

Private Company Financial Reporting Committee

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Judith H. O'Dell CPA CVA
Chair

January 25, 2012

Ms. Leslie Seidman
Chairman
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856

Re: Proposed Accounting Standards Update, *Consolidation: Principal versus Agent Analysis* (“Proposed ASU”)

Dear Ms. Seidman:

The PCFRC has reviewed and discussed the Proposed ASU. Overall the Committee believes that the Proposed ASU will be an improvement to the consolidation literature (especially general/limited partnership considerations) by adding the principal versus agent analysis. Specific comments and recommendations are provided below in the Committee’s responses to the questions posed in the Proposed ASU.

In addition, the PCFRC believes that the Proposed ASU is an interim step in continued improvements that are necessary for this topic. Even though the Proposed ASU revises guidance related to variable interest entities (VIEs), additional revisions in guidance are necessary. For example, significant disparity in practice still exists among preparers and practitioners in identifying VIEs and determining whether a reporting entity is the primary beneficiary. This disparity has created concerns among users of financial statements. Implementation guidance needs to be improved; real life private company examples are needed. In addition, the consolidations topic is not well organized and could be improved, principally in the subtopic of recognition. This would help readers to more easily understand and implement this relatively complicated area of the accounting literature.

Respondent 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?

PCFRC Response: The PCFRC agrees with the approach. However, the glossary does not define agent or principal. A number of examples in the Proposed ASU are used to distinguish between the two, however the differences are not distinct enough to clearly identify when a decision maker is one versus the other. Definitions in the glossary would provide the principles necessary to properly interpret the examples. The determination may be as simple as determining if the decision maker has disproportionate benefits based on the decisions they make. The PCFRC recommends defining agent and principal in the glossary.

Respondent 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?

PCFRC Response: The decision maker's exposure to variability of returns appears to be the greatest indicator. If this assumption is true, the Proposed ASU should clearly say so. The PCFRC believes the Proposed ASU will impact numerous consolidation decisions because the power to direct was a major factor in considering consolidation. The Proposed ASU will significantly impact this existing factor. As such, the PCFRC asks the FASB to re-confirm that was their intent that the decision maker's exposure to variability of returns is the greatest indicator.

Respondent 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?

PCFRC Response: The illustrative examples are an improvement over prior examples.

Respondent 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?

PCFRC Response: The rights of others to remove a decision maker should have a significant effect on whether the decision maker has the power to direct and should be considered, even if multiple parties are involved. However, the PCFRC is concerned that there will be inconsistent interpretation in practice. Accordingly, additional examples are recommended. The specific examples that would be beneficial are those that involve general and limited partners of real estate entities. In addition, the examples should include a description of participating rights of limited partners for those real estate entities.

Respondent 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?

PCFRC Response: The PCFRC believes the level of seniority of a decision maker's fee would be an indicating factor, however not a primary one.

Respondent 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?

PCFRC Response: Exposure to negative returns should have greater weight.

Respondent 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.

PCFRC Response: A reassessment process has worked well in practice. Therefore a reassessment when the decision maker's capacity has changed is appropriate.

Respondent 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?

PCFRC Response: The PCFRC believes including this category as a separate consideration is appropriate, especially because all criteria must be met for an entity to be considered the primary beneficiary. Unfortunately, there may be situations in which no entity is defined as the primary beneficiary because there are different interpretations in practice. In practice, the definitions of variable interests differ due to the “implicit” condition being a consideration. If the fee arrangement can easily be changed by the decision maker then many will consider the fees as variable interests.

Respondent 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?

PCFRC Response: Such entities are rarely encountered in the nonpublic company environment, with the exception of certain financial institutions. As such, the PCFRC offers no response.

Respondent 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?

PCFRC Response: Not applicable to private companies.

Respondent 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?

PCFRC Response: Related party considerations are one of the most significant financial reporting challenges faced by private companies. Therefore, the PCFRC recommends that the FASB provide adequate examples in the final standard.

Respondent 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?

PCFRC Response: The PCFRC is concerned that the accounting guidance in this area will not be interpreted consistently by private company financial statement preparers and practitioners. This may not be an issue for many private company general partner entities as many of these entities do not prepare GAAP financial statements. Nevertheless, the proposed guidance appears to be an improvement.

Respondent 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.

PCFRC Response: The transition requirements appear complex, however since this is overall an improvement in the standards and different consolidation decisions will be made, the transition appears appropriate. Optional transition (cumulative effect or retrospective application) should be allowed.

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

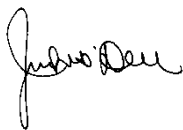
PCFRC Response: The PCFRC believes early adoption should be permitted.

Respondent 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.

PCFRC Response: Refer to PCFRC responses above.

The PCFRC appreciates the FASB's consideration of these recommendations and comments. Please feel free to contact me if you have any questions or comments.

Sincerely,



Judith H. O'Dell
Chair
Private Company Financial Reporting Committee