its compensation agreement(s)  
- the decision maker’s exposure to variability of returns from other interests that it holds in the entity.

\(^1\) And certain partnerships and other entities.  
\(^2\) I.e. a reporting entity consolidating entities that it does not control and not consolidating entities that it controls.
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I agree with the FASB that "when a decision maker is evaluating its capacity, the assessment should not solely be based on any one of the factors, but should consider the overall nature of the arrangement and should take into account all available evidence". This is reasonable, sufficient and complete in order to promote the appropriate consolidation outcomes.

Finally I support that the proposals will align US Gaap more closely with IFRS regarding whether a decision maker is acting as a principal or an agent. This will improve comparability in international financial reporting in this area.

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3 See proposed Update, paragraph BC10.
Answers to other specific questions raised by the FASB

Principal versus Agent Analysis

**Question 1:** When determining whether a decision maker is a principal or an agent, the proposed amendments require the analysis to consider the decision maker’s overall relationship with the entity and the other parties involved with the entity. This analysis would be based on a qualitative assessment. Do you agree with this approach? If not, why?

Yes. A **qualitative, principles-based assessment is more appropriate given that decision maker agreements are often tailored to a particular entity. A qualitative assessment would also help to prevent structuring opportunities, and inappropriate consolidation or non-consolidation outcomes.**

**Question 2:** The evaluation of a decision maker’s capacity would consider the following factors:  
   a. The rights held by other parties  
   b. The compensation to which the decision maker is entitled in accordance with its compensation agreement(s)  
   c. The decision maker’s exposure to variability of returns from other interests that it holds in the entity.

Are the proposed factors for assessing whether a decision maker is a principal or an agent appropriate and operational? If not, why? Are there any other factors that the Board should consider including in this analysis?

Yes, the proposed factors for assessing whether a decision maker is a principal or an agent are reasonable, appropriate and operational. I would add that where a decision maker is assessed as an agent, it should be able to identify the principal.

**Question 3:** The proposed Update would require judgment in determining how to weigh each factor in the overall principal versus agent analysis. Do you agree that the proposed amendments, including the related implementation guidance and illustrative examples, will result in consistent conclusions? If not, what changes do you recommend?

*In most cases the proposed amendments, including the related implementation guidance and illustrative examples, will result in consistent conclusions, in that independent assessments should result in the same conclusions when based on the same information and evidence. There may be a small number of cases where a conclusion is finely balanced. These should be judged by considering wider issues until a more definitive conclusion could be made. (In any case, if such a conclusion is that the decision maker is an agent, then it should be able to identify the principal.)*

**Question 4:** Should substantive kick-out and participating rights held by multiple unrelated parties be considered when evaluating whether a reporting entity should consolidate another entity? If so, do you agree that when those rights are held by multiple unrelated parties, they should not in and of themselves be determinative? If not, why? Are the guidance and
implementation examples illustrating how a reporting entity should consider rights held by multiple unrelated parties in its analysis sufficiently clear and operational?

Yes, I agree with the proposals and the Basis for Conclusions here. Clearly, the decision maker is an agent when a party holds a unilateral, substantive right to remove the decision maker. Kick-out and participating rights held by multiple unrelated parties should be considered as a factor in the overall evaluation of the decision maker’s capacity.

**Question 5:** The proposed Update would not include a criterion focusing on the level of seniority of a decision maker’s fees when evaluating the decision maker’s capacity. Do you agree that the seniority of the fee relative to the entity’s other operating liabilities that arise in the normal course of the entity’s activities should not be solely determinative of a decision maker’s capacity? If not, why?

Yes, I broadly agree with this concept. This is a factor, but not a solely determinative one.

**Question 6:** The evaluation of a decision maker’s capacity places more emphasis on the decision maker’s exposure to negative returns (for example, an equity interest or a guarantee) than interests that only expose the decision maker to positive returns. When performing the principal versus agent analysis, should the assessment differentiate between interests that expose a decision maker to negative returns (or both negative and positive returns) from interests that expose the decision maker only to positive returns? If not, why?

Yes, the principal versus agent analysis should differentiate between interests that expose a decision maker to negative returns (or both negative and positive returns) from interests that expose the decision maker only to positive returns. The form and structure of a decision maker’s compensation is an important factor in the analysis.

**Question 7:** A reporting entity would be required to evaluate whether there has been a change in the decision maker’s capacity by considering whether there has been a change in the purpose and design of the entity. For example, the purpose and design of the entity may change if the entity issues additional equity investment that is at risk to the decision maker. Do you agree with this proposed requirement? If not, please specify when this relationship should be reassessed and why.

Yes, I agree with this. This is clearly reasonable, and is also consistent with the qualitative approach adopted in the principal versus agent analysis.

**Question 8:** The Board decided to include the principal versus agent assessment as a separate analysis within the overall consolidation assessment, rather than replacing the current guidance for evaluating whether a decision-making arrangement is a variable interest (and accordingly, a principal) with the revised principal versus agent analysis. The Board believes that if an entity’s fee arrangement does not meet the definition of a variable interest (for example, a nominal performance-based fee), the decision maker should not be required to continue the consolidation assessment. Do you agree? If not, why?
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I suggest that this is a reasonable approach. Although it increases complexity, it is more complete and should result in more appropriate consolidation outcomes.

Question 9: The Board expects the proposed principal versus agent guidance may affect the consolidation conclusions for entities that are consolidated as a result of the decision maker having a subordinated fee arrangement (for example, collateralized debt obligations). However, the Board does not otherwise expect the proposed amendments to significantly affect the consolidation conclusions for securitization entities, asset-backed financing entities, and entities formerly classified as qualifying special-purpose entities. Do you agree? If not, why?

I broadly agree here. In any event the resulting assessments would be more transparent and this is the key point.

Interests Held by Related Parties

Question 11: For purposes of applying the proposed principal versus agent guidance, the proposed amendments would require a reporting entity to include the decision maker’s direct and indirect interests held in an entity through its related parties. Do you agree with the requirement that a decision maker should include its proportionate indirect interest held through its related parties for purposes of applying the principal versus agent analysis? Why or why not?

I agree that a decision maker should include its proportionate indirect interest held through its related parties for purposes of applying the principal versus agent analysis. This is clearly economically rational. A proportionate indirect interest is economically equivalent to a direct interest of the same amount (and can be economically replicated with a direct interest of the same amount).

Evaluation of Partnerships and Similar Entities

Question 12: The amendments in this proposed Update would require a general partner to evaluate its relationship with a limited partnership (or similar entity) by applying the same principal versus agent analysis required for evaluating variable interest entities to determine whether it controls the limited partnership. Do you agree that the evaluation of whether a general partner should consolidate a partnership should be based on whether the general partner is using its decision-making authority as a principal or an agent?

Yes, this is internally and economically consistent amongst such entities.
Effective Date and Transition

Question 13: Do you agree with the proposed transition requirements in paragraph 810-10-65-4? If not, how would you propose to amend those requirements, and why? Please provide an estimate of how long it would reasonably take to implement the proposed requirements.

In general I would suggest that retrospective application would provide the most meaningful information to users of financial statements.

Question 14: Should early adoption be permitted? If not, why?

In general I would recommend that you should permit early adoption.

Yours faithfully

Chris Barnard