

MINUTES



Financial Accounting
Standards Board

To: Board Members
From: Statement 140 and Interpretation 46(R)
Teams (Sperry, ext. 445)
Subject: Minutes of the July 30, 2008 Board
Meeting: Statement 140 and
Interpretation 46(R)—Effective Date
and Transition (Including Disclosures) **Date:** August 20, 2008
cc: FASB: Golden, Bielstein, Lott, Donoghue, Lusniak, Mayer, Yust, Sperry,
Barker, Roberge, Hood, Chookaszian, Posta, Gabriele, Sutay, Glotzer, Allen,
Klimek, C. Smith, Mechanick, Nickell, Reager, Mathys, Cropsey, Proestakes,
Wilkins, Stoklosa, FASB Intranet; IASB: Leisenring, Kusi-Yeboah, Teixeira

The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Statement, Interpretation, or FASB Staff Position.

Topic: Statement 140 and Interpretation 46(R)—Effective Date and Transition (including disclosures)

Basis for Discussion: Board Memorandum No. 95 and Appendices

Length of Discussion: 9:00 a.m. to 10:15 a.m.

Attendance:

Board members present: (by phone) Batavick, Herz, Linsmeier, Seidman, and L. Smith

Board members absent: None

Staff in charge of topic: Donoghue, Mayer, and Roberge

Other staff at Board table: FASB: Golden, Reager, C. Smith, Sperry, and Yust

Summary of Decisions Reached

At the July 30, 2008 meeting, the Board discussed the transition and effective date for the proposed Statements to amend FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, and FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*. The Board unanimously decided to change its tentative decisions reached at the June 11, 2008 Board meeting regarding transition and effective date to a single effective date for fiscal years beginning after November 15, 2009. However, the Board also decided to separately issue a FASB Staff Position (FSP) that would require additional disclosures as soon as possible (see below).

The Board clarified that the initial consolidation of a variable interest entity as a result of the initial application of the proposed Statement to amend Interpretation 46(R) would require an enterprise to initially measure all assets and liabilities at fair value, with any difference being recorded as a cumulative effect adjustment to retained earnings that would be recorded as of the beginning of the first fiscal year in which the proposed Statements would be initially applied.

The Board decided that many of the disclosures approved for the proposed Statements to amend Statement 140 and Interpretation 46(R) at the June 4, 2008 Board meeting will be included in a separate FSP. In addition, the Board decided that the proposed FSP would require a nontransferor enterprise that holds a significant variable interest in a qualifying special-purpose entity to make certain disclosures required by the proposed Statement to amend the Interpretation 46(R) disclosures. The Board decided that the proposed FSP would be effective as soon as possible, but no later than the first interim reporting period in 2009. The Board also decided that the proposed FSP would only be applicable to public companies and that the exposure period for the proposed FSP would be 30 days. The purpose of a disclosure-only FSP is to meet financial statement user needs for greater transparency for off-balance sheet transactions as well as to permit preparers and others with adequate time to consider and implement the other proposed amendments to Statement 140 and Interpretation 46(R).

The Board directed the staff to proceed with drafting the proposed FSP for vote by written ballot.

Objectives of Meeting:

The objectives of the meeting were to ask the Board whether it wanted to reconsider its tentative decision reached at the June 11, 2008 Board meeting regarding the effective date and transition for the proposed Statements to amend Statement 140 and Interpretation 46(R), whether the proposed amendments to the disclosures that were tentatively approved at the June 4, 2008 Board meeting should be required at a date earlier than the other proposed amendments to Statement 140 and Interpretation 46(R), and whether any changes need to be made to those disclosures. The objectives of the meeting were met.

