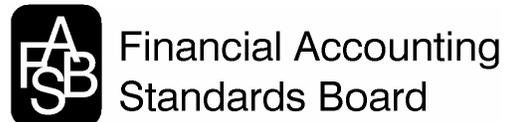


MINUTES



To: Board Members

From: Miller (ext. 276)
Minutes of the December 17, 2003

Subject: CON VIE Board Meeting **Date:** January 8, 2004

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

Topic: Redeliberation of proposed modifications to FASB Interpretation No. 46, *Consolidation of Variable Interest Entities*

Basis for Discussion: Board memorandum dated December 16, 2003

Length of Discussion: 9:30 a.m. to 10:30 a.m.

Attendance:

Board members present: Herz, Crooch, Batavick, Schipper, Schieneman (by phone), Seidman, and Trott

Board members absent: None

Staff in charge of topic: McIntosh, Lott

Other staff at Board table: Smith, Laurenzano, Sogoloff, and Miller

Outside participants: None

Summary of Decisions Reached:

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 staff announced that, in response to requests by constituents, the final Interpretation will include the complete text of Interpretation 46 as revised, and will be titled FASB Interpretation No. 46, *Consolidation of Variable Interest Entities* (revised December 2003), also referred to as Interpretation 46(R). The Board decided that Interpretation 46(R) would:

1. Provide that the condition that would preclude an enterprise from applying the scope exception for certain entities that are businesses if that enterprise and/or its related parties participated significantly in the design or redesign of the entity should not apply if the entity is a franchisee. The remaining conditions in this scope exception, adopted by the Board at the December 10, 2003 Board meeting, apply to a franchisee.
2. Provide that an enterprise shall not consolidate a governmental organization and shall not consolidate a financing entity established by a governmental organization unless the financing entity (a) is not a governmental organization and (b) is used by the business enterprise in a manner similar to a variable interest entity in an effort to circumvent the provisions of Interpretation 46(R).
3. Provide that a troubled debt restructuring, as defined in paragraph 2 of FASB Statement No. 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings*, as amended, shall be accounted for in accordance with that Statement and is not an event that requires the reconsideration of whether the entity involved is a variable interest entity or whether an enterprise with a variable interest in a variable interest entity is the primary beneficiary of that entity.
4. Provide that an enterprise with an interest in an entity to which the provisions of Interpretation 46 have not been applied as of December 24, 2003, shall apply Interpretation 46 or Interpretation 46(R) to that entity in accordance with

the effective date provisions of Interpretation 46(R) as described in item 5 below.

5. Provide the following effective date provisions for a:
 - a. Public entity that is not a small business issuer
 - 1) A public entity¹ (enterprise) that is not a small business issuer shall apply Interpretation 46(R) to all entities subject to it no later than the end of the first reporting period that ends after March 15, 2004 (as of March 31, 2004, for calendar-year enterprises). This effective date includes those entities to which Interpretation 46 was previously applied.
 - 2) However, prior to the required application of Interpretation 46(R), a public entity (enterprise) that is not a small business issuer shall apply Interpretation 46 or Interpretation 46(R) to those entities that are considered to be special-purpose entities² no later than as of the end of the first reporting period that ends after December 15, 2003 (as of December 31, 2003, for calendar-year enterprises).
 - 3) A public entity (enterprise) that is not a small business issuer that has applied Interpretation 46 to an entity prior to the effective date of Interpretation 46(R) shall either continue to apply Interpretation 46 until the effective date of Interpretation 46(R) or apply Interpretation 46(R) at an earlier date.
 - b. Public entity that is a small business issuer
 - 1) A public entity (enterprise) that is a small business issuer shall apply Interpretation 46(R) to all entities subject to it no later than the end of the

¹ The term *public entity* is defined in paragraph 395 of FASB Statement No. 123, *Accounting for Stock-Based Compensation*. The term *small business issuer* is defined in SEC Regulation S-B §228.10 (a) (1).

² The term *special-purpose entity* refers to an entity that previously would have been accounted for by applying the guidance in EITF Issues No. 90-15, "Impact of Nonsubstantive Lessors, Residual Value Guarantees, and Other Provisions in Leasing Transactions," No. 96-21, "Implementation Issues in Accounting for Leasing Transactions involving Special-Purpose Entities," and No. 97-1, "Implementation Issues in Accounting for Lease Transactions, including Those Involving Special-Purpose Entities," and EITF Topic No. D-14, "Transactions involving Special-Purpose Entities." Special-purpose entities for this provision are expected to include any entity whose activities are primarily related to securitizations or other forms of asset-backed financings or single-lessee leasing arrangements.

first reporting period that ends after December 15, 2004 (as of December 31, 2004, for calendar-year enterprises). This effective date includes those entities to which Interpretation 46 had previously been applied.

2) However, prior to the required application of Interpretation 46(R), a public entity (enterprise) that is a small business issuer shall apply Interpretation 46 or Interpretation 46(R) to those entities that are considered to be special-purpose entities no later than as of the end of the first reporting period that ends after December 15, 2003 (as of December 31, 2003, for calendar-year enterprises).

3) A public entity (enterprise) that is a small business issuer that has applied Interpretation 46 to an entity prior to the effective date of Interpretation 46(R) shall either continue to apply Interpretation 46 until the effective date of Interpretation 46(R) or apply Interpretation 46(R) at an earlier date.

c. Nonpublic entity

1) A nonpublic entity³ (enterprise) with an interest in an entity that is subject to Interpretation 46(R) and that is created after December 31, 2003, shall apply Interpretation 46(R) to that entity immediately. A nonpublic enterprise shall apply Interpretation 46(R) to all entities that are subject to it by the beginning of the first annual period beginning after December 15, 2004.

6. Provide the following transition guidance:

- a. The effect of adopting Interpretation 46(R) shall be reported as a cumulative effect of an accounting change.
- b. Restatement of previously issued financial statements will be encouraged but not required.

7. Incorporate revised guidance on the identification of variable interests into Appendix B of Interpretation 46(R).

³ The term *nonpublic entity* is defined in paragraph 395 of FASB Statement No. 123, *Accounting for Stock-Based Compensation*.

The Board decided not to reexpose Interpretation 46(R) for further comment and to proceed with the balloting process.

Matters Discussed and Decisions Reached:

The Board discussed the comments received on the Exposure Draft of the proposed modification of FASB Interpretation No. 46, *Consolidation of Variable Interest Entities*, and concluded redeliberations of certain proposed modifications in response to the comments received.

Proposed Scope Exception for Certain Businesses

The Board discussed whether the condition that would preclude an enterprise from applying the scope exception for certain entities that are businesses if that enterprise and/or its related parties participated significantly in the design or redesign of the entity should be retained. The Board also discussed whether, if that condition is retained, it should apply if the entity is a franchisee.

The staff said that some constituents had questioned whether that condition was necessary to describe the type of entity to which the Board intends this scope exception to apply. Other constituents suggested that if that condition is retained, it should not apply if the entity is a franchisee.

Mr. Trott said he thought that condition should be retained, but that he would support excluding franchisee entities from it. He said that he believes that if franchisees were excluded from that one condition, the remaining three conditions of the scope exception adopted at the December 10, 2003 Board meeting would be sufficient to identify the franchisees to which Interpretation 46(R) should be applied.

Mr. Crooch agreed with Mr. Trott.

Ms. Seidman also agreed with Mr. Trott, provided that the Board did not intend for the relationship between franchise entities to be considered a related party

relationship. She said that if the Board did consider franchise entities to be related parties, then those entities would not qualify for the business scope exception under the conditions that preclude its application when (a) substantially all of the activities of the entity involve or are conducted on behalf of the reporting enterprise or its related parties or (b) the reporting enterprise and its related parties provide more than half of the equity, subordinated debt, or other form of subordinated financial support. Board members agreed that they generally would not consider franchisees and franchisors to be related parties for the purposes of applying the Interpretation; but thought franchise entities would need to look to facts and circumstances for satisfaction of those conditions.

