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June 29, 2004

Mr. Larry Smith, Chairman  
FASB Emerging Issues Task Force  
401 Merritt 7, P.O. Box 5116  
Norwalk, CT 06856-5116

Re: EITF Issue No. 04-7, *Determining Whether an Interest Is a Variable Interest in a Variable Interest Entity*

Dear Mr. Smith:

Goldman Sachs appreciates the opportunity to comment on EITF Issue No. 04-7. We commend the Agenda Committee for adding this complex issue to the Task Force's agenda. As noted in the related Issue Summary, an integral part of applying FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities* (FIN 46R), is determining which interests in a variable interest entity are variable interests. We believe the goal of the Task Force should be the development of guidance that leads to the consistent identification of variable interests, resulting in increased comparability across companies.

With that goal in mind, we were active members of the ISDA working group that developed the ISDA paper entitled "Analyzing Derivative Instruments under FIN 46R" (the ISDA Paper). We understand significant portions of the ISDA Paper were used to develop the Issue Summary. We agree with the ISDA working group's analysis that neither the fair value model nor the cash flow model (Views A and B, respectively, in the ISDA Paper and the Issue Summary) is clearly required under FIN 46R and neither model considers all forms of variability because both models narrowly define variability. Moreover, both models do not consider the design of the entity and the economics as comprehensively as other models. Consequently, we do not support Views A and B.

The ISDA working group also developed two alternative models, Views C and D, respectively. We supported View D of the ISDA Paper and note it has not been presented to Task Force members. We believe the Task Force should consider all views;

a robust analysis of all views can only deepen the Task Force's understanding of a very complex issue.

Having said that, we note the substantive difference between Views C and D of the ISDA Paper relates to the treatment of synthetic assets, which the FASB staff addressed by splitting the Issue Summary into two separate issues, Issue 1 and Issue 2. For the most part, View D of the ISDA paper has been subsumed into View C of Issue 1. Therefore, we would not object to View C described in Issue 1 of the Issue Summary (because it produces the same results, albeit for different, conceptually nuanced reasons), provided it was strengthened to require consideration of the design of the entity and a comprehensive economic analysis of each party's rights and obligations when evaluating whether a contract creates and/or absorbs variability.

### **Synthetic Asset Misidentified in Issue 2, Example 1**

Regarding Issue 2, the treatment of synthetic assets, we note the synthetic asset has been misidentified in Example 1. The synthetic asset that has been created is not the forward contract that establishes the (synthetic) long position in commodity X from the VIE's perspective. Rather, the synthetic asset that has been created is an amortizing debt instrument created from the difference between the forward sale and forward purchase contract prices.

As stated on page 16 of the ISDA Paper within View D, the combination of the two forward contracts creates a cash annuity to the VIE that services the VIE's debt. Stated differently, the present value of that annuity informs the total proceeds the VIE can expect to realize from its debt issuance. By themselves, each forward contract introduces (creates) commodity price risk to the VIE. However, when taken together based on the design of the entity, each forward contract creates offsetting variability (i.e., changes in the price of commodity X do not impact the VIE's cash flows). That is, the forward purchase contract creates a long derivative exposure while the forward sale contract creates a short derivative exposure. Consequently, neither forward contract is a variable interest because each creates offsetting variability.

In our view, the only variable interest holders in Example 1 are the debt investors, who are exposed to the credit risk of both forward counterparties. Although that risk may be small (if both counterparties are of high credit quality), it generally is much greater than the credit risk borne by the forward counterparties because they generally are senior in the waterfall.

### **Multicurrency VIEs**

Depending on how the Task Force resolves Issue 1, we believe it may be necessary to consider another related issue regarding multicurrency VIEs – what currency should be used to perform the FIN 46R expected cash flow analysis. The choice of currency can inform which variable interest holder may be the primary beneficiary because currency

risk is often a significant source of variability. We are aware of at least four different views:

View 1 – the predominate currency of the VIE’s assets

View 2 – the predominate currency of the VIE’s liabilities

View 3 – the predominate currency of either the VIE’s assets or liabilities after considering the design of the entity

View 4 – the functional currency of the VIE by analogy to FAS 52.

We support View 1, given FIN 46R’s focus on variability created by the VIE’s assets. Regarding View 4, we do not believe VIEs are generally designed to have a functional currency as that principle is used in FAS 52 because most are not businesses; thus, the identification of the functional currency would be arbitrary in most cases. Consistent with paragraph 40 of FAS 52, we believe that “[a]rbitrary rules that might dictate the identification of the functional currency in each case would accomplish a degree of superficial uniformity but, in the process, might diminish the relevance and reliability of the resulting information.”

We appreciate the opportunity to comment on this complex and important issue. Should the Task Force decide to form a working group to study this Issue in more detail, we respectfully request that we be considered for inclusion in the working group. If you have any questions or comments regarding our letter, please do not hesitate to contact me at 212-357-8437.

Sincerely,

/s/ Matt Schroeder  
Matthew L. Schroeder