

Ernst & Young's On-Call Advisory Alert

April 3, 2008

Accounting Alert

FASB April 2, 2008 Board Meeting on SFAS 140¹ Amendments and Education Session on FIN 46(R)² Amendments

Matters discussed at FASB Board meetings are subject to issuance of proposed guidance (e.g., Exposure Draft) for comment prior to issuance of a final standard.

Matters discussed at FASB Education Sessions do not result in Board decisions. Changes to the Staff's recommendations may be made before being voted on and/or approved at a Board meeting. The Staff indicated it plans to discuss the FIN 46(R) related matters discussed at the April 2, 2008 Education Session at the April 9, 2008 Board Meeting.

The Staff indicated it plans to also discuss whether "Linked Presentation" is appropriate and what the criteria for linkage should be at the April 9, 2008 Board Education Session. Under Linked Presentation, a party consolidating an SPE under FIN 46(R) would show the SPE's assets on its balance sheet and the SPE's third party liabilities as a contra-asset.

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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

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 to SFAS 140 and FIN 46(R) by December 31, 2008. The effective date of the Amendments and the transition provisions were not discussed.

SFAS 140 Board Meeting:

The Staff indicated the Amendments are intended to be “short term” fixes and that a longer term project (a time of several years was mentioned) to completely reconsider US GAAP’s derecognition criteria would be undertaken as part of the effort to conform US GAAP and IFRS. A staff research paper is expected to be issued by the IASB on its Derecognition project shortly.

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 is being accounted for. The isolation analysis must consider all arrangements made in connection with the transfer. This means transfers between sister

companies will likely be sales in the sister companies' standalone financials and borrowings (which would likely be eliminated in consolidation) in the ultimate parent’s consolidated financials.

Board Decision:

A majority of the Board 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 further recommended paragraph 9(b)’s sale requirements be integrated into paragraph 9(c) and changed to require that constraints imposed on the transferee’s ability to sell or pledge the transferred assets imposed by the transferor would preclude sale accounting. The Staff acknowledged that questions would arise in practice in determining if a constraint is imposed by the transferor or by another party.

Board Decision:

A majority of the Board agreed with the Staff’s recommendation.

Topic 3-

The Staff recommended all SFAS 140 sale criteria should be evaluated only with regard to (a) the entire asset or (b) portions of a financial asset that are “participating interests,” as defined in the 2005 FASB Exposure Draft, *Accounting for Transfers of Financial Assets*

Participating interests must have the following characteristics:

- They are ownership interests in an individual financial asset other than an equity instrument, a derivative financial instrument, or a hybrid financial instrument with an embedded derivative that is not clearly and closely related as described in SFAS 133³.
- All cash flows received from the individual financial asset are divided among the participating interests (including any interest retained by the transferor, its consolidated affiliates, or its agents) in proportion to the share of ownership represented by each.
- Servicing fees representing adequate compensation and, if applicable, a share of the contractual interest representing all or a portion of the transferor's gain on sale, received by the transferor as consideration related to the sale, of the participating interest, are not included in that determination.
- The ownership shares remain constant over the life of the original financial asset.
- Participating interest holders have no recourse, other than standard representations and warranties, to the

transferor (or its consolidated affiliates or agents) or to each other, and no participating interest holder is subordinated to another. That is, no participating interest holder is entitled to receive cash before any other participating interest holder. The rights of each participating interest holder (including the transferor if it retains a participating interest) have the same priority, and that priority does not change in the event of bankruptcy or other receivership of the transferor, the original debtor, or any participating interest holder.

- Neither the transferor (or its consolidated affiliates, its agents, or a bankruptcy trustee or other receiver for the transferor, its consolidated affiliates, or its agents) nor any participating interest holder has the right to pledge or exchange the entire financial asset in which they own a participating interest.

Board Decision:

A majority of the Board agreed with the Staff's recommendation.

FIN 46(R) Education Session:

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 and/or market conditions change significantly, and
- b. At least once a year.

³ Accounting for Derivative Instruments and Hedging Activities

Board Reaction:

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

Topic 2-

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. The Staff referred to seven factors (not discussed) that should be considered in making the decision and indicated four of the criteria are substantially the same as the four criteria contained in the IFRS related guidance: SIC 12⁴.

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; variable interests that have "insignificant" participation and are "passive" (no definitions were provided) in Variable Interest Entity gains and losses (not FIN 46(R) variability) cannot be the Primary Beneficiary.

Board Reaction:

While an Alternative View was discussed that would require that Step 3 be performed before concluding that a party is not a Variable Interest Entity's Primary Beneficiary, it appeared a majority of 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) exist. The Staff recommended

⁴ Consolidation – Special Purpose Entities

implicit variable interests be included in required FIN 45⁵ disclosure requirements.

Board Reaction:

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

Topic 5-

The Staff asked if, and when, interest rate risk variability should be considered in determining a Variable Interest Entity's Primary Beneficiary. The Staff referred to FASB Staff Position FIN 46(R)-6.⁶

An example posited by the Staff was a Variable Interest Entity that has assets and liabilities with matched duration whose assets yield LIBOR plus 200% and whose liabilities yield LIBOR flat.

Board Reaction:

Some Board members indicated they believe interest rate risk should be considered while others indicated they believe it should not.

We expect the Staff and the Board will discuss this more at future Board Meetings and/or Education Sessions.

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⁵ 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

⁶ Determining the Variability to Be Considered in Applying FASB Interpretation No. 46(R)