Matters Discussed and Decisions Reached:

Issue 1: Reconsideration of Effective Date

1. Mr. Mayer stated that since the Board's tentative decision at the June 11, 2008 Board meeting, various constituents have expressed concern with the tentative decisions reached regarding the effective date and transition for the proposed Statements to amend Statement 140 and Interpretation 46(R). The staff stated that most constituents told the Board and staff that they believe the dual effective date adds complexity and does not allow sufficient time for implementation.
2. Mr. Mayer stated that the staff has been communicating with the federal banking regulators and the Office of Federal Housing Enterprise Oversight to keep them informed of the proposed amendments. He noted that the staff is concerned about whether the tentative effective dates will provide regulators with adequate time to consider the impact of the amendments on capital requirements and to develop and implement any necessary changes to the regulatory capital requirements.
3. Ms. Smith noted that the staff spoke with a significant number of buy-side and sell-side analysts as well as other financial intermediaries who invest in money center

banks and specialty finance companies. The staff noted that all of the analysts appeared well informed of the Board's decisions to date and were generally supportive of the proposals. The staff reported that almost all of the analysts preferred a single effective date effective of 2010 with enhanced disclosures in the interim time period—recognizing that the enhanced disclosures would still rely on a current, deficient model. However, users noted that they hope that the interim disclosures would not lessen the Board's commitment to making the full proposals effective in 2010.

4. Ms. Smith also noted that users emphasized the crucial importance of completing the implementation in 2010 and cited the need for sufficient time to adjust to the proposed change for preparers, regulators, and users themselves, given the current state of the market. She also noted that users do not believe that an effective date at the beginning of 2009 would be workable, even for new transactions. She stated that analysts felt that they could work through the inherent complexities of the dual effective dates currently proposed by the Board; however, the potential market disruption could be meaningful.
5. Ms. Smith stated that a few users did feel that a 2009 effective date would provide sufficient time for implementation, particularly for new transactions. She reported that the largest concern of those users is that changing the implementation date allows a wholly deficient model to continue, perhaps indefinitely.
6. The staff presented two alternatives for the Board's consideration:
 - a. Alternative A—This alternative is similar to the Board's tentative decision reached at the June 11, 2008 Board meeting; however, in addition to existing qualifying special-purpose entities, the effective date for when an enterprise must apply the proposed amendments to Interpretation 46(R) to all existing variable interest entities would be 2010. Accordingly, this alternative would provide different effective dates based on when the transfer was completed or when the variable interest entity was created.
 - b. Alternative B—This alternative proposes a single effective date for the proposed Statements to amend Statement 140 and Interpretation 46(R) for fiscal years beginning after November 15, 2009 (January 1, 2010, for a calendar year-end entity).

7. Mr. Mayer stated that under either Alternative A or Alternative B, the proposed amendments to Statement 140 would be applied prospectively, except that Alternative B would require that all existing qualifying special-purpose entities be evaluated for consolidation on the proposed effective date. He also stated that the proposed amendments to Interpretation 46(R) would require that they be applied to all entities that are variable interest entities, including those in which Interpretation 46(R) was previously applied.
8. **Staff Recommendation:** The staff recommended Alternative B. The staff acknowledged the concerns that Alternative B would allow qualifying special-purpose entities to be created in 2009. However, the staff noted that once the final amendments are issued, an entity would likely need to disclose any transactions completed in 2009 that utilized a qualifying special-purpose entity to achieve derecognition and that each qualifying special-purpose entity would then need to be evaluated for consolidation on the effective date of the final Statements to amend Statement 140 and Interpretation 46(R). The staff recommended that an overall disclosure objective should be provided in both of the proposed Statements to amend Statement 140 and Interpretation 46(R).
9. **Board Vote:** The Board decided to unanimously support the staff's recommendation for Alternative B.
10. **Board Comments:** Mr. Herz stated that he and a number of Board members have spoken with constituents, including investors, financial institution regulators, parties on Capitol Hill, and preparers.
11. Mr. Smith noted that he originally felt that the Board should adopt Alternative A because qualifying special-purpose entities have been broken for some time and that the Board should fix the problem as soon as possible. He then stated that in light of the time that has passed, and the amount of time that will pass in the remaining due process he now agrees with Alternative B, because of the relatively short time that would be available for implementation. Mr. Smith stated that his major concern was to allow adequate time for regulators to consider the implications of the

changes that may be made to the proposed amendments in the course of due process. He also stated that his support for Alternative B was tied to the Board's subsequent approval of accelerated proposed amendments to the disclosures (see paragraphs 24–36).

12. Ms. Seidman stated that she supported Alternative B at the prior meeting and continued to support Alternative B at this time for the reasons stated at that time, supplemented further by the user feedback provided by Ms. Smith.
13. Mr. Linsmeier accepted the staff recommendation to ensure sufficient time for (a) redeliberations, (b) preparation of the Exposure Draft, (c) the comment period, (d) the issuance of a final standard, and (e) implementation. He stated that he is changing his vote to Alternative B only as a result of the current timeline and that he continues to hold the view that the Board needs to issue a new standard that can be implemented as soon as possible, with the understanding that the Board will help the markets with new disclosure requirements effective for fiscal years beginning after November 15, 2008.
14. Mr. Batavick also agreed with the staff recommendation of Alternative B. He stated further that he felt that the single effective date would reduce complexity, improve comparability, and provide adequate time for the preparers, users, regulators, auditors, etc., to understand and apply the proposed amendments. Mr. Batavick agreed with Mr. Linsmeier that a practical consideration of the timeline and the importance of the Board's due process makes Alternative B the preferred alternative. He also agreed with the other Board members that tantamount to agreeing to the single effective date is a corresponding agreement by the Board for the proposed amendments to the disclosures that would be effective in 2009.
15. Mr. Herz stated his agreement with Mr. Smith, in particular, that he did not object in light of the user feedback presented by Ms. Smith. Mr. Herz further stated that he was chagrined by the Board's recent discoveries that, with the benefit of hindsight, the reporting by a number of preparers, specifically large financial

institutions, did not live up to the needs of the investment community and the public in general.

16. Mr. Herz continued by stating that when there exists evidence of poor reporting it becomes useful to ask to what extent the poor reporting is based on a lack of standards, a lack of faithful application, or lack of proper enforcement. He concluded that in this instance it is a combination of all of the above. Mr. Herz acknowledged that while certain aspects of Statement 140 and Interpretation 46(R) may be improved, it is clear that the notion of a qualifying special-purpose entity was stretched beyond recognition in a number of instances.
17. Mr. Herz then stated his hope that other agencies that are responsible for proper application of the rules would create some boundaries that permit consistent application of a standard. Mr. Herz noted the problems with applying some of the conditions for meeting the definition of a qualifying special-purpose entity, including the requirement that activities are significantly limited and entirely specified. Mr. Herz noted that some preparers act as though certain transactions comply with those conditions even though the transactions must clearly be actively managed. He stated that with the benefit of hindsight, these transactions were, and had to be, actively managed as problems occurred with the underlying collateral.
18. Mr. Herz stated that until some of the problems came to light, the disclosures that were required on maximum exposures, nontraditional loans, and concentrations of risks were not appropriately made. He noted that some preparers told him that this was because the risks were viewed as remote or immaterial; however, with the benefit of hindsight these risks were neither remote nor immaterial. Mr. Herz stated that his sincere hope is that with this project the Board can move forward with something that is better for investors and the capital markets.
19. Mr. Linsmeier agreed with Mr. Herz's disappointment in the change to the proposed effective date. He asserted that he believes that markets need to receive better accounting, reporting, and disclosure information as soon as possible and

would not be sympathetic to comment letters suggesting deferral of the Board's proposed Statements to amend Statement 140 and Interpretation 46(R).

20. Mr. Herz stated that the IASB also is deliberating on this topic, specifically the consolidation issue. He noted that the staff of the FASB was in contact with and working with the IASB to develop a common principle.

Issue 2: Clarification of Measurement Requirements of Initial Application of the Amendments to Interpretation 46(R)

21. **Staff Recommendation:** Mr. Mayer recommended that the Board clarify that the initial consolidation of a variable interest entity as a result of the initial application of the proposed Statement to amend Interpretation 46(R) would require the enterprise to initially measure all assets and liabilities at fair value, with any difference being recorded as a cumulative effect adjustment in retained earnings that would be recorded as of the beginning of the first fiscal year in which the proposed Statements would be initially applied.

22. **Board Vote:** The Board unanimously decided to accept the staff's recommendation.

23. **Board Comments:** None.

Issue 3: Proposed Amendments to the Statement 140 and Interpretation 46(R) Disclosure Requirements

24. Mr. Mayer stated that financial statement users have told the FASB that the enhanced disclosures are an integral part of the project to amend Statement 140 and Interpretation 46(R) and should be effective as soon as possible.

25. **Staff Recommendation:** The staff recommended that the Board require disclosures similar to those approved at the June 4, 2008 Board meeting that would be effective for a public entity in fiscal years beginning after November 15, 2008, and interim periods within those fiscal years, with earlier application encouraged.

The staff also recommended that the proposed amendments to the Statement 140 and Interpretation 46(R) disclosures be included in a separate FSP.

26. **Board Vote:** The Board decided unanimously to accept the staff's recommendation to include the proposed amendments in a separate FSP. The Board also voted to indicate its intent to have the proposed FSP effective as soon as possible and to request respondents to identify what information they will need to gather to comply with the proposed FSP, how long it would take them to comply, and when they believe would be a feasible effective date.
27. **Board Comments:** Mr. Herz asked whether the staff considered an earlier implementation. Mr. Mayer responded that the staff considered the timeline to complete the project and the time preparers will need to compile the information in determining its recommendation.
28. Mr. Herz indicated that the recommended timeline would not meet the goal for requiring enhanced disclosures as soon as possible, although he would not object to the staff's recommendation if that was determined to be the soonest feasible. Mr. Golden stated that as soon as possible would likely be an effective date at the end of the quarter in which the proposed Statements are issued and that a final FSP would likely be issued some time in November 2008.
29. Ms. Seidman stated that she did not think it would be feasible for companies with quarters ending in November to comply with the proposed FSP within that time frame. She further noted that the application of the disclosure requirements for sponsors could require more time than would be provided. Mr. Smith indicated his concern as to whether nontransferors would be able to comply with the short time period.
30. The Board discussed possible ways to solicit feedback regarding the feasibility of an accelerated effective date, including presenting two possible effective dates and soliciting comments during the exposure period. Mr. Golden recommended that the Board indicate its desire to make the proposed FSP effective as soon as possible and

to request respondents to identify what information they will need to gather to comply with the proposed FSP, how long it would take them to comply, and when they believe would be a feasible effective date. The Board agreed.

31. Mr. Linsmeier discussed three items from the proposed amendments to the disclosures in the proposed FSP and proposed Statements. First, for the requirement that non-transferors discuss the terms of an arrangement to provide financial support, he suggested adding language requiring the disclosure for both explicit and implicit arrangements of financial support.
32. Second, Mr. Linsmeier recommended that while drafting the linked presentation disclosures, the staff should require disclosure of specific assets that are required to pay specific liabilities and consider information that regulators will need to know when considering changes to regulatory capital requirements. He explained further that the information should be disaggregated by the nature of the continuing involvement, risks, etc. Mr. Herz agreed with the objective of the comment.
33. Ms. Seidman stated that there should be a clear distinction within the linked presentation disclosure between assets that are required to pass through to liabilities in the normal course of business and assets that are required to pay liabilities in the event of default. Mr. Linsmeier and Mr. Mayer suggested a requirement to disclose specifics regarding the relationship between the assets and liabilities.
34. Third, Mr. Linsmeier discussed specific disclosure requirements regarding Interpretation 46(R). He questioned why some disclosures are required in the proposed amendments to Interpretation 46(R), but are not included in the proposed FSP, including significant risks of a variable interest entity and liquidity guarantees. Mr. Roberge responded that it would take a significant amount of time to gather the information necessary for preparing the disclosures for any variable interest holder other than the primary beneficiary, because entities are not likely to have identified the necessary information at the inception of an arrangement involving a variable interest entity.

35. Mr. Smith asked whether the requirement to disclose terms of the arrangements that would require additional financial support would encompass the disclosure of significant risks. Mr. Roberge responded that *that* would depend on the specific arrangement, apply to fewer entities, and that many interest holders would not have considered this since the inception of the variable interest entity and therefore the requirement may not be feasible.
36. Mr. Linsmeier stated that his approval of the proposed FSP was subject to the improvements in the disaggregation of disclosure discussed in paragraphs 31–34.

