MINUTES

Financial Accounting Standards Board

To:	Board Members
From:	Consolidations Team
Subject:	Minutes of the November 6, 2002 Board Meeting — **Date:** November 15, 2002
Time Code	A: CON-P
Cc:	Bielstein, Smith, Petrone, Leisenring, Consolidations Team, Swift, Polley, Gabriele, Sutay, Thompson, Mahoney, Cassel, Martin, Wilkins, FASB Intranet

Topic:	Transferors Retained Interests, Market-based Fees, Related Parties, Not-for-profit Organizations, Disclosures, and Effective Date
Basis for Discussion:	Staff Memorandums dated October 4, 2002
Length of Discussion:	Starting Time: 8:30 a.m.
	Concluding Time: 12:00 p.m.
Attendance:	
Board members present:	Herz, Crooch, Schipper, Trott, Wulff, Schieneman, and Foster
Board members absent:	None
Staff in charge of topics:	Lott, Coburn, and Richards
Other staff at Board table:	Smith
Outside participants:	Leisenring (IASB)

MATTERS DISCUSSED, DECISIONS REACHED, AND FOLLOW-UP ACTION

The Board discussed the following issues related to the proposed Interpretation, *Consolidation of Certain Special-Purpose Entities*:

1. Transferors' retained interests in transferred assets
2. Market-based fees
3. Related parties
4. Not-for-profit organizations

5. Privately held businesses

6. Disclosures

7. Effective date.

The Board reached the following decisions:

1. The Board decided that transferors' retained interests should be considered variable interests in transferee entities even if the retained interests only relate to specific assets in those entities. In doing so, the Board reversed a previous decision at its October 30, 2002 Board meeting. The Board confirmed that transferors' retained interests would be considered variable interests only in entities that actually hold the transferred assets. A transferor does not have a variable interest in an entity that holds beneficial interests in the transferred assets. For example, a transferor to a qualifying special-purpose entity (qualifying SPE) does not have a variable interest in a conduit entity that holds beneficial interests issued by the qualifying SPE. The Board will consider some additional information to be provided by the staff at the next meeting.

2. The Board decided that when an enterprise evaluates entities subject to consolidation based on variable interests (variable interest entities), that enterprise should first determine if any party is a decision maker. A decision maker is any party that has the authority to purchase or sell assets or makes other operating decisions that significantly affect the revenues, expenses, gains, and losses of the variable interest entity. If there is a decision maker that either holds variable interests in the variable interest entity that would absorb a majority of the expected losses or holds variable interest that allows the decision maker to obtain a majority of the residual benefits from the variable interest entity's operations, the decision maker is the primary beneficiary. If there is no decision maker, parties to variable interest entities should determine whether their variable interests will absorb a majority of the expected losses if they occur and whether they are entitled to a majority of the residual benefit, if any.

3. The Board decided to revise the market-based fee provisions in paragraph 19 of the proposed Interpretation by (1) noting that a fee that is market based at inception and becomes non-market based because of market changes should not result in consolidation, (2) eliminating the presumption that a fee from a variable interest entity is not market based, (3) indicating that the ability to replace a service provider without cause suggests that a fee is market based, and (4) replacing references to "market-based fees" with "fees commensurate with the services provided."

4. The Board decided to emphasize the identification of an agency relationship in related party provisions rather than focus on the significance of the services provided or other factors. The Board also decided that an enterprise with a variable interest in a variable interest entity should include variable interests held by the enterprise's employees and board members as its own interests for purposes of determining whether or not it is the primary beneficiary. The Board confirmed that in situations where a group of related parties is deemed to be the primary beneficiary of a variable interest entity, only one party should consolidate that entity, and the parties should apply the tiebreaker provisions of the proposed Interpretation to decide which party should consolidate. In a related decision, the Board decided to eliminate subparagraphs (a) and (d) of that paragraph, which stated that only substantive operating enterprises and parties with the largest variable interests could be primary beneficiaries.

5. The Board decided that not-for-profit organizations should be excluded from the scope of the final Interpretation. A not-for-profit organization should not consolidate or be consolidated by another enterprise as a result of applying the Interpretation. However, the Board noted that not-for-profit organizations would still be subject to the related-party provisions of that Interpretation.

6. The Board decided not to exclude private businesses from the scope of the final Interpretation. The Interpretation will require that if an enterprise in a group of commonly controlled enterprises consolidates another member of

the group, the consolidating enterprise should follow the requirements in paragraphs 11 and D12 of FASB Statement No. 141, *Business Combinations*, and initially measure the consolidated assets and liabilities at their carrying amounts.

7. The Board decided to expand paragraph 24 of the proposed Interpretation to require the primary beneficiary to disclose the nature, purpose, size, activities, and potential risks of the consolidated variable interest entity. If the variable interest entity received a transfer of financial assets that qualified for sale treatment under FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, the primary beneficiary should include the relevant Statement 140 disclosures in the same note to its financial statements that describes the entity.

8. The Board decided that an enterprise that holds variable interests in a variable interest entity that absorbs a significant amount of expected losses, but that is not the primary beneficiary, should disclose the nature, purpose, size, and activities of the variable interest entity as well as its maximum exposure to losses from the entity.

9. The Board decided that the final Interpretation would be effective immediately for variable interest entities created after the issuance date, and that the interpretation would be effective for existing entities (those created before the issuance date and still outstanding as of the effective date) for fiscal periods beginning after June 15, 2003. The Board also decided that, upon issuance of the final Interpretation, an enterprise should evaluate whether it is reasonably possible that at the effective date it will be required to either consolidate or make disclosure about its involvement with a variable interest entity. If so, the enterprise will be required to disclose its involvement with and certain other information about the variable interest entity.

DISCUSSION

Variable Interest Approach

Transferors' Retained Interests in Transferred Assets

The Board reconsidered its decision of October 30, 2002 which stated that retained interests in assets transferred to an entity subject to the proposed Interpretation are not considered variable interests in the entity unless the assets those retained interests relate to constitute all, or substantially all, of the assets of the variable interest entity. As part of that discussion, the Board considered an approach developed by Mr. Trott. According to that approach, when an enterprise evaluates variable interest entities for consolidation, it should first determine if it is a decision maker. A decision maker is defined as any party that has the authority to purchase or sell assets or makes other operating decisions that significantly affect the revenues, expenses, gains, and losses of the variable interest entity. If the enterprise is a decision maker and either holds variable interests that would absorb a majority of the expected losses or variable interests that allow the decision maker to obtain a majority of the expected residual return from the entity's operations, that party is the primary beneficiary. If there is no decision maker that meets those qualifications, all parties involved with a variable interest entity should determine whether they should consolidate the variable interest entity based on their variable interest holdings alone.

The Board decided that transferors' retained interests in assets transferred to an entity under the proposed Interpretation are variable interests in the entity the assets were transferred to, even if the retained interests relate only to specific assets in the entity. This decision was based on concerns that the Board's decision of October 30, 2002, would allow new structures to be set up that would thwart the intent of the variable interest model. The Board also stated that adopting Mr. Trott's approach would address some of the problems that led the Board to its previous decision. Ms. Schipper and Mr. Foster dissented to the decision that transferors' retained interests in assets transferred to an entity under the proposed Interpretation are variable interests in the entity the assets were transferred to, even if the retained interests relate only to specific assets in the entity.

The Board decided to adopt the approach developed by Mr. Trott to identify the primary beneficiary of a variable interest entity. The Board noted that, in instances where a decision maker is evident, the decision maker either acts as a controlling owner of the variable interest entity or works as the agent of the controlling owner. The Board reasoned that the decision maker's ownership of either the variable interests in the entity that absorb the majority of its expected losses or that allow the decision maker to obtain the majority of the residual benefits from the entity's operations demonstrates that the decision maker has a controlling financial interest in the entity and, thus, should consolidate.

Market-Based Fees

The Board discussed the provisions of the proposed Interpretation related to service fees from variable interest entities. The Board decided that a description of fees commensurate with the services provided more clearly articulated the Board's intent than the term "market-based fees." The Board noted that the clarifying language would make the presumption that a fee from a variable interest entity is not commensurate with the value of the services unnecessary. The Board also decided to include provisions in the Interpretation which state that if a fee were commensurate with the value of the service at the time it is negotiated, changes in the market would not cause the fee to be considered a variable interest.

Related Parties

The Board discussed the provisions of the proposed Interpretation relating to variable interests of related parties and decided that the provisions of the Interpretation would be clearer if it emphasized the objective of identifying agency relationships. The Board noted that if a party provides significant services to another entity it would be a strong indicator that the service provider may be acting as an agent of the entity. However, all facts and circumstances should be considered to determine whether an agency relationship exists.

The Board confirmed that in situations where a group of related parties is deemed to be the primary beneficiary of a variable interest entity, the following two criteria should be used to identify the enterprise that should consolidate:

(a) identify the principle in a principal-agent relationship, if one exists

(b) determine which enterprise's activities are the most closely associated with the variable interest entity.

Not-For-Profit Organizations

The Board decided to exclude not-for-profit organizations from the scope of the final Interpretation, except that they would still be subject to the related-party provisions of the Interpretation.

Privately Held Enterprises

The Board confirmed its decision not to exclude private businesses under common control from the scope of the final Interpretation. However, the Board decided that to be consistent with FASB Statement No. 141, *Business Combinations*, enterprises should use the carryover basis to record assets, liabilities, and noncontrolling interests of an entity that previously was under common control but not consolidated whether it is initially consolidated during the transition period or at a later date.

Disclosures

Mr. Schieneman informed the Board of the results of a survey of certain analysts about entities that hold financial assets.

The Board stated that the primary beneficiary should be required to disclose the nature, purpose, size, activities, and potential risk of variable interest entities for which it is the primary beneficiary. The Board also decided that if a variable interest entity received a transfer of financial assets that qualify for sale treatment under FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, the primary beneficiary should include the relevant disclosures required by that statement in the same note to the financial statement that describes the variable interest entity.

The Board stated that a reporting entity that holds variable interests in a variable interest entity that absorbs a significant amount of expected losses, but that is not the primary beneficiary, should disclose the nature, purpose, size, and activities of the variable interest entity as well as its maximum exposure to losses from that entity.

Effective Date

The Board stated variable interest entities created after issuance of the final Interpretation should be subject to its provisions from their inception. The Board also discussed the proposed effective date for entities already in existence at the time the Interpretation is issued. The Board stated that it is important to adopt the provisions of the Interpretation as soon as possible. However, because changes have been made to the variable interest model during the Board's redeliberations, reporting entities may need additional time to study the final Interpretation and apply its provisions. The Board decided to extend the effective date for existing variable interest entities to periods beginning after June 15, 2003, but to require reporting entities to assess the possibility that they will be required to either consolidate or make disclosures about their involvement with any variable interest entities. If either alternative is reasonably possible, the reporting entity should be required to make disclosures about its involvement with the variable interest entity.

Summary For Action Alert

Same as Matters Discussed

General Announcements

None