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VIA EMAIL TO: director@FASB.org

Technical Director
File Reference No. PCC-13-02
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

Re: Proposed Accounting Standards Update, *Applying Variable Interest Entity Guidance to Common Control Leasing Arrangements*

To Whom It May Concern:

Our firm, Financial Reporting Advisors, LLC, provides accounting and SEC reporting advisory services, litigation support services, and dispute resolution services. We specialize in applying generally accepted accounting principles to complex business transactions. Although our corporate clientele is principally public companies, we have a number of private company clients, and we also provide technical accounting advisory services to several accounting firms with respect to those firms' private company attest practices. We appreciate the opportunity to provide comments on the FASB's Proposed Accounting Standards Update, *Applying Variable Interest Entity Guidance to Common Control Leasing Arrangements* (the ED).

We supported the Financial Accounting Foundation's (FAF's) decision to create the Private Company Council (PCC) and to make the decisions of the PCC subject to approval by the Financial Accounting Standards Board (FASB) because we believed it was a reasonable approach to comprehensively understanding and addressing the unique needs of users of private company financial statements, to the extent that those unique needs are consistent with the objectives of general purpose financial statements.¹ We rejected the recommendation of the Blue-Ribbon Panel on Standard Setting for Private Companies to establish a separate standard setter because we believed that approach would inevitably result in different standards for general purpose financial statements. As we noted in our letter, it is both unexplainable and unsustainable for two U.S. companies to account for the exact same transaction differently *solely* because one company has more shareholders than the other.

¹ Please refer to our comment letter dated January 12, 2012 to the FAF's *Plan to Establish the Private Company Standards Improvement Council*.

Needless to say, we have been unpleasantly surprised by the recent actions of the PCC and FASB. With respect to the ED, to be blunt, we are disturbed by all aspects of the proposal—the due process being followed, the PCC’s decision-making process, and the proposed amendment to the Codification.

Due Process

A less than two month comment period is simply inadequate for constituents to study and respond thoughtfully to a proposal that will have the effect of moving certain special purpose entities off-balance-sheet. It is particularly troublesome when the targeted audience is “private company stakeholders,” a constituency that historically has not been an active participant in the standard setting process. We are especially concerned that financial institution loan officers (a group we perceive to be significant users of private company financial statements) are only now becoming aware (or frankly may not yet be aware) of this proposal. We are aware, anecdotally, that some such users are surprised by the existence and content of this proposal.

We find the first question for respondents to the ED to be off-putting. We do not know the reason behind this question, but it gives the impression that the PCC/FASB is only interested in hearing from “bona fide” private company constituents. The PCC cannot have it both ways—if the changes proposed by the PCC will become part of U.S. Generally Accepted Accounting Principles (GAAP) and thereby benefit from being a part of the gold standard in financial reporting, then the PCC must solicit and consider input from all parties that have a stake in financial reporting. Good ideas—and legitimate concerns—may come from anywhere and the PCC and the FASB need to be open to constructive input regardless of its origin. The implications of this question are particularly curious given the request for information in Question 3, which can only be provided by parties with extensive experience with public entities.

PCC Decision-Making Process

We are disappointed that any decisions on recognition and measurement differences are being made prior to the finalization of the private company decision-making framework. We note that the framework proposed by the PCC and FASB “is not intended to be an entirely new conceptual framework that would lead to a basis for preparing financial statements of private companies that is fundamentally different from the basis for preparing financial statements of public companies.” If indeed that is the framework, we are surprised the ED was ever issued for public comment. It is hard to imagine a more fundamental difference in a basis for preparing financial statements than a conclusion that the presentation of consolidated financial statements should be optional for private entities.

Paragraph BC5 states “the Board believes that the proposed Update should not apply to public business entities and employee benefit plans because they lack the arrangements that this accounting alternative addresses.” If that statement is accurate, there is no reason to limit the scope of the ED to private entities. The ED could apply to all entities. The problem is the statement in paragraph BC5 is simply not accurate. There are public entities that have the same arrangements as the arrangements addressed in the ED. The following are examples of public entities that could have the same arrangements that the ED addresses:

- Business entities that are public only because they have issued public debt

- Employee-owned business entities that are public only because they have exceeded a specified number of shareholders
- Public business entities that are controlled or effectively controlled by an individual or a family
- Public business subsidiaries of private or public parent entities.

