MINUTES

Financial Accounting Standards Board

To:	Board Members
From:	Consolidations Team
Subject:	Minutes of the October 16, 2002 Board Meeting — **Date:** October 25, 2002
Time Code	A: CON-P
Cc:	Bielstein, Smith, Petrone, Leisenring, Consolidations Team, Swift, Polley, Gabriele, Sutay, Thompson, Mahoney, Cassel, Wilkins, FASB Intranet

Topic:	Scope and Variable Interests
Basis for Discussion:	Staff Memorandums dated October 4, 2002
Length of Discussion:	Starting Time: 9:00 a.m.
	Concluding Time: 12:00 p.m.
Attendance:	
Board members present:	Herz, Crooch, Schipper, Trott, Wulff, Schieneman, and Foster
Board members absent:	Crooch after 11:00 a.m.
Staff in charge of topics:	Coburn and Lott
Other staff at Board table:	Smith and R. Richards
Outside participants:	Leisenring (IASB)

MATTERS DISCUSSED, DECISIONS REACHED, AND FOLLOW-UP ACTION

The Board discussed issues related to the scope of the proposed Interpretation, *Consolidation of Certain Special-Purpose Entities*, and the application of the variable interest approach. The Board reached the following tentative decisions:

1. The Board decided not to define substantive operating enterprises or special-purpose entities (SPEs). Instead, entities engaged in business-related activities would be divided into two categories: (1) entities for which the consolidation decision should be based on voting interests and (2) entities for which the consolidation should be based on variable interests.

2. The Board decided to remove references to subsidiaries of substantive operating enterprises from the scope exception in paragraph 8(c). Thus, a group of assets and liabilities that are held within a separate corporation, partnership, trust, or other structure will be classified into one of the two categories discussed in item 1. Groups of assets and liabilities that are part of a larger entity would not be subject to consolidation unless the entity was consolidated.

3. The Board decided to include scope exceptions for registered investment companies subject to the Investment Company Act of 1940 and for transferors to formerly qualifying SPEs as described in paragraph 25 of FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*.

4. The Board decided that a transferor that retains a subordinated interest in assets transferred to an entity other than a qualifying SPE is considered to be a variable interest holder in that entity.

5. The Board decided that the evaluation of variable interests should be primarily based on expected losses, but will also consider the ability to benefit from the enterprise's activity. The Board decided to include a broader discussion of variable interests in the final Interpretation that would focus both on risk of loss and opportunities for gain similar to those of holders of a majority voting interest.

6. The Board decided that an enterprise should be required to consolidate an entity subject to consolidation based on variable interests if it holds a majority of the variable interests.

7. The Board decided that all parties involved with an entity subject to consolidation based on variable interests should reconsider consolidation if the governing documents or contractual arrangements among the parties change. The consolidating enterprise also should reconsider consolidation if it reduces its interest in the entity. Also, if another entity acquires some or all of the consolidating enterprise's interest it should reconsider consolidation.

DISCUSSION

Scope

Identification of the Types of Entities Within the Scope of the Interpretation

The Board stated that, for purposes of the proposed Interpretation, the population of business entities should be divided into two mutually exclusive groups—entities subject to consolidation based on voting interests and entities subject to consolidation based on variable interests. The Board stated that paragraph 9 of the proposed Interpretation with modifications to be discussed later should determine whether a business entity is subject to consolidation based on voting or variable interests.

The Board also decided that the proposed Interpretation should not use the terms SPE or substantive operating enterprise, but refer to entities only in terms of those for which voting or variable interests are an appropriate basis for determining consolidation.

Paragraph 8(c) Exception

The Board decided to remove references to subsidiaries of substantive operating enterprises from paragraph 8(c). The Board reasoned that if the provisions of paragraph 9 are appropriate for identifying entities subject to consolidation based on variable interests, they should apply regardless of which entity is the nominal owner. In addition, removing references to subsidiaries of substantive operating enterprises would reduce the risk that entities could circumvent the intent of the proposed Interpretation. The Board noted that its decision would produce different results for an asset owned directly by an enterprise subject to consolidation based on voting interests and an asset held by an entity in which the enterprise owned a majority voting interest. Nevertheless, the Board decided that it would be inappropriate to consider consolidation of selected assets and liabilities of an entity without consolidating an entire entity. One Board member requested that the proposed Interpretation clearly state the Board's intention that only assets and liabilities within a separate legal structure are subject to consolidation by other parties.

Scope Exceptions

The Board voted unanimously in favor of extending the scope exception for transferors to qualifying SPEs to transferors to formerly qualifying SPEs as described in paragraph 25 of Statement 140.

The Board also voted in favor of a scope exception for registered investment companies subject to the Investment Company Act of 1940. The Board reasoned that the proposed Interpretation should not require an accounting treatment that is prohibited by SEC regulations. The Board decided not to provide a scope exception for all companies that apply the AICPA Investment Company Guide because the AICPA is reconsidering its scope and some companies that currently apply the guide would not be prohibited from consolidating a non-investment company investee under SEC regulations.

Variable Interests

Evaluation of Variable Interests

The Board generally agreed with the staff's analysis of variable interests and decided to include a discussion of some general types of variable interests in the final Interpretation. The Board stated that some interests in an entity subject to consolidation based on variable interests would not likely represent variable interests unless they are bundled with other interests in the entity.

The Board decided that transferors' subordinated retained interests in assets transferred to non-qualifying SPEs should be considered variable interests in those entities. The Board reasoned that retained interests of transferors are effectively guarantees on the assets transferred to non-qualifying SPEs.

The Board decided that the evaluation of variable interests should be primarily based on expected losses, but will also consider the ability to receive or obtain benefits from the entity's activity.

Identification of a Primary Beneficiary

A majority of Board members voted in favor of a majority of variable interests threshold for identifying a primary beneficiary of an entity subject to consolidation based on variable interests. Ms. Schipper and Mr. Foster dissented. Those in favor of a majority threshold stated that (1) it would be more operational because fewer enterprises will have to undertake a variable interest analysis, (2) it would likely result in the same consolidation decision as the significant and significantly more criterion in many cases, and (3) the majority threshold is preferable since the variable interests model effectively imputes a controlling financial interest and that becomes more evident as the amount of variable interests increases. One Board member asked if the majority threshold could be softened so that it would not become a "bright line" requirement. Board members who supported the majority requirement stated that precise computations should not be required. Another Board member stated that the Interpretation should include disclosure requirements for enterprises that hold a significant amount of variable interests that is significantly more than any other enterprise but that does not hold a majority.

Reconsideration of Consolidation

The Board voted unanimously that all parties involved with an entity subject to consolidation based on variable interests should reconsider consolidation if the governing documents or contractual arrangements related to the entity change. The Board deferred its decision on whether changes in economic conditions or other factors that change the expected losses of an SPE would cause the parties to reconsider consolidation. However, the Board did decide that a primary beneficiary should reconsider consolidation if it reduces its interest in the entity. If another entity acquires some or all of the primary beneficiary's interest, that entity should reconsider consolidation.

The Board decided to allow certain events to trigger reconsideration of consolidation decisions rather than requiring each entity involved with an entity subject to consolidation based on variable interests to reconsider at each reporting date because reconsideration at each reporting date would be difficult and time consuming and the information needed to make the decision about whether an entity has a majority of variable interests may not be readily available.

SUMMARY FOR ACTION ALERT

Same as Matters Discussed...

GENERAL ANNOUNCEMENTS

None.