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January 7, 2012

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File Reference No. 2011-220  
Consolidation (Topic 810): Principal versus Agent Analysis

The Accounting Principles and Auditing Standards Committee (“the Committee” or “We”) of the California Society of Certified Public Accountants (“CalCPA”) is grateful for the opportunity to comment on the proposed Accounting Standards Update referenced above. The Committee is the senior technical committee of CalCPA. CalCPA has approximately 35,000 members. The Committee is comprised of 43 members, of whom 56 percent are from local or regional firms, 12 percent are sole practitioners in public practice, 9 percent are in academia, and 2 percent are in an international firm.

The Committee generally supports the changes in this Proposed Accounting Standards Update, but some members of the Committee take issue with some of the proposed changes, as indicated in our responses to the specific questions below.

### 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?

The Committee believes that quantitative assessments have not been adequate and have enabled reporting entities to interpret data to achieve desired results and agrees with the application of this qualitative 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 arrangements(s)
- c. The decision maker's exposure to variability of returns from other interests 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?

The Committee believes that the proposed factors for assessing whether a decision maker is a principal or agent are appropriate and operational.

**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?

Although the Committee believes that there will inevitably be differences in judgments that will result in inconsistencies, it agrees with the requirement and believe it has the potential of minimizing inconsistencies.

**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?

The Committee agrees with the handling of kick-out and participating rights and that the guidance and implementation examples are sufficiently 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?

The Committee agrees that the level of seniority of the decision maker's fees should not be determinative of the decision maker's capacity.

**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 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?

The Committee agrees that greater emphasis should be placed on negative returns (or both negative and positive returns) than on interests that expose the decision maker exclusively to positive returns.

**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 the relationship should be reassessed and why.

The Committee agrees with the proposed requirement.

**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?

The Committee agrees with the proposal to include the principal versus agent assessment as a separate analysis rather than replacing the current guidance.

**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?

The Committee agrees and does not believe that the proposed principal versus agent guidance will significantly affect the consolidation conclusions for entities other than those that are consolidated as a result of the decision maker having a subordinated fee arrangement.

**Question 10:** Update 2010-10 was issued to address concerns that some believe that the consolidation requirements resulting from Statement 157 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?

The Committee agrees that the application of the proposed Update will accomplish the objective of allowing investment managers to avoid consolidating money market funds they manage.

## 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?

While the Committee agrees that the decision maker should consider both direct and indirect interests held in an entity through its related parties, the Committee does not agree with the use of the proposed formula under which a proportionate interest is measured. The Committee believes, for example, that a reporting entity with a 60% interest in a related party that holds a 40% interest in a variable interest entity has the equivalent of an approximate 40% interest in the variable interest entity, not a 24% interest.

## 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?

The Committee agrees with the proposal.

## Effective Date and Transition

**Question 13:** Do you agree with the proposed transition requirement 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.

The Committee agrees with the proposal and does not have an estimate of the time it would reasonably take to implement the proposed requirements.

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

The Committee was divided as to whether or not early adoption should be permitted. Some members believed that the proposed changes represent an improvement in the requirements for consolidation and that entities should be allowed to apply them immediately. Other members believed that early adoption would adversely affect comparability among entities.

## Nonpublic Entities

**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.

The majority of the members of the Committee believe that there should be separate guidance for nonpublic entities. Those members believe that the consolidation of variable interest entities does not necessarily improve financial reporting for the nonpublic entity and the cost of the analysis, and the consolidation process when required, is not justified by the benefit derived from having performed the analysis or prepared consolidated financial statements. Those members believe that disclosure of the related party relationship generally provides information that is sufficient to meet the needs of the users of the financial statements of nonpublic entities.

We would be glad to discuss our opinions with you further should you have any questions or require additional information.

Sincerely,

A handwritten signature in black ink that reads "Howard Sibel". The signature is written in a cursive, flowing style.

Howard Sibelman  
Chair  
Accounting Principles and Auditing Standards Committee  
California Society of Certified Public Accountants