

January 25, 2012

Ms. Leslie F. Seidman Chairman Financial Accounting Standards Board 401 Merritt 7 P. O. Box 5116 Norwalk, CT 06856-5116

Re: Exposure Draft, Consolidation (Topic 810), Principal versus Agent Analysis

Dear Ms. Seidman,

The Financial Reporting Committee (FRC) of the Institute of Management Accountants (IMA) is writing to share its views on the Exposure Draft, Consolidation (Topic 810), *Principal versus Agent Analysis* (ED).

The FRC is the financial reporting technical committee of the IMA. The FRC includes preparers of financial statements for some of the largest companies in the world, representatives from the world's largest accounting firms, valuation experts, accounting consultants, academics and analysts¹. The FRC reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations.

In general, we support the amendments proposed in the ED. Our responses to the Questions for Respondents are included in the attached Appendix.

Specifically, in assessing consolidation, we endorse the requirement to analyze a decision maker's ability as either a principal or agent to influence significant activities impacting the economic performance of an entity. We like that the required analysis applies to both voting interest entities (including partnerships) and variable interest entitles and more closely aligns US GAAP with IFRS. We agree with the judgmental, qualitative nature of the analysis that considers the rights held by others, the decision maker's compensation and exposure to variable returns. While the proposed amendments may introduce more judgment than applied today, the proposed principal versus agent analysis allows the consolidation assessment to be based on specific facts and circumstances. The judgmental nature of the analysis elevates the importance of the

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¹ Additional information about the IMA Financial Reporting Committee can be found at www.imafrc.org.

implementation guidance and illustrative examples and we have suggestions for improvements in our responses to Questions 3 and 10 in the attached Appendix.

We would be pleased to discuss these comments with you or the FASB staff. I can be reached at (212) 664-1733.

Sincerely,

Allan Cohen

Chair, Financial Reporting Committee Institute of Management Accountants

ATTACHMENT

Questions for Respondents Consolidation (Topic 810), *Principal versus Agent Analysis*

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?

As noted in our cover letter, we agree with the approach.

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, in addition to consideration of an entity's purpose and design, we believe the proposed factors are appropriate and operational. We are not aware of other factors necessary for the analysis.

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?

Generally, yes, the proposed Update will result in consistent conclusions in situations with similar facts and circumstances. However, as noted in our cover letter, the judgmental nature of the principal versus agent analysis elévates the importance of the implementation guidance and illustrative examples. We believe that more robust nonfinancial services illustrative examples need to be added, such as:

 a franchisor/franchisee illustrative example that includes factors typically found in franchising agreements, such as the requirement to buy ingredients from the franchisor, franchisor first right of refusal or approval for proposed dispositions, marketing support for new product, etc.;

- a foreign joint venture for consumer product manufacturer that includes factors such as royalty payments for use of brands, payments by manufacturer for marketing support, inability to readily repatriate cash without economic penalty (other than the obvious restrictions proposed for 810-10-25-1B a.1.iii.); and
- a hotel management arrangement in which a hotel company operates a property owned by an investment partnership for fees and performance-related payments.

Additionally, we believe that Case H which attempts to illustrate a bottling arrangement is much too simplistic. In such arrangements, one party owns the beverage brands and receives payments for the key ingredients (brand concentrates) and makes payments, explicitly or implicitly, for marketing support. The example needs to be revised to include these factors in the analysis.

Collaborative nonfinancial services arrangements are not uncommon and we suggest that the FASB staff reach out to companies in various industries (such as, franchise, consumer product, hotel and bottling) to develop robust illustrative examples. For example, we believe that in collaborative joint venture arrangements which by design provide that both parties act as principals, a principal versus agent analysis may be unnecessary. For example, we believe that by design in Case H both parties may be acting in a principal capacity. In such cases, we believe that the principal versus agent analysis may be eliminated or at least abbreviated.

As noted in our response to Question 10, we suggest the inclusion of a money market fund example. Finally, we question why the guidance for Cases G and I excludes an evaluation of compensation.

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, we believe that kick-out and participating rights should be considered and that such rights held by multiple unrelated parties should not in and of themselves be determinative. The more important analysis is determining whether the rights are substantive. This evaluation should involve consideration of all facts and circumstances, including the number and dispersion of parties that need to come together to exercise the rights and whether the decision maker's other interests create a barrier or disincentive to exercise. In many cases, these factors will result in the conclusion that the rights are not substantive. However, once the rights are deemed substantive, we believe they should be determinative. Given the sensitivity of the analysis to specific facts and circumstances, the guidance needs to be robust.

