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FASB Issues Exposure Draft on Consolidation of Special-Purpose Entities

On June 28, 2002, the Financial Accounting Standards Board (FASB or "the Board") issued an Exposure Draft of a proposed Interpretation, *Consolidation of Certain Special-Purpose Entities-an interpretation of ARB No. 51*. Except as discussed below, the proposed Interpretation would apply to any business enterprise-public or private-that has an ownership interest, contractual relationship, or other business relationship with a special-purpose entity (SPE).

Background

Accounting Research Bulletin No. 51, *Consolidated Financial Statements*, states that "there is a presumption that consolidated statements are more meaningful than separate statements and that they are usually necessary for a fair presentation when one of the companies in the group directly or indirectly has a controlling financial interest in the other companies. The usual condition for a controlling financial interest is ownership of a majority voting interest. . . ."

In the Exposure Draft, the Board noted that SPEs are not always structured such that they are subject to control through ownership of voting interests; therefore, the Board believes the consolidation of an SPE should be based on an assessment of either (1) the SPE's voting interests if there is a controlling financial interest or (2) the SPE's "variable interests."

Key Provisions

According to the proposed Interpretation:

- Variable interests are the means through which (1) financial support is provided to an SPE and (2) the parties providing financial support are positively or negatively impacted by activities and events that change the values of the SPE's assets and liabilities.
- Variable interests may arise from contractual rights and obligations, such as those that result from loans or debt securities, residual interests in transferred assets, management contracts, service contracts, leases, guarantees, nonvoting ownership interests, or other arrangements.
- If the voting interests in the SPE do not convey a controlling financial interest, the SPE should be consolidated by its primary beneficiary [i.e., the party that holds (1) a majority of the variable interests in the SPE or (2) a significant portion of the total variable interests where such variable interest is significantly greater than any other party's variable interest].
- Every party that has a relationship with that SPE should assess as of each reporting date whether it provides significant financial support to the SPE and, therefore, is the SPE's primary beneficiary.
- No enterprise shall be deemed to be the primary beneficiary of a subsidiary, division, department, branch or other portion of a "substantive operating enterprise," as defined.

The purpose of this publication is to briefly describe key regulatory and professional developments that have recently occurred in the field of accounting and to provide links to locations where additional information can be found on each topