**MINUTES**

Financial Accounting Standards Board

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| **To:** | Board Members |
| **From:** | Interpretation 46(R) Team (Burnap, ext. 283) |
| **Subject:** | Minutes of the January 28, 2009, Board Meeting: Interpretation 46(R) Redeliberations |
| **Date:** | February 20, 2009 |
| **cc:** | FASB: Golden, Bielstein, Lott, Donoghue, Lusniak, Mayer, Schonefeld, Sperry, Barker, Roberge, Hood, Chookaszian, Posta, Gabriele, Sutay, Glotzer, Allen, Klimek, C. Smith, Mechanick, Nickell, Mathys, Burnap, 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.*

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| Topic: | Interpretation 46(R)—Redeliberations |
| Basis for Discussion: | Board Memorandum No. 14, 15, 16, 17, 18, 19 |
| Length of Discussion: | 10:00 a.m. to 11:30 a.m. |
| Attendance: | |
| Board members present: | FASB: Herz, Linsmeier, Seidman, L. Smith, and Siegel |
| | IASB: Leisenring |
| Board members absent: | None |
| Staff in charge of topic: | Roberge and Nickell |
| Other staff at Board table: | Golden, C. Smith, Mathys, and Burnap |

Summary of Decisions Reached

The Board began redeliberations of six issues related to FASB proposed Statement, *Amendments to FASB Interpretation No. 46(R)* and decided the following:

1. *Reconsideration of an entity's status as a variable interest entity (VIE).* The Board decided to retain the guidance in paragraph 7 of FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*, which requires an entity to reassess whether an entity is a VIE when certain triggering events occur, and add an additional criterion for reassessing an entity's status. The preliminary language describing this criterion is as follows (subject to refinement during drafting):

   *An event occurs which causes the equity holders of the entity to lose the direct or indirect ability through voting rights or similar rights to make decisions about the entity's activities that have a significant effect on the success of the entity.*

2. *Deconsolidation guidance*. The Board decided to provide explicit guidance on accounting for the derecognition of VIEs, both upon transition to the final Statement and upon a deconsolidation event occurring after the final Statement's effective date. The Board decided that an entity should account for such a deconsolidation event using the accounting for the loss of control of a subsidiary in ARB No. 51, *Consolidated Financial Statements*, as amended by FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements*.
3. *Significant variable interests.* The Board decided to remove the significance exception from paragraphs 6 and 24 of the proposed amendments to Interpretation 46(R). The Board decided that it also would reconsider the concept of "significance" as it relates to the disclosure requirements after all remaining issues have been redeliberated.
4. *Elimination of the quantitative analysis*. The Board decided to eliminate the quantitative analysis in Interpretation 46(R) and paragraph 14C of the proposed Statement, which explicitly factors in expected losses and expected residual returns. The Board also decided to analyze the implications of eliminating the previously required quantitative calculation for determining the primary beneficiary of a VIE (the "expected losses calculation") on other guidance within the proposed Statement. Further, the Board asked the staff to analyze and provide recommendations as to the feasibility of uniformly amending the expected losses concept throughout the proposed Statement.
5. *Transition guidance*. The Board decided to utilize a transition method similar to the transition provided in paragraph 37 of Interpretation 46(R). That is, enterprises must recognize and measure consolidated elements at their carrying values as if they had been consolidated at the inception of the entity or a subsequent reconsideration date. If ascertaining the carrying value is not practicable, enterprises can measure consolidated elements at fair value.
6. *Separate classification of elements*. The Board decided to further analyze the implications of separate classification of elements of consolidated VIEs. This includes determining whether the separate classification should be permitted or

required to be presented on the face of the financial statements or in disclosures. Further, the Board asked the staff to provide a recommendation on which consolidated elements should be allowed separate classification.

Objectives of Meeting:

The objectives of the meeting were to redeliberate (1) the reconsideration of an entity's status as a VIE, (2) deconsolidation guidance, (3) significant variable interests, (4) the elimination of the quantitative assessment, (5) transition guidance, and (6) separate classification of elements. The objectives of the meeting were met.

