

Ernst & Young's On-Call Advisory Alert

March 27, 2008

Accounting Alert

March 27, 2008 FASB Education Sessions on SFAS 140¹ and FIN 46(R)² Amendments

Matters discussed at the Education Session (not attended by all Board members) are summarized below. Education Sessions do not result in Board decisions. Changes to the Staff's recommendations will likely be made before being voted on and/or approved at a Board meeting.

Exposure Drafts of the proposed changes are expected to be released for public comment in 2008, with the SFAS 140 Exposure Draft expected in the second quarter of 2008. It appears the Board is attempting to issue final Amendments by December 31, 2008.

At the end of the Session, the Staff indicated it plans to discuss SFAS 140 Topics 1 to 3 at the April 2, 2008 Board meeting and SFAS 140 Topic 4 and all FIN 46(R) Topics at the April 2, 2008 Education Session.

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On-Call Advisory Services:

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¹ Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, a replacement of FASB Statement 125

² Consolidation of Variable Interest Entities an interpretation of ARB No. 51

SFAS 140:**Topic 1-**

The Staff recommended reversing a prior Board decision that would have changed paragraph 9(a)'s sale requirements to require "true sale" opinions hypothetically assuming the transferor was the party to all transferor affiliate involvement with the transferee.

The Staff recommended clarification of paragraph 9(a)'s sale requirements to indicate the transferred assets must be legally isolated from (a) the transferor and (b) all transferor affiliates consolidated in the financial statements in which the SFAS 140 transferor is being accounted for. This means transfers between sister companies will likely be sales in the sister companies' standalone financials and borrowing (would likely be eliminated in consolidation) in the ultimate parent's consolidated financials.

Board Reaction:

It appeared Board members agreed with the Staff's recommendation.

Topic 2-

The Staff recommended the concept of QSPEs be eliminated from SFAS 140. As a result, QSPEs would no longer be exempt from FIN 46(R).

The Staff recommended that paragraph 9(b)'s sale requirements be integrated into paragraph 9(c) and changed to require constraints on the transferee's ability to sell or pledge the transferred assets imposed by:

- a. The transferor will preclude sale treatment (one Board member indicated this would presumably be the case for all constraints on non-SPE transferees), and

- b. Transferee investors will not preclude sales treatment, provided there is a third party benefiting business purpose for the constraint (e.g., reducing (or eliminate) transferee taxes).

Board Reaction:

It appeared Board members agreed with the Staff's recommendation.

Topic 3-

The Staff recommended all SFAS 140 sale criteria be evaluated at the "unit of account" of the contractually transferred (as opposed to the whole) portion of the asset.

As a result, it would be possible to account for the transfer of loan participations as sales if all sale requirements are met for the sold portion (not the entire asset).

Board Reaction:

It appeared Board members agreed with the Staff's recommendation.

Topic 4-

The Staff recommended the "Linked Presentation" be required in accounting for a consolidated SPE that own only financial assets (other than non-financial assets obtained as a result of collection efforts) when there is an unconditional, non-terminable obligation (presumably "clean-up" calls would be allowed) to pass through SPE asset cash flows to SPE third party liability holders.

Under the Linked Presentation, the party consolidating the SPE would show the SPE's assets on its balance sheet and the SPE's third party liabilities as contra-assets. Both transferors

to SPEs and investors in SPEs would be eligible to use the Linked Presentation.

Board Reaction:

One Board member asked if there was a compelling reason to allow the Linked Presentation (e.g., regulatory capital treatment, etc.) or whether footnote disclosure of the nature of the “link” would be more appropriate.

An Alternative View expressed was that the Linked Presentation should only be allowed if SPE assets are also the only source of repayment of SPE liabilities.

The Board asked the Staff to perform more work and that this Topic be discussed at another Education Session, including:

- a. The theoretical basis for the Linked Presentation, and
- b. If both the assets and the liabilities constituting the Linked Presentation should be allowed (or required) to be marked to market.

FIN 46(R):

Topic 1-

The Staff recommended adding the following Reconsideration Events for both Variable Interest Entity and Primary Beneficiary determinations:

- a. Actual and/or future projected gains or losses change significantly, and
- b. At least once a year.

Board Reaction:

It appeared Board members agreed with the Staff's recommendation.

Topic 2-

The Staff recommended FIN 46(R)'s current provision by which Troubled Debt Restructurings are not Reconsideration Events be eliminated.

Board Reaction:

It appeared Board members agreed with the Staff's recommendation.

Topic 3-

The Staff recommended FIN 46(R) be revised so all Primary Beneficiary determinations are made as follows:

- Step 1:** A party (if any) who:
- a. Is entitled to more than non-substantive Variable Interest Entity gains and losses and
 - b. Is qualitatively determined to “control” the Variable Interest Entity
- is the Primary Beneficiary.

Guidance would be provided on the factors to consider in assessing control. While those factors were not fully discussed, it appears they will be similar to the corresponding criteria in IFRS related SIC 12³.

³ Consolidation – Special Purpose Entities

Step 2: If no one is determined to be Primary Beneficiary in Step 1, qualitatively determine if:

- a. Any party is Primary Beneficiary because they absorb more than 50% of expected gain or loss, or
- b. There is sufficient dispersion that there is no Primary Beneficiary.

Step 3: If neither Step 1 nor 2 are conclusive, determine the Primary Beneficiary quantitatively; “insignificant” variable interests can not be the Primary Beneficiary.

Board Reaction:

It appeared Board members agreed with the Staff's recommendation.

Topic 4-

The Staff recommend no guidance be provided on how to determine if “implicit variable interests” (e.g., guarantees) exists. The Staff recommended implicit variable interests be included in required FIN 45⁴ disclosure requirements.

Board Reaction:

It appeared Board members agreed with the Staff's recommendation.

Other Topics-

The Staff indicated other topics on its Agenda (e.g., how to consider interest rate risk) were not discussed due to time constraints and will be discussed at the April 2, 2008 Education Session.

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⁴ Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others an interpretation of FASB Statements No. 5, 57, and 107 and rescission of FASB interpretation No. 34