

Summary of Decisions Reached at December 10, 2003 Board Meeting Regarding FASB Interpretation No. 46, *Consolidation of Variable Interest Entities*

The Board considered comments received on the Exposure Draft of the Proposed Modification of FASB Interpretation No. 46, *Consolidation of Variable Interest Entities*, and redeliberated certain proposed modifications. The Board decided the final Interpretation would:

1. Provide that an enterprise need not apply Interpretation 46 to an entity that is a business as to be defined in the final Interpretation, unless one of more of the following conditions exist, (Other generally accepted accounting principles would apply to such entities):
 - a. The reporting enterprise and its related parties* were involved in the formation of the entity. However, this condition would not apply if the entity is an operating joint venture under joint control of the reporting enterprise and one or more independent parties.
 - b. Substantially all of the activities of the entity involve or are conducted on behalf of the reporting enterprise or its related parties.
 - c. The reporting enterprise and its related parties provide more than half of the equity, subordinated debt or other forms of subordinated financial support to the entity.
 - d. The activities of the entity primarily relate to securitizations, leasing arrangements, or other forms of asset-backed financing.

*The term related parties as used in this list of conditions refers to all parties identified in paragraph 16, except de facto agents under item 16 (d)(i).
2. Remove the decision maker and guarantor bias in the calculation of an entity's expected residual returns. Paragraph 8 of Interpretation 46 will be modified to indicate that the expected variability in fees paid to a decision maker and the expected variability in fees paid to providers of guarantees of the values of all or substantially all of the entity's assets

shall not be included in a variable interest entity's expected losses and expected residual returns (that is, those fees shall be variable interests), unless such fees meet the criteria in FSP FIN 46-7. A footnote will be added to paragraph 8 that will refer to Appendix B, as amended, for discussion of other types of fees that may be considered variable interests.

3. Extend the proposed exception to the application of Interpretation 46 to all entities created on or before December 31, 2003, for which an enterprise is unable to obtain the information necessary to apply that Interpretation after making an exhaustive effort. No examples or further explanation of the term *exhaustive* will be provided.
4. Not include the proposed scope exception for mutual funds in the form of trusts, trusts of a bank's trust department, and similar arrangements that are organized and operated in a manner consistent with customary existing practices. That exception is no longer necessary due to the modification to the treatment of a decision maker's fees in paragraph 8.
5. Retain and strengthen the emphasis on qualitative analysis of expected losses in determining whether an entity has sufficient equity.
6. Amend paragraph 8 to clarify that a variable interest entity's expected losses shall include the expected negative variability in the fair value of its net assets that are not variable interests and that a variable interest entity's expected residual returns shall include the expected positive variability in the fair value of its net assets that are not variable interests. For this purpose, variability in fair value of net assets includes variability resulting from the entity's operating results.
7. Provide a list of events that would require an enterprise to reconsider whether an entity with which it is involved is a variable interest entity instead of stating a general principle with examples. The list of

examples in the proposed Interpretation will be the only events that would require reconsideration.

8. Provide a list of events that require reconsideration of whether an enterprise is the primary beneficiary of a variable interest entity instead of stating a general principle with examples. In addition to requiring reconsideration on the occurrence of the events listed in the proposed Interpretation as examples, the final Interpretation will (a) require the primary beneficiary to reconsider when the entity issues new interests to parties other than the existing primary beneficiary or its related parties and (b) require parties other than the primary beneficiary to reconsider when they acquire additional interests in the entity from any source. The Board discussed whether troubled debt restructurings should be accounted for in accordance with FASB Statement 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings*, as amended, and not be considered reconsideration events. The Board plans to continue to discuss this matter on December 17, 2003.
9. Clarify that the right of prior approval in paragraph 16(d) creates a de facto agency relationship only if the right could constrain the party's ability to manage the economic risks or realize the economic rewards from its interests in a variable interest entity through sale, transfer, or encumbrance of those interests.
10. Modify paragraph 17 to indicate that the determination of which party in a related party group is the primary beneficiary requires judgment as to which party is most closely associated with the entity, which shall be based on an analysis of all relevant facts and circumstances. Factors that should be considered in making this determination would include:
 - a) Principal/agency relationships within the related party group
 - b) The relationship and relative significance of the activities of the variable interest entity to each of the parties within the related party group

- c) Each party's exposure to the expected losses of the variable interest entity
- d) The design of the variable interest entity.

11. Prohibit an enterprise from reinstating goodwill for variable interest entities to which Interpretation 46 has been applied before the effective date of the modification that provides for the recognition of goodwill when an enterprise becomes the primary beneficiary of a business.

12. Replace the guidance on the application of Interpretation 46 provided in Appendix B. Drafting of this replacement is in process.

13. Incorporate the guidance from the following FASB Staff Positions (FSPs) in the Interpretation to modify Interpretation 46:

- a. FSP FIN 46-1 "Applicability of FASB Interpretation No. 46, *Consolidation of Variable Interest Entities*, to Entities Subject to the AICPA Audit and Accounting Guide, Health Care Organizations".
- b. FSP FIN 46-3 "Application of Paragraph 5 of FASB Interpretation No. 46, *Consolidation of Variable Interest Entities*, When Variable interests in Specified Assets of a Variable Interest Entity Are Not Considered Interests in the Entity under Paragraph 12 of Interpretation 46".
- c. FSP FIN 46-4 "Transition Requirements for Initial Application of FASB Interpretation No. 46, *Consolidation of Variable Interest Entities*".
- d. FSP FIN 46-6 "Effective Date of FASB Interpretation No. 46, *Consolidation of Variable Interest Entities*".
- e. FSP FIN 46-7 "Exclusion of Certain Decision Maker Fees from Paragraph 8(c) of FASB Interpretation No. 46, *Consolidation of Variable Interest Entities*".

The proposed FSP FIN 46-d, "Treatment of Fees Paid to Decision Makers and Guarantors as Described in Paragraph 8 in Determining Expected Losses and Expected Residual Returns of a Variable Interest Entity under FASB Interpretation No. 46, *Consolidation of Variable Interest Entities*" will not be finalized as the key concepts discussed in this proposed FSP relating to the treatment of fees pursuant to paragraph 8(c) would not be applicable upon the modification to paragraph 8 previously described.

The Board deferred until December 17, 2003, its discussion related to a possible scope exception for entities created for the issuance of debt by governments, the effective date of the final Interpretation, and the discussion on whether to reexpose that Interpretation.