The Board unanimously decided that the condition that would preclude an enterprise from applying the scope exception for certain entities that are businesses if that enterprise and/or its related parties participated significantly in the design or redesign of the entity should be retained but should not apply if the entity is a franchisee.

Consolidation of Governments and Entities Created by Governments

At the December 10, 2003 Board meeting, the Board asked the staff to further explore the implications of providing an exception for consolidation by a business enterprise of a governmental organization or government financing vehicle.

The Board observed that the accounting for and by federal, state, and local governmental organizations in the United States is promulgated by the Federal Accounting Standards Advisory Board (FASAB) and the Governmental Accounting Standards Board (GASB) and not the FASB. The FASAB, the GASB, or some other organization may decide to apply an FASB standard to a governmental organization, but that is not a decision to be made by the FASB. Because the FASB does not have the authority to establish accounting standards for governmental organizations, it is usually unnecessary for the FASB to state whether a particular standard applies to those organizations. However, the Board acknowledged that confusion exists as to whether Interpretation 46 should

be applied by a private (nongovernmental) enterprise that receives financing from, or is otherwise involved with, a governmental organization or financing entity established by a governmental organization, because of the nature of those arrangements. Therefore, the Board decided to exempt an enterprise from consolidating, in accordance with Interpretation 46(R), a governmental organization or financing entity established by a governmental organization. This provision would not apply to a financing entity created by a governmental organization that is used by a nongovernmental enterprise to circumvent the Interpretation if that entity is not itself a governmental organization.

The Board decided an exception for consolidation by governmental entities is not necessary, since the FASB does not have the authority to require consolidation by a federal agency, state, or local governmental organization.

Troubled Debt Restructurings

At the December 10, 2003 Board meeting, the Board requested the staff draft exceptions to reconsideration events in paragraphs 7 and 15 of Interpretation 46 for troubled debt restructurings accounted for in accordance with FASB Statement No. 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings*. The Board supported this draft provision. The Board also agreed that the basis for conclusions should indicate that an investor in the debt of a troubled entity would not need to assess whether an entity is a variable interest entity if the investment would not represent a significant variable interest in the entity and the investor or its related parties did not participate in the design or redesign of the entity.

Effective Date of Interpretation 46 or Interpretation 46(R)

Mr. Trott proposed, and the Board adopted, the following multiple effective date provisions to address concerns of constituents that additional time be provided to understand and implement Interpretation 46 and Interpretation 46(R) but that no

further delay be provided for public entities (enterprises) to apply consolidation guidance for variable interest entities to entities commonly referred to as *special-purpose entities*.

The Board decided that an enterprise with an interest in an entity to which the provisions of Interpretation 46 have not been applied as of December 24, 2003, shall apply Interpretation 46 or Interpretation 46 (revised December 2003) to that entity in accordance with the effective date and transition provisions of the revised Interpretation, which are as follows:

a. Public entity that is not a small business issuer

1) A public entity (enterprise) that is not a small business issuer shall apply Interpretation 46(R) to all entities subject to it no later than the end of the first reporting period that ends after March 15, 2004 (as of March 31, 2004, for calendar-year enterprises). This effective date includes those entities to which Interpretation 46 was previously applied.

2) However, prior to the required application of Interpretation 46(R), a public entity (enterprise) that is not a small business issuer shall apply Interpretation 46 or Interpretation 46(R) to those entities that are considered to be special-purpose entities no later than as of the end of the first reporting period that ends after December 15, 2003 (as of December 31, 2003, for calendar-year enterprises).

3) A public entity (enterprise) that is not a small business issuer that has applied Interpretation 46 to an entity prior to the effective date of Interpretation 46(R) shall either continue to apply Interpretation 46 until the effective date of Interpretation 46(R) or apply Interpretation 46(R) at an earlier date.

b. Public entity that is a small business issuer

1) A public entity (enterprise) that is a small business issuer shall apply Interpretation 46(R) to all entities subject to it no later than the end of the first reporting period that ends after December 15, 2004 (as of December 31, 2004, for calendar-year enterprises). This effective date includes those entities to which Interpretation 46 had previously been applied.

2) However, prior to the required application of Interpretation 46(R), a public entity (enterprise) that is a small business issuer shall apply Interpretation 46 or Interpretation 46(R) to those entities that are considered to be special-purpose entities no later than as of the end of the first reporting period that ends after December 15, 2003 (as of December 31, 2003, for calendar-year enterprises).

3) A public entity (enterprise) that is a small business issuer that has applied Interpretation 46 to an entity prior to the effective date of Interpretation 46(R) shall either continue to apply Interpretation 46 until the effective date of Interpretation 46(R) or apply Interpretation 46(R) at an earlier date.

c. Nonpublic entity

1) A nonpublic entity (enterprise) with an interest in an entity that is subject to Interpretation 46(R) and that is created after December 31, 2003, shall apply Interpretation 46(R) to that entity immediately. A nonpublic enterprise shall apply Interpretation 46(R) to all entities that are subject to it by the beginning of the first annual period beginning after December 15, 2004.

The effect of adopting Interpretation 46(R) should be reported as a cumulative effect of an accounting change. Restatement of previously issued financial statements will be encouraged but not required.

The Board acknowledged that permitting public entities to apply either the guidance in Interpretation 46 or Interpretation 46(R) creates potential noncomparability for a brief period. The Board considered the advantages associated with improved financial reporting for variable interest entities, and the implementation difficulties associated with requiring that Interpretation 46(R) be implemented by all public entities, and concluded that a brief period of noncomparability would be tolerable.

Dissent

Mr. Batavick and Ms. Seidman objected to the issuance of Interpretation 46(R) because it does not clarify a new but critical concept underlying the variable interest model and because the effective dates for some types of entities are too soon to provide for an orderly transition.

They believe there is currently a lack of clarity surrounding the application of the expected loss-return test, which is the gateway in determining whether an entity is a variable interest entity and the key quantitative test for identifying who should consolidate an entity. The Board is aware that different approaches exist that result in different conclusions about whether an entity is a variable interest entity and also whether a reporting entity is the primary beneficiary. Mr. Batavick and Ms. Seidman find it troubling that entities with the same contractual structures could reach different conclusions about whether the entity is a variable interest entity and who should consolidate it. They believe the Board should provide more guidance for calculating expected losses and expected residual returns so that the new consolidation model will be applied with a high degree of consistency.

Interpretation 46(R) contains numerous changes from the original Interpretation 46 and from the Exposure Draft that was issued in October 2003. While they generally support those changes, Mr. Batavick and Ms. Seidman believe that with an issuance date in late December 2003, the effective dates of Interpretation 46(R) do not give preparers of financial statements and their auditors a reasonable amount of time to digest the clarified provisions, analyze the effect on their organizations, implement the effect of any changes, and subject them to internal and external audit procedures. Given the large number of securitization vehicles held by institutions engaged in these activities, the nonstandard nature of their terms, the materiality of the assets and liabilities involved, and the heightened awareness of these transactions in the marketplace, they believe it is as important to delay the effective date for entities typically thought of as *special-purpose entities* as it is for other types of entities within the scope of Interpretation 46(R) (for which an additional deferral has been provided). Those Board members believe it is in the best interest of the capital markets that

reporting entities have additional time to implement those accounting changes, especially in complex areas such as structured finance.

Appendix B

The Board reaffirmed their previous decision to incorporate revised Appendix B guidance into Interpretation 46(R).

Ballot

The Board decided that Interpretation 46(R) would not be reexposed for further comment. The Board also decided to proceed with the balloting process for Interpretation 46(R).)

Follow-up Items:

None.

General Announcements:

The FASB staff announced that the final FSP FIN 46-8, "Evaluating Whether as a Group the Holders of the Equity Investment at Risk Lack the Direct or Indirect Ability to Make Decisions about an Entity's Activities through Voting Rights or Similar Rights under FASB Interpretation No. 46, *Consolidation of Variable Interest Entities*", would be posted to the FASB website no later than the end of the day on Friday, December 19, 2003.