Issue 4: Required Disclosures for a Nontransferor Enterprise That Holds a Significant Variable Interest in a Qualifying Special-Purpose Entity

37. **Staff Recommendation:** The staff recommended that a nontransferor enterprise that holds a significant variable interest in a qualifying special-purpose entity should be required to make certain disclosures (as provided in the Board meeting handout) until the proposed Statements to amend Statement 140 and Interpretation 46(R) are effective. The staff reasoned that a nontransferor enterprise that holds a significant variable interest in a qualifying special-purpose entity would be subject to the disclosure requirements in Interpretation 46(R) when the scope exception in paragraph 4(d) of that Interpretation is deleted as proposed, if the enterprise concludes it is the primary beneficiary, a significant variable interest holder, or the sponsor of a variable interest entity.
38. **Board Vote:** The Board unanimously decided to accept the staff's recommendation.
39. **Board Comments:** None.

Issue 5: Scope and Comment Period of Proposed FSP to Statement 140 and Interpretation 46(R)

40. **Staff Recommendation:** The staff recommended that the proposed amendments to the Statement 140 and Interpretation 46(R) disclosures and the staff's proposed

disclosures for a nontransferor enterprise that holds a significant variable interest in a qualifying special-purpose entity should be included in a separate proposed FSP that is only applicable to public companies that has a 30-day comment period.

41. **Board Vote:** The Board unanimously decided to accept the staff's recommendation.
42. **Board Comments:** None.

Issue 6: Board Direction to Draft the Proposed FSP for Written Ballot

43. Mr. Mayer stated that the purpose of a disclosure-only FSP is to expeditiously meet financial statement user needs for greater transparency for off-balance sheet transactions and to allow preparers with time to implement the disclosures.
44. **Staff Recommendation:** Mr. Mayer recommended that the Board direct the staff to proceed with drafting the proposed FSP that details the proposed amendments to the disclosures for vote by written ballot.
45. **Board Vote:** The Board unanimously decided to accept the staff's recommendation.
46. **Board Comments:** None.

Follow-up Items:

47. Mr. Linsmeier's comments above regarding the classification and disclosure of linked presentation of assets and liabilities led to the following Board discussion:
48. Mr. Herz recommended separate balance-sheet presentation for assets and liabilities of consolidated variable interest entities and said that he would not object, nor would he require, separate presentation on the income statement presentation. Ms. Seidman agreed with the recommendation and Mr. Linsmeier stated that he would want the same information as a required disclosure for the proposed FSP.

49. Ms. Donoghue requested that the Board clarify the scope of this change, specifically whether this would apply only to special-purpose entities or variable interest entities. Mr. Smith said that he felt that the classification requirement also would be applicable to covered bonds and other transactions that may not involve transfers or variable interest entities.
50. Mr. Linsmeier stated that unsolicited comment letters have been received suggesting that the Board reconsider linked presentation. He stated further that linked presentation was considered by the Board and not used by the Board for financial statement presentation for many reasons. He noted that among these reasons were (a) problems with scope of what may be linked on the face of the financial statements, for example, specific inventory required for a performance obligation and (b) whether linked presentation would be appropriate for voting interest entities as well as variable interest entities. He expressed his belief that the consideration of linked presentation should be considered as part of a broader discussion than that of this isolated circumstance. He also stated his desire that this be discussed in the basis for conclusions in the proposed Statements to amend Statement 140 and Interpretation 46(R).
51. Mr. Golden clarified that since the Board is asking that the linked presentation classification requirement be irrespective of a transfer or consolidation of a variable interest entity that, the guidance may be best addressed in a new standard outside of this project.
52. Mr. Herz stated that the Notice to Recipients for the proposed Statement to amend Interpretation 46(R) should include a question as to whether a two-step approach is needed to receive additional input. Ms. Seidman recommended obtaining a very clear understanding of the IASB's relevant deliberations regarding a possible two-step approach. Mr. Linsmeier suggested including a question as to whether any companies anticipate needing to use the second step of the two-step approach. Mr. Herz expressed a concern that the second step may become a crutch.

53. Ms. Seidman commented on input received expressing concerns regarding the timing of the project and stated her view that she feels the deferral of effective dates for the proposed Statements to amend Statement 140 and Interpretation 46(R) as decided by the Board were appropriate to address these concerns. Ms. Seidman also noted the comments that any change to the accounting guidance should be made within the context of international convergence and that the Board would have preferred to address these topics through convergence. However, both the Board and the IASB have received mandates to address these topics, both Boards are presently deliberating proposed amendments. The proposed amendments by both Boards are intended to be more similar.

General Announcements:

None.