Matters Discussed and Decisions Reached:

**Issue 1: Reconsideration of an Entity's Status As a VIE**

1. Mr. Roberge stated that in the proposed Statement, the requirements in paragraph 7 of the proposed amendments to reconsider whether an entity is a VIE were changed from a list of criteria to a modification in facts and circumstances. Respondents expressed concern that they didn't know when to reassess an entity's status because the evaluation of an entity was supposed to be continuous. Some users were concerned about an entity's ability to flip in and out of VIE status and the corresponding effects on financial statement comparability.
2. The staff presented three views for the Board to consider:
   a. Alternative A: Retain the guidance that is in the proposed Statement—an ongoing assessment would be necessary.
   b. Alternative B: Retain the guidance in paragraph 7 of Interpretation 46(R).
   c. Alternative C: Add a criterion to paragraph 7 of Interpretation 46(R) as follows:
      > The equity holders of the entity lose the direct or indirect ability through voting rights or similar rights to make decisions about the entity's activities that have a significant effect of the success on the entity.
3. **Staff Recommendation:** The staff recommended Alternative C because it captures the essence of what reconsideration events are meant to do, which is to identify those entities that are no longer controlled through voting rights.
4. **Board Decision:** The Board unanimously supported the staff's recommendation for Alternative C.
5. **Boards Comments:** Mr. Siegel was concerned about the timeliness of when information concerning consolidation risks would be made available to investors. He expressed concern that the additional criterion may delay investors from learning

such information if an enterprise is permitted to wait until another enterprise loses voting rights in an entity and the entity becomes a VIE before starting to disclose potential consolidation risks.

6. Mr. Roberge noted that the staff's intention was to avoid having the entity only being reconsidered when it undergoes a change in design. When an entity switches from a voting interest entity to a VIE, an enterprise should know when a change in power has occurred. Mr. Roberge pointed out that if the additional criterion is tripped, the entity would be VIE under paragraph 5(b)(1) of Interpretation 46(R).

7. Mr. Linsmeier clarified the proposed change with a hypothetical scenario of an enterprise that currently consolidates under the voting model but that may need to reassess its decision on whether it should consolidate under a VIE model. Mr. Roberge noted that the focus of the change is to identify entities that were not the consolidator under a voting model, but that would be the primary beneficiary under a VIE model. In reference to Mr. Linsmeier's example, Mr. Roberge noted that if the primary beneficiary in a VIE model is the same as the consolidator under the voting interest model, none of the additional VIE disclosure requirements would apply anyway.

8. Mr. Nickell stated the staff felt that this criterion would be the timeliest way to capture a change, since no other criterion would identify a change in power faster. As soon as the entity is no longer controlled by vote under the ARB 51 model, it would immediately enter the Interpretation 46(R) model.

9. Mr. L. Smith explained that when an enterprise becomes a VIE, the primary beneficiary may be aware of the change in power; however, the other variable interest holders may not know of the change and may not be able to make the appropriate disclosures.

10. Mr. Roberge clarified that when an enterprise has a material interest in an entity, it should know when there is a change in power, especially if it has to perform an impairment test.

11. Mr. L. Smith stated that there may be some enterprises that do not know that a change in power occurred and that the primary beneficiary now has the power to control the entity. As such, there will be some variable interest holders that do not make the

disclosures because they do not know the entity is a VIE. Mr. Roberge noted that it is equally challenging for a variable interest holder to determine if the current reconsideration events in paragraph 7 of Interpretation 46(R) have occurred.

12. Ms. Seidman noted that issues surrounding the disclosures of a variable interest holder when an entity is no longer in the voting model but is actually in the VIE model should be discussed when the Board reconsiders disclosures.

13. Mr. Roberge stated that all of the criteria in paragraph 7 of Interpretation 46(R) would be added back to the proposed Statement with the addition of the new criterion.

