

MINUTES



To: Board Members

From: Miller (ext. 276)

Subject: Minutes of the August 13, 2003 Board Meeting **Date:** August 13, 2003

cc: Bielstein, Smith, Petrone, Lott, Leisenring, Project Team, Thompson, Sutay, Gabriele, Swift, Polley, FASB Intranet

Topic: FASB Interpretation No. 46,
Consolidation of Variable Interest Entities—Technical corrections and implementation issues

Basis for Discussion: Board memorandum dated July 30, 2003 and August 6, 2003

Length of Discussion: 11:30 a.m. to 12:00 p.m.

Attendance:

Board members present: Herz, Schipper, Crooch, Trott, Schieneman, Seidman, and Batavick

Board members absent: None

Staff in charge of topic: McIntosh

Other staff at Board table: Smith, Lott, McBride, and Miller

Outside participants: None

Summary for ACTION ALERT:

The Board added a limited scope project to its agenda to modify FASB Interpretation No. 46, *Consolidation of Variable Interest Entities*, to address the following issues:

1. Whether the term *investor* in part (i) of the last sentence of paragraph 5 should include the investor's related parties as indicated in footnote 6
2. Whether to change the second reference to paragraph 5 in paragraph 11 (regarding development stage enterprises) to paragraph 5(a) to clarify that paragraph 11 does not exempt development stage companies from the requirements of paragraph 5(b).
3. Whether events other than those listed in paragraph 15 should require an enterprise to reconsider whether it is the primary beneficiary of a variable interest entity
4. Whether a decision maker's fee should be considered part of the expected returns of a variable interest entity under paragraph 8(c) if the decision maker has (a) no exposure to the expected losses of the entity (its fee does not provide subordinated financial support), (b) no right to expected residual returns except a fee that has no expected variability, and (c) no other interest in the entity.

The Board directed the staff to prepare FASB Staff Positions to delay the effective date of Interpretation 46 for the following parties:

1. Non-registered investment companies that are currently accounting for their investments in accordance with the specialized accounting guidance in the AICPA Audit and Accounting Guide, *Audits of Investment Companies* (the Audit Guide). The deferral would not extend to investments made after March 27, 2002 that are held by an investment company that is not a separate legal entity. The Board decided to delay the effective date for these parties while the AICPA finalizes its Statement of Position (SOP) on the clarification of the scope of the Audit and Accounting Guide, *Audits of Investment Companies* and accounting by the parent companies and equity method investors for investments in investment companies. When the AICPA issues the final SOP, the Board will consider modifying paragraph 4(e) of Interpretation 46 to provide an exception for companies that apply the Audit Guide as revised by the SOP.
2. A decision maker that (a) receives fees paid by a variable interest entity that provide the decision maker with no exposure to expected losses (the fees do not provide subordinated financial support for the entity) and no rights to receive expected residual returns other than expected residual returns provided by paragraph 8(c), and (b) has no other interests in the variable interest entity. The Board decided to delay the effective date for those parties

to allow time to consider a modification of Interpretation 46 that may affect those parties. (Refer to issue 4 above).

The Board decided not to delay the effective date for any other entities.

The staff announced that draft FASB Staff Positions are being prepared to provide additional guidance on the following provisions of Interpretation 46:

1. The computation of expected losses and expected residual returns, including:
 - The amounts of the fees required to be included by paragraphs 8(c) and 8(d)
 - The effects of those fees on expected losses
 - Whether other parties' rights to remove the decision maker is a factor to consider
 - Clarification that the expected variability in paragraph 8(a) is based on estimates of an entity's net income or loss before the effects of variable interests.
2. The determination of which party absorbs a majority of expected losses and expected residual returns.

One Board member stated that financial statements issued prior to the finalization of the FASB Staff Positions should be based on the preparers' and auditors' current understanding of how to apply the Interpretation. The staff said that transition guidance will be included in the FASB Staff Positions for those situations where the finalized FASB Staff Position is different from the approach used in issued financial statements.

Matters Discussed and Decisions Reached:

The Board considered whether and how to address several issues related to FASB Interpretation No. 46, *Consolidation of Variable Interest Entities*. The Board unanimously agreed to add a limited-scope project to its agenda to:

1. Consider modifying Interpretation 4 to address whether a decision maker's fees should be considered part of the expected returns of a variable interest entity under paragraph 8(c) if the decision maker has no exposure to the expected losses of the entity and no right to expected residual returns except a fee that has no expected variability. The Board directed the staff to prepare a FASB Staff Position to delay the effective date of the Interpretation for decision makers that might be affected by this modification.

2. Consider modifying Interpretation 46 to clarify whether the term *investor* in part (i) of the last sentence of paragraph 5 should include the investor's related parties as indicated in footnote 6.
3. Direct the staff to prepare a FASB Staff Position to delay the effective date of Interpretation 46 for non-registered investment companies that are currently accounting for their investments in accordance with the specialized accounting guidance in the AICPA Audit and Accounting Guide, *Audits of Investment Companies*. The deferral would not extend to investments made after March 27, 2002 that are held by an investment company that is not a separate legal entity.
4. Consider modifying Interpretation 46 to clarify that paragraph 11 does not exempt development stage companies from the requirements of paragraph 5(b).
5. Consider modifying Interpretation 46 to address whether events other than those listed in paragraph 15 should require an enterprise to reconsider whether it is the primary beneficiary of a variable interest entity.

Ms. Seidman stated that in her view, some of the clarifications reflect amendments of Interpretation 46. Because the expected loss/residual return test is the gateway to determining (a) whether an entity is a VIE and (b) whether the reporting entity is the primary beneficiary, Ms. Seidman believes that it would be preferable to make the clarifications before most entities have applied Interpretation 46 to their existing special purpose entities. In addition, several organizations have indicated that they need more time to implement Interpretation 46 in an orderly manner. Ms. Seidman stated that her preference would be to delay the effective date of Interpretation 46 for all entities until any clarifying guidance is issued, so that we have the smoothest transition possible.

The majority of the Board voted not to delay the effective date of Interpretation 46 for any entities other than those decision makers and private investment companies for which the Board has directed the staff to prepare FASB Staff Positions on deferral. Ms. Seidman voted to delay the effective date for all entities.

Follow-up Items:

None.

General Announcements:

The staff announced that draft FASB Staff Positions are being prepared to provide additional guidance on the following provisions of Interpretation 46:

1. The computation of expected losses and expected residual returns, including:
 - The amounts of the fees required to be included by paragraphs 8(c) and 8(d)
 - The effects of those fees on expected losses
 - Whether other parties' rights to remove the decision maker is a factor to consider
 - Clarification that the expected variability in paragraph 8(a) is based on estimates of an entity's net income or loss before the effects of variable interests.

2. The determination of which party absorbs a majority of expected losses and expected residual returns.