The PCC and FASB assert that most users of private company financial statements believe “*consolidation is not relevant*” to them because they focus on the cash flows and tangible net worth of the standalone lessee, as opposed to the consolidated cash flows and tangible net worth of the reporting entity as presented under U.S. generally accepted accounting principles” (emphasis added) and that “consolidation of the lessor entity distorts the financial statements of the lessee entity.” But the basis for conclusions provides no discussion or explanation of this fundamental difference in financial analysis. In fact, it seems very difficult to understand why users of private company financial statements think differently than users of public company financial statements with respect to consolidation of lessor entities. For example, in our experience it appears that lenders to both private companies and public companies focus on the cash flows and collateral of the borrower. Absent understanding why users of private company financial statements would focus on different metrics than users of public company financial statements, we cannot understand why GAAP with respect to consolidation of VIE lessors should differ between private and public entities.

The ED also implies that the reason for creating the VIE—for tax and estate-planning purposes rather than to structure off-balance-sheet debt arrangements—should be a factor in the decision-making process. We strongly disagree with using “intent” as a basis to determine which off-balance-sheet arrangements stay off-balance-sheet and which arrangements should be recognized on-balance-sheet. The guidance on VIEs in Topic 810 is not limited, nor should it be, to situations in which the VIE exists primarily to keep debt off the books. Instead, the VIE guidance focuses, as it should, on whether conditions indicate that the reporting entity controls the VIE. There is no logical argument that the reason for creating the VIE should result in a change in the principle governing consolidation.

Further, public entities are just as active as private entities in structuring business operations to minimize income taxes. One does not need to look further than the recent phenomenon of “nontraditional” Real Estate Investment Trusts that have been established by public entities for an example of structuring of business operations to minimize income taxes. Master Limited Partnerships (MLPs) formed by public entities are another common example. Some of these MLPs are VIEs and most are affiliated in some manner with their public entity sponsors.

Paragraph BC29 states the proposal would be responsive to the “unique” needs of private companies. We struggle to understand what makes the arrangements addressed by the ED “unique” to private entities.

The Proposed Amendment to the Codification

We agree that the current guidance on consolidation of VIEs by private entities where the reporting entity and the VIE have common ownership is subjective and sometimes results in financial reporting that is not decision useful to users of financial statements. In our experience, these common ownership arrangements often create confusion and frustration to all parties involved—the private entity, the external auditor, and the lender.

Accordingly, we agree that these arrangements deserve another look by standard setters to see if the accounting guidance can be improved. We believe the accounting guidance can be improved, but we disagree with the solution proposed in the ED for the following reasons.

- We believe the needs of users of financial statements with respect to the arrangements addressed by the ED are no different for users of private entity financial statements than users of public entity financial statements.
- We believe there should be a high threshold for recognition and measurement differences between public and private entities given that GAAP is developed for general purpose financial statements. Such differences add complexity, confuse users, impede private entities from accessing the public markets, and dilute the GAAP “brand.”
- The ED guidance is limited to only certain VIE situations. If the guidance in the ED is appropriate guidance, we do not understand why it is limited to only leasing arrangements.
- With respect to leasing entities, we believe the scope of the ED is too broad.
 - The ED would make it optional for a qualifying reporting entity (a private lessee entity) to consolidate a VIE lessor entity even in the situation in which a reporting entity is explicitly guaranteeing the indebtedness of the VIE lessor entity.
 - The ED would make it optional for a qualifying reporting entity (a private lessee entity) to consolidate a VIE lessor entity that is wholly-owned by the reporting entity. [It is very easy to make a wholly-owned subsidiary a VIE—simply capitalize the subsidiary with a subordinated inter-company note rather than equity.]
- The ED uses a term, “common control,” that is not a defined term in GAAP. The Emerging Issues Task Force attempted to define common control in Issue No. 02-5, *Definition of “Common Control” in Relation to FASB Statement No. 141*, but was not successful. In addition to the uncertainty about whether a specific situation is a common control situation, the ED also seems to confuse “common control” with “common ownership.” For example, the example proposed to be eliminated from the Codification by the ED is a common ownership situation, but, absent the addition of more facts (for example, the owner of Leasing Entity controls Manufacturing Entity or the two owners of Manufacturing Entity are siblings), it is not a common control situation.
- We believe the basis for conclusions to the ED somewhat overstates the complexity argument. We agree it can be complex to decide whether a lessor VIE should be consolidated when the reporting entity first becomes involved with the lessor VIE. The literature also requires that the reporting entity reassess every period whether the reporting entity continues to be the VIE’s primary beneficiary. However, absent a change in facts and circumstances, once that determination is made, the ongoing accounting for a consolidated VIE is no more complex than the accounting for a consolidated voting interest entity.