14. Ms. Seidman clarified that the troubled debt restructuring portion of paragraph 7 will not be added back to the proposed Statement, and that there will be some conforming language surrounding paragraph 7.

**Issue 2: Deconsolidation Guidance**

15. Mr. Roberge asked the Board if it would like to provide explicit guidance as it relates to derecognition of VIEs both at transition and upon a deconsolidation event subsequent to the effective date of the proposed Statement. If an enterprise is required to deconsolidate, the enterprise would have to apply the guidance in Statement 160. Mr. Roberge noted that the staff recognizes that EITF Issue 08-10, "Selected Statement 160 Implementation Questions," would amend the current guidance in Statement 160 and that the Issue would be properly referenced (that is, the entity would know if the guidance in Issue 08-10 was applied to them because Statement 160 would have been amended for that guidance). He noted that at transition, as a result of the deconsolidation, any amount that would have been a gain or loss would instead be a cumulative adjustment through retained earnings.

16. **Board Decision:** The Board decided to provide explicit guidance on accounting for the derecognition of VIEs, both upon transition to the final Statement and upon a deconsolidation event occurring after the final Statement's effective date. The Board decided that an entity should account for such a deconsolidation event using the accounting for the loss of control of a subsidiary in ARB 51, as amended by Statement 160.

17. **Board Comments:** Mr. Golden clarified that derecognition at transition would follow Statement 160, but with the gain or loss going through cumulative retained earnings.

He also stated that prospective deconsolidation (after the adoption of the proposed Statement) would follow Statement 160.

18. Ms.Seidman noted that a VIE should not be treated differently than a voting interest entity in terms of the accounting consequence when an enterprise gains or loses control. She also noted the scenario of an asset-backed securitization in which gains or losses could be recognized when control has shifted but in which consideration is not exchanged due to the step up in the portion that is retained.

**Issue 3: Significant Variable Interests**

19. Mr. Nickell pointed out that paragraph 6 of Interpretation 46(R) states that "an enterprise is not required to determine whether an entity with which it is involved is a variable interest entity if it is apparent that the enterprise's interest would not be a significant variable interest…." He also stated that paragraph 24 limits the Interpretation 46(R) disclosure requirements for non-primary beneficiaries to enterprises that hold a significant variable interest.

20. Mr. Nickell stated that the proposed Statement attempted to clarify the concept of a significant variable interest by amending paragraph 6 to include the following: "An enterprise has a significant variable interest if the interest is significant to either the variable interest entity or to the enterprise." Respondents to the Exposure Draft expressed diverse views on whether they believed significance should be defined in relation to the VIE or to the reporting enterprise that is evaluating the entity for consolidation.

21. Mr. Nickell stated that users recommended that the *significant* threshold be removed. Some users were concerned that the term *significant* implies something greater than the term *material* and expressed strong concerns that practitioners would apply significance at a level in excess of material and, thus, avoid determining if the entity in which they have an interest is a VIE (and that they would not make the applicable disclosures).

22. **Staff Recommendation:** The staff recommended removing the significance exception from the proposed Statement. A removal of the significance exception would mean that the disclosure requirements would apply to all variable interests

(subject to the materiality threshold, which is an overriding consideration in the application of all U.S. generally accepted accounting principles [GAAP]).

23. **Board Decision:** The Board decided to remove the significance exception from paragraphs 6 and 24 of the proposed amendments to Interpretation 46(R). The Board decided that it also would reconsider the concept of significance as it relates to the disclosure requirements after all remaining issues have been redeliberated.

24. **Board Discussion:** Ms. Seidman expressed concern with having too many disclosures and suggested that a screen be in place to limit the number of enterprises that would have to make VIE disclosures. She was concerned that, given an insignificant level of involvement, the disclosures may not be operational.

25. Mr. Nickell thought that a materiality threshold would serve as a sufficient screen because an enterprise's management would need to decide what is material to investors (which is required in the application of all accounting standards). Users seem to want a lot of information about VIEs, and the proposal would require management to decide whether it believes its interest is material and should be disclosed. Such a change would be consistent with other disclosure requirements. It was noted that users generally want more information related to VIEs.

