

American Institute of CPAs 220 Leigh Farm Road Durham, NC 27707-8110

February 17, 2012

Susan M. Cosper, CPA Technical Director FASB 401 Merritt 7 PO Box 5116 Norwalk, CT 06856-5116

Re: November 3, 2011 Exposure Draft of a Proposed Accounting Standards Update (ASU), Consolidation (Topic 810): Principal versus Agent Analysis [File Reference No. 2011-220]

Dear Ms. Cosper:

One of the objectives that the Council of the American Institute of Certified Public Accountants (AICPA) established for the PCPS Executive Committee is to represent the views of local and regional firms on professional issues in keeping with the public interest, primarily through the Technical Issues Committee (TIC). This communication is in accordance with that objective. These comments, however, do not necessarily reflect the positions of the AICPA.

TIC has reviewed the ED and is providing the following comments on selected questions for respondents for your consideration.

#### **GENERAL COMMENTS**

In general, TIC supports the proposed amendments in the ED. However, additional implementation guidance and clarifications are suggested below for certain aspects of the proposal to ensure consistent application of the amendments.

#### **SPECIFIC COMMENTS**

### 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. TIC agrees with the proposed 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?

TIC believes the proposed factors are appropriate and operational and that no additional factors need to be considered.

**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?

TIC doesn't necessarily agree that the proposed amendments, including the related guidance and examples, will promote consistent conclusions in all cases. TIC reviewed Cases A (Investment Fund—Large Capital Fund), B (Investment Fund—Performance-Based Fees) and C (Investment Fund—Performance-Based Fees and Additional Interests) on pages 63-69, which provide guidance on assessing a decision maker's capacity as a principal versus agent.

As one of the parameters changes, TIC is uncertain whether two different people examining the same scenario would reach consistent conclusions. For example, if the equity interest in Case A is increased from 10% to 20%, so that the equity interest more closely resembles the scenario in Case C, it is unclear how that additional equity interest should be evaluated. Some may infer that the additional equity interest represents excessive compensation for the responsibility assumed (i.e., the fund manager's authority was limited to managing a diversified portfolio of publicly traded companies with large market capitalizations within defined parameters) and conclude that the fund manager was acting as a principal. Others may not see the percentage increase as excessive and conclude that the compensation is within customary bounds indicating that the fund manager, all else being equal, is acting as an agent.

TIC recommends that the amendments or implementation guidance clearly describe the key principles underlying the importance and relative priority of each factor (i.e., the rights held by others, the decision maker's compensation and the decision maker's other economic interests) and how to analyze specific fact patterns based on those principles in making the principal v. agent assessment. While the examples presented in the ED are certainly useful, the rationale used in each case should be generalized into guidance that could be applied to any scenario. As of now, the principles are embedded in the examples

rather than forming the basis for the examples. As a result, TIC believes preparers and practitioners will have difficulty applying the rationale in the examples to other fact patterns consistently.

**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. TIC agrees that the seniority of the fee should not be the sole determinative factor. TIC believes all factors need to be considered, with no one factor being determinative.

**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. TIC agrees that the principal versus agent analysis should differentiate between negative and positive returns. TIC believes that a decision maker is more likely to be a principal if the potential for negative returns exists.

**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.

TIC agrees with the proposed requirement. New paragraphs 810-10-35-6 and 810-10-35-7, which state that the decision maker's (or general partner's) capacity shall be reconsidered if there has been a change in the purpose and design of the entity (or limited partnership), is preferred over the current requirement to reassess the relationship between limited and general partners at each reporting date for which financial statements are presented.

TIC assumes that the Board has decided to drop all requirements for periodic reassessment of the purpose and design of the entity based on the guidance in paragraph BC32 and a comparison of paragraph 810-20-25-6 (limited partnerships) in the current Codification to proposed paragraphs 810-10-35-6 and 810-10-35-7. If this assumption is incorrect, please clarify the guidance accordingly.

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?

TIC does not understand the Board's rationale behind this question. If the Board's intent is to exclude money market funds from consolidation, then TIC recommends that they be eliminated from the scope of the standard. It is not cost effective to go through the principal versus agent analysis only to conclude that money market funds will be excluded from consolidation. TIC therefore does not support the proposed rescission of the indefinite deferral in ASU 2010-10, *Consolidation (Topic 810) - Amendments for Certain Investment Funds*, unless the Board also scopes out Rule 2a-7 funds, as that is the intent.

## **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?

In general, TIC agrees that a decision maker should include its proportionate indirect interest held through its related parties in the principal versus agent analysis. However, TIC joins AICPA's Financial Reporting Executive Committee in its concerns about the application of this requirement in practice. For example, TIC believes guidance is needed to address situations where the decision maker cannot control the indirect interest. If, as a result of the indirect interest, the decision maker did not exert control over the related party, then TIC questions whether the indirect interests should be considered in the principal versus agent analysis, as the proposed amendments suggest.

# **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, TIC agrees that the current rule, which includes a presumption that the general partner controls and therefore should consolidate a limited partnership, should be discontinued. TIC supports the proposed amendment that would require a general partner to evaluate consolidation of a limited partnership on the basis of whether it has the ability to use its decision-making authority in a principal or agent capacity.

### **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.

This is a complex standard, which may require a long transition period for some entities. TIC is uncertain what the ideal time period would be but recommends that the FASB set the effective date to accommodate the needs of preparers, especially real estate limited partnerships. Once the effective date for public entities has been established, an additional year for nonpublic entities should also be considered.

TIC requests that the effective date for nonpublic entities exclude interim periods during the initial year of adoption. Many private entities do not prepare interim financial statements, and those that do will need a complete annual period (i.e., an extra year from the effective date applicable to public companies) for initial implementation of the standard. TIC therefore recommends that the effective date for private entities be stated in the following format:

For nonpublic entities, the amendments are effective for fiscal years ending after December 15, 20XX, and interim and annual periods thereafter.

TIC believes adjusting the opening balance of retained earnings in the period of adoption is the preferable transition method since restating prior periods presented would be burdensome for many entities.

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

TIC recommends that early adoption of the standard be permitted. TIC believes certain entities may be ready to adopt the standard early and should have the option to do so.

# **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.

In general, TIC believes the principal versus agent analysis for public and nonpublic entities should be the same. However, the examples in the ED are not relevant to the typical entities within TIC's constituency. TIC recommends expanded guidance on related party interests. Given the complexity of the standard, many nonpublic entities may need extra time to understand the new amendments and implement the changes. As discussed above, TIC recommends an extended effective date for these entities.

TIC appreciates the opportunity to present these comments on behalf of PCPS member firms. We would be pleased to discuss our comments with you at your convenience.

Sincerely,

Karen Kerber, Chair

Karen Kerber

**PCPS Technical Issues Committee** 

cc: PCPS Executive and Technical Issues Committees