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# Financial Services



# On-Call Accounting Alert

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## June 11, 2008 FASB Meeting on FIN 46(R)<sup>1</sup> Amendment

### Summary:

As discussed in detail below, the Board agreed on:

1. A revised approach for determining a variable interest entity's ("VIE") primary beneficiary ("PB"), the party who consolidates the VIE,
2. Amendment effective date and transition provisions,
3. Transitional disclosures, and
4. A 60 day Exposure Draft comment period.

The Board instructed the Staff to proceed with the final drafting of the Exposure Draft for Board approval. The Staff indicated it hopes to release the Exposure Draft by the end of July, which the Staff indicated is an aggressive timeline.

The Board previously decided SFAS 140 QSPEs will no longer be exempt from FIN 46(R). The Board also previously decided a redetermination must be made each time a variable interest ("VI") holder issues financial statements (e.g., quarterly, for public companies) of:

1. Whether an entity is a VIE, and
2. If a VI holder is the VIE's PB.

<sup>1</sup> Consolidation of Variable Interest Entities, an interpretation of ARB No. 51."

## **PB Determination:** (a two step process)

**Step 1:** The PB is the party (if any) qualitatively determined to have:

1. Power to direct VIE activities, and
2. The possibility (ignoring likelihood) of:
  - Receiving significant VIE benefits or
  - Absorbing significant VIE losses (in both cases, not FIN 46 (R) variability),

including from “implicit VIs.”

In determining if a VI holder has power, “substantive kick out rights” (defined in FIN 46(R) ¶B20) are not to be considered relevant as power is deemed to exist based only on current rights, unless they are “temporary.” While the Staff will perform further analysis during the Exposure Draft’s comment period, the Exposure Draft will provide that kick out rights continue to be relevant in determining if an entity is a VIE under FIN 46 ¶5(b) (1), if a decision maker has a VIE VI pursuant to FIN 46(R) ¶B19, and under EITF 04-5.<sup>2</sup>

**Step 2:** If it cannot be qualitatively determined in Step 1 that there is a PB, the PB is the party (if any) quantitatively determined to have > 50% of VIE expected loss or residual return (a current FIN 46 (R) analysis).

### **Transition and Effective Date:**

When the Amendment is first applied, its effect will be shown as a cumulative effect adjustment equal to the difference between the PB’s pre-consolidation carrying amount of its VIE interests and the PB’s net VIE carrying amount upon VIE consolidation or deconsolidation. Prior financials will not be restated.

The Amendment will apply to all VIEs other than certain existing QSPEs at the start of the first fiscal year beginning after November 15, 2008. For QSPEs that do not issue new beneficial interests or acquire assets they are not contractually committed to acquire after the start of the first fiscal year beginning after November 15, 2008, the Amendment will apply at the start of the first fiscal year beginning after November 15, 2009. The Exposure Draft will ask for comments on whether those effective dates are practical or if they should be deferred (e.g., to the

start of the first fiscal year beginning after November 15, 2009 for all VIEs).

An enterprise with a VI or a potential VI in an entity created before Amendment effectiveness previously determined to be a QSPE, and which was therefore exempt from FIN 46(R), will not be required to apply FIN 46(R)’s consolidation provisions to the QSPE (disclosure will be required) if, after making exhaustive efforts, it is unable to obtain the information necessary to determine if it is the VIE’s PB or to perform the accounting necessary to consolidate the VIE.

### **Transitional Disclosure:**

If the Amendment is effective after the start of the first fiscal year beginning after November 15, 2008, the following information must be disclosed in interim and annual financials issued in the first fiscal year beginning after November 15, 2008 if it is reasonably possible an enterprise will initially consolidate, deconsolidate, or disclose information about a VIE upon Amendment effectiveness:

1. The nature, purpose, size, and activities of the VIE,
2. The enterprise’s maximum exposure to loss from its involvement with the VIE,
3. The reason the VIE was not previously consolidated, and
4. The reasons the VIE was previously consolidated and why it’s reasonably possible the VIE will not be consolidated upon Amendment implementation.

Certain other Amendment disclosures (specifics were not discussed) will also be required in the first fiscal year beginning after November 15, 2008.

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<sup>2</sup> “Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights

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