26. Ms. C. Smith noted that users want more disclosures about VIEs because the perceived level of risk is higher than in other relationships. Users question the ability of preparers to self-judge the level of future significance.

27. Mr. Herz pointed out that VIEs do not always have an ongoing reporting infrastructure so a user can't go to the monthly or quarterly financials and obtain information. The lack of a reporting infrastructure is one of the contributing factors to the high risk users associated with VIEs. The increased disclosure is to make up for the infrastructure deficiency.

28. Mr. Leisenring stated that increased disclosures are the result of the derecognition models not properly reflecting the underlying risk because the beneficial interest is not marked to market. Users want no continuing involvement at all, but since that is not the accounting treatment, they want disclosures.

29. Mr. Linsmeier noted that users are concerned that derecognition occurs too frequently and that consolidation has not occurred frequently enough, such that when an

enterprise is involved with a VIE, users want to know more information. If more consolidation occurs with the primary beneficiary, less disclosure about the underlying risks for parties that are not the primary beneficiary would be needed.

30. Messrs. Siegel and Herz noted that in the past, some enterprises have misjudged the risk when applying the significance threshold, which has given rise to the current environment. This has contributed to the desire for increased disclosures.

**Issue 4: Elimination of the Quantitative Analysis for Determining a Primary Beneficiary**

31. Ms. Mathys stated that while the current discussion will focus on whether or not the qualitative analysis in paragraph 14C of Interpretation 46(R) should be retained, the Board may want to consider some form of quantitative analysis (which may or may not be in the form of an expected loss calculation) when redeliberating the issue of *shared power* at a future Board meeting.

32. Ms. Mathys pointed out that paragraph 14 of Interpretation 46(R) provides the guidance for determining which enterprise, if any, is the primary beneficiary of a VIE. Currently, an enterprise is required to consolidate a VIE if the enterprise has a variable interest or interests that will absorb the majority of the entity's expected losses, receive a majority of the entity's expected residual returns, or both.

33. Ms. Mathys stated that constituents are of the opinion that the application of the current guidance is difficult to understand, apply, and audit. In practice, several different approaches and methodologies are used to apply the expected loss calculation, which can lead to inconsistent application and results for VIEs with similar characteristics and traits. Also, the quantitative analysis can identify a different primary beneficiary of a VIE from that which was identified by applying a qualitative analysis to the same entity.

34. Ms. Mathys stated that most respondents supported removing the quantitative analysis in Interpretation 46(R), including practitioners, users, regulators, and auditors. Respondents noted that all of the examples provided in the proposed Statement determined a primary beneficiary without a quantitative analysis, and suggested that if the quantitative analysis were to be retained, more implementation guidance would be needed.

35. Ms. Mathys stated that some respondents wanted the quantitative analysis to be retained because the qualitative analysis may not always identify a primary beneficiary and the quantitative analysis could be used to support the qualitative assessment.

36. Ms Mathys expressed the staff's view that under a power-based model, a qualitative analysis focusing on power and the right to receive benefits or the obligation to absorb losses that could be significant is superior to the quantitative analysis. The staff is concerned that if the quantitative analysis is retained, preparers may default to the quantitative method to find a primary beneficiary.

37. Ms. Mathys stated that the IASB's ED 10, *Consolidated Financial Statements*, does not require a quantitative analysis.

38. **Staff Recommendation:** The staff recommended eliminating the quantitative analysis in paragraph 14C of the proposed amendments.

39. **Board Decision:** The Board decided to eliminate the quantitative analysis in Interpretation 46(R) and in paragraph 14C of the proposed amendments, which explicitly factors in expected losses and expected residual returns. The Board also decided to analyze the implications of eliminating the previously required quantitative calculation for determining the primary beneficiary of a VIE (the expected loss calculation) on other guidance within the proposed Statement. Further, the Board asked the staff to analyze and provide recommendations on the feasibility of uniformly amending the expected losses concept throughout the proposed Statement.

