

Letter of Comment No: 136
File Reference: 1082-200
Date Received: 09/24/02



California
Society

Certified
Public
Accountants

September 3, 2002

Suzanne Q. Bielstein
Director – Major Projects and Technical Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: File Reference No. 1082-200
Consolidation of Certain Special-Purpose Entities

Dear Ms. Bielstein:

The Accounting Principles and Auditing Standards Committee of the California Society of Certified Public Accountants (the Committee) has discussed the above-referenced exposure draft and appreciates this opportunity to comment thereon.

The Committee is the senior technical committee of our state society. The Committee is composed of 40 members, of whom 7% are from national CPA firms, 68% are from local or regional firms, 15% are sole practitioners in public practice, 5% are in industry, and 5% are in academia.

We are providing the following comments for your consideration.

The Committees greatest concern is that the exposure draft is difficult to understand and interpret. As a result, because of the complexity of the interpretation, we do not believe that it would be consistently applied in practice.

Some of the difficulty is simply attributable to the manner in which the exposure draft is written. Two examples are provided below:

Paragraph 3 states, "The distinguishing characteristics of SPEs subject to this interpretation is that voting equity interests do not give the holders a controlling financial interest. . . ." This suggests that this interpretation does not apply to SPEs in which the holders have a controlling financial interest. The Committee believes that the interpretation is intended to apply to all SPEs that were not excluded in paragraph 8. The conditions in Paragraph 9 are then to be applied to the SPEs not removed from the scope to determine those SPEs for which the equity holders do not have a controlling financial interest.

In paragraph 7, a *Substantive Operating Enterprise* (SOE) is defined as an enterprise that is not an SPE. However, since SPE is not specifically defined, it is not possible to make a determination whether an entity is a SOE by exclusion. We believe that a better approach would be to define the characteristics required to be considered a substantive operating enterprise, and then define an SPE as an enterprise that is not an

SOE. We also do not believe that it is correct to include in the definition of SOE the suggestion that an SOE “usually issues financial statements of its own” since there are literally millions of small businesses which never issue financial statements.

The Committee does not believe that the exposure draft provides sufficient guidance for issues this involved and complicated. One area requiring further guidance involves the second condition of Paragraph 9 which deals with the sufficiency of an equity investment. Members of the Committee had different understandings of what would be considered sufficient. Many believed that as long as the owners were obligated to fund any deficiencies (e.g. general partners in a partnership without recourse debt), and no others parties had a “higher-priority” obligation to provide financial assistance, then that this would be a sufficient equity investment. Others believed that the adequacy of capital test would preclude that conclusion. Also, others were unsure what was included or excluded from the term “financial support from variable interest holders” and “direct or indirect assistance.”

We recommend that the examples in Appendix A include situations commonly encountered by closely-held businesses and include situations in which presumptive conditions are overcome. For example, several examples involving the leasing of real estate could demonstrate situations which, when tested under the conditions of the interpretation, the SPE would be (1) evaluated for consolidation based on voting interests, (2) consolidated by the lessee, and (3) consolidated by the lessor based on evaluation of variable interests.

Finally, we believe that a decision tree would help in the process of evaluating the considerations which an SPE for consolidation.

A second general concern was that the Committee believe that this interpretation was issued to deal with problems that have been identified in public companies and did not consider whether how the interpretation will affect closely-held companies under common control. We believe that, before issuance, consideration should be given to applying the principles of the exposure draft to closely-held businesses on a test basis. The results should be discussed with a panel of typical users of financial statements of these entities to determine if the result is meaningful for their purposes.

The Committee appreciates this opportunity to comment, and will be pleased to discuss our comments with FASB staff at your convenience.

Very truly yours,



John Bellitto, Chair
Accounting Principles and Auditing Standards Committee