Although we support the overall judgmental approach and aligning the voting interest model with the variable interest model in the proposed Update, we note that some believe that the proposed rules could potentially lead to consolidation of a large number of entities that previously were not consolidated due to the existence of participating rights. For example, today under the voting interest model, if another party must agree to a significant operating decision such as establishing the annual operating budget, some believe in practice that the entity likely would not be

consolidated. However, under the proposal, if there are other important decisions that are made by the entity, the entity potentially would consolidate. There seems to be a lot of confusion in practice about how to apply the proposed Update in the traditional participating rights situation. We believe that it would be helpful to know the Board's intent in this regard and if a change to current practice for this specific issue is intended.

Additionally, we encourage the Board to include an example that clarifies if a limited partner investor would consolidate a limited partnership where the general partner is considered an agent of the partnership. Under prior guidance for these entities, limited partners would only consolidate where the presumption of general partner control was overcome and where the limited partner could unilaterally control the entity, for example, if the limited partner held a majority ownership position and could unilaterally kick-out the general partner.

We urge the Board to be sensitive to concerns regarding clarity and operationality in comment letters it receives on the proposed Update. Only the application of the proposed guidance over time will reveal if the guidance is clear and operational.

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, we agree that the level of seniority of the fee should not be solely determinative of a decision maker's capacity and agree with the proposed Update's elimination of that criterion. However, since the analysis of principal versus agent includes consideration of compensation, we question the need for a separate analysis of fees required in the retained portion of paragraph 810-10-55-37.

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, we agree with the principal versus agent analysis in the proposed Update which places more emphasis in the assessment on exposure to negative returns. Such emphasis is a difference with distinction in analyzing economic performance. Exposure to not receiving a performance-related payment (opportunity loss) is different from exposure to the loss of invested capital or exposure to absorbing losses (actual monetary loss). We believe that exposure to nonreceipt of a fee that is intended to cover costs or receipt of a fee that is less than the costs represents exposure to negative returns since there could be actual monetary losses, contrary to the Board's conclusion in paragraph BC 25.

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.

We believe the proposed requirement is appropriate. Further, we believe that reassessment should not be limited to a change in the purpose and design but should consider other factors integral to the primary beneficiary determination.

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?

We are unclear why this separate analysis is necessary and believe it represents an unnecessary extra step. See our response to Question 5.

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?

Our committee members involved with such entities are currently evaluating the impact and will be providing feedback in separate comment letters.

Question 10: Update 2010-10 was issued to address concerns that some believe that the consolidation requirements resulting from Statement 167 would have required certain funds (for example, money market funds that are required to comply with or operate in accordance with requirements that are similar to those included in Rule 2a-7 of the Investment Company Act of 1940) to be consolidated by their investment managers. The amendments in this proposed Update would rescind the indefinite deferral in Update 2010-10 and would require money market funds to be evaluated for consolidation under the revised guidance. The Board does not intend the application of the proposed Update to result in money market funds being consolidated. Do you agree that the application of the proposed Update will meet this objective? If not, why and what amendments would you recommend to address this issue?

We do not believe that the proposed Update will necessarily yield the Board's intended outcome for money market funds in all cases. Given the significant emphasis placed on subordinated interests as a determinative factor that a decision maker is acting in a principal capacity, we believe that an investment manager may be deemed to be acting in a principal capacity in a fund where it has provided implicit or explicit subordinated support (whether by choice or potential regulatory requirement).

We encourage the FASB to include a money market fund example to illustrate that the existence of an investment manager's support would not be determinative that the investment manager is acting in a principal capacity. Instead the principal or agent determination should be based on a weighing of all factors including evaluation of the purpose and design of the fund. An example which focuses on the unique characteristics of a money market fund, including the highly regulated nature and restrictive investment parameters, as well as the reasons driving the need for investment manager's support could illustrate and reinforce the application of the proposed Update to these funds, including the Board's intent that these funds should not be consolidated.

Alternatively, if the Board is concerned that providing a money market fund example could lead to inappropriate analogies being drawn for other, unintended entities or structures, the Board could provide an explicit scope exception for these funds.

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?

We agree with the requirement in the proposed amendments to include proportionate indirect interest of a related party in the principal versus agent analysis.

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?

We agree that a general partner should evaluate consolidation using a principal versus agent analysis and like the consistency with other voting interest entities and variable interest 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.

We agree with the proposed transition requirements in proposed paragraph 810-10-65-4. We believe that a minimum of one year from the date of issuance of the final Update is needed for implementation and that adoption should be as of the beginning of a fiscal year.

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

No, the consolidation assessment is too fundamental and inconsistent adoption would too negatively impact comparability during the transition.

Nonpublic Companies

Question 15: Should the amendments in this proposed Update be different for nonpublic entities (private companies or not-for-profit organizations)? If the amendments in this proposed Update should be applied differently to nonpublic entities, please provide a rationale for why.

We believe that accounting standards regarding recognition and measurement, such as the proposed Update, should be the same for public and nonpublic entities.