40. **Board Discussion:** Mr. Siegel expressed concern about the ability of enterprises to structure entities that have risks and rewards but no power to avoid consolidation.

41. Mr. Roberge stated that Mr. Siegel's concerns will be addressed when the staff returns to the Board with views on power and how (or whether) it should be linked to risk and rewards.

42. Mr. Linsmeier noted that the current method of quantifying risks and rewards will not help in the shared power circumstances. For instance, the expected losses can be interpreted to mean those that are expected at the design of the entity and not those that might be incurred when things do not go as planned. Since the new approach is to look through the life of the entity and identify where losses might occur when

things do not go as planned, the current method is not adequate. He recognized that another form of a quantitative test may be needed to evaluate shared power.

43. Mr. Leisenring stated that the IASB Exposure Draft is not internally consistent, and that the document is presumptive in saying that an entity has the power if the same entity has the most variance in economic outcomes. He doesn't think the IASB Exposure Draft would consolidate more entities than what are being consolidated now under SIC Interpretation 12, *Consolidation—Special Purpose Entities*, and IAS 27, *Consolidated and Separate Financial Statements*. He raised the point that when consolidation is based on power, the enterprise that has the current power may be different from the entity that has future power and that there are complexities surrounding this issue.

44. Mr. Herz supported the removal of the quantitative test, but is anxious to see how power is dealt with in later issues, particularly shared power. He reiterated Mr. Leisenring's point that risks and rewards do not always follow the power and vice versa.

45. Ms. Seidman pointed out that one of the characteristics used to identify a VIE involves an evaluation of whether there is adequate equity at risk to cover expected losses, and that there are many other places within Interpretation 46(R) that reference expected losses and expected returns. She suggested that the staff do more work to identify all of the situations in which expected losses are used so that a better understanding of the elimination of the quantitative assessment can be made.

46. Messrs. L. Smith, Siegel, and Linsmeier agreed that a sweep through of Interpretation 46(R) should be completed to have a more thorough understanding of when and how the expected loss model is used. It also was suggested that the staff determine whether the term *expected loss* and its related definition could be changed to something that more clearly conveys the concept.

**Issue 5: Transition Guidance**

47. Mr. Nickell stated that in the proposed Statement, the transition provisions state that the initial consolidation of VIEs shall be accounted for in accordance with FASB Statement No. 141 (revised 2007), *Business Combinations*, except for amounts that would have otherwise been recognized in goodwill or, as a gain or loss, would go

through retained earnings. Most respondents objected to these transition provisions due to the lack of comparability in future financial results. Some respondents suggested using the transition provisions that were in the original Interpretation 46(R) because there were no significant practice issues associated with those transition provisions.

48. **Staff Recommendation:** The staff recommended that the transition provisions be similar to the original Interpretation 46(R). The consolidating entity would initially measure the assets, liabilities, and non-controlling interest of the VIE at their carrying amounts, that is, what the carrying amount would be had the Interpretation been effective when the enterprise first met the conditions to be the primary beneficiary of the VIE. If calculating the carrying value is not practicable, an enterprise would use fair value.

49. Mr. Nickell stated that applying the provisions of Statement 141(R) to newly consolidated entities would incorrectly imply that there was a change in control of the entity upon adopting the proposed Statement. Applying a transition method similar to that in Interpretation 46(R) correctly indicates that the VIE should have been consolidated all along (or at least since the latest reconsideration event) and that a change in control has not occurred.

50. **Board Decision:** The Board agreed with the staff recommendation.

51. **Board Discussion:** None.

**Issue 6: Separate Classification of Elements**

52. Ms. Mathys stated that the majority of users prefer separate classification of elements of a VIE in financial statements of the consolidating enterprise because they believe that such classification, combined with the enhanced disclosures in the proposed Statement, would provide transparent and useful information regarding an enterprise’s involvement and associated risks with VIEs. However, some respondents oppose separate classification because they believe that consolidated VIEs are controlled by the enterprise and, thus, are no different than other subsidiaries consolidated under ARB 51.