We believe the consolidation decisions that are most problematic under current GAAP involve implicit variable interests. Therefore, we recommend that the FASB take a fresh look at its definition of an implicit variable interest and that any change to the definition of an implicit variable interest should apply to both public and private entities. We considered whether to recommend that the FASB simply remove the notion of an implicit variable interest from the VIE guidance, but ultimately concluded that the notion

of an implicit variable interest should continue to be part of the VIE guidance. Instead, we recommend that the FASB modify the factors used to identify an implicit variable interest to specifically exclude the fact that the reporting entity is a related party to the VIE from the analysis used to identify implicit variable interests. Standard setters have long struggled with whether the fact that two parties are related should change the accounting for transactions or arrangements between the two parties. In the FASB's recent exposure draft on leasing, the FASB concluded that entities should not account differently for leases between related parties than leases between unrelated parties. We believe the same thought process should allow the FASB to make our suggested modification to the definition of implicit variable interests and such a change could (and should) be applied to both public and private entities.

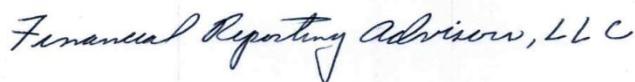
This change would cause the lessee entity to conclude it does not have a variable interest in the VIE lessor in many of the situations that are most troublesome in practice today. If a lessee entity does not have an implicit or explicit variable interest in a lessor VIE, the lessee entity would be required to consolidate the lessor VIE only if (1) a related party has a variable interest in the lessor VIE *and* (2) the lessee entity has power over the lessor VIE (rather than the owner of the lessor entity). We believe the practical effect of this recommendation would be to reduce the number of situations in which a private entity lessee concludes it has a variable interest in a VIE lessor and to reduce the number of situations in which the private entity lessee would consolidate a VIE lessor. This in turn would eliminate some situations in which a lender now needs supplemental information such as a consolidating statement of financial position or a consolidating statement of income.

One Other Suggestion

We have noticed that some lessor entities under common ownership with private lessee entities are concluded to be VIEs when it is not clear the lessor entity is really a VIE. Specifically, an entity that does not have sufficient equity to permit it to finance its activities without subordinated financial support is a VIE. One type of subordinated financial support is a guarantee of the entity's debt. Our experience is that lenders to private entities, like a private lessor entity, generally require a personal guarantee of the entity's debt by the investor(s) in the entity. This requirement for an investor(s) guarantee appears to hold true even in situations in which it appears the private lessor entity has sufficient equity at risk. However, the existence of the investor(s) guarantee creates a presumption that the private lessor entity does not have sufficient equity. Some interpretative guidance addressing this situation may allow for some lessor entities that are currently considered to be VIEs to be treated as voting interest entities and thereby reduce the frequency of the consolidation result that the PCC finds troubling without fundamentally altering the criteria for consolidation by private companies.

Once again we appreciate the opportunity to comment on the Proposed Accounting Standards Update, *Applying Variable Interest Entity Guidance to Common Control Leasing Arrangements*. If there are any questions, please contact Richard R. Petersen at 312-345-9102.

Sincerely,



Financial Reporting Advisors, LLC