53. Ms. Mathys presented three alternatives:

a. Alternative A: Require enterprises to separately classify the elements of their consolidated VIEs from other elements in their financial statements.

b. Alternative B: Permit, but not require, separate classification of the elements of consolidated VIEs in the financial statement of the primary beneficiary.

c. Alternative C: Prohibit separate classification of elements in the financial statements.

54. **Staff Recommendation:** The staff recommended Alternative B because permitting separate classification is the most desirable alternative. Although some enterprises believe that separate presentation of the material elements of consolidated VIEs in financial statements is already permitted, the staff believes the Board should explicitly state that this presentation is allowed to resolve any ambiguity regarding the acceptability of presenting segregated information related to VIEs under U.S. GAAP.

55. **Board Decision:** The Board requested that the staff conduct further analysis of the implications of separate classification of elements of consolidated VIEs. This includes determining whether the separate classification should be permitted or required to be presented on the face of the financial statements or in disclosures. The staff also was asked to provide a recommendation on which consolidated elements would be allowed separate classification.

56. **Board Comments:** Concerning Alternative B, Mr. Leisenring pointed out that if the assets were truly restricted, current U.S. GAAP may already require enterprises to separately present assets. He raised the concern that where current guidance requires separate presentation, some preparers may interpret the term *permit* to mean *optional,* which would represent a potential conflict with current U.S. GAAP.

57. Mr. Roberge acknowledged that in some instances, separate presentation is optional and/or required, but noted that respondents requested that the Board explicitly declare in the final guidance whether separate presentation would be permitted.

58. Mr. Linsmeier did not agree with the staff recommendation and preferred Alternative A, but he also indicated that the requirement be limited to separate presentation of assets that are restricted solely for funding VIE obligations.

59. Mr. L. Smith supported Alternative B, except when the assets are restricted solely for funding obligations of VIEs, in which case he supported required disclosures. He did

not agree that restricted assets should be required to be separated on the face of the financial statements.

60. Mr. Linsmeier made the observation that Alternative C is not appropriate because preparers of financial statements are always allowed to choose what information is presented.

61. Mr. Siegel stated that one user supported Alternative C because it signaled that a VIE is the same as other consolidated entities. Another user said that the worst case scenario would be to have the restricted assets on the face of the balance sheet for some enterprises and not for others.

62. Ms. Seidman noted that the Board should be flexible in terms of whether the information about restricted assets is on the face of the balance sheet or in the notes. She expressed the concern that separate presentation could clutter the balance sheet.

63. Mr. Herz noted that another alternative would be to have the separate assets and liabilities on two separate lines. There would be one line for consolidated assets and another for consolidated liabilities. Additionally, there would be an explanation in the notes that breaks apart the types of assets.

64. There was a discussion about whether there needs to be delineation between when certain assets have to pay off certain liabilities and when the liabilities are linked to assets but other assets may be used to fulfill the obligation. Mr. L. Smith supported separate presentation when certain assets are required to fulfill certain obligations.

65. Mr. Leisenring pointed out that if there were two lines for consolidated entities (assets and liabilities) with disclosures that break out the components, then an enterprise would not substantively consolidate VIEs.

66. Mr. Golden made the observation that the Board is unsure whether restricted assets should be on the face of the balance sheet or in the notes, and whether such presentation or disclosures should be required or permitted.

Follow-up Items:

67. The Board would like to reconsider the concept of significance as it relates to the disclosure requirements after all remaining issues have been deliberated.

68. The Board also decided to analyze the implications of eliminating the previously required quantitative calculation for determining the primary beneficiary of a VIE (the expected loss calculation) on other guidance within the proposed Statement.

69. The Board decided to further analyze the implications of separate classification of elements of consolidated VIEs. This includes determining whether the separate classification should be permitted or required to be presented on the face of the financial statements or in disclosures. The Board also asked the staff to provide a recommendation on which consolidated elements should be allowed separate classification.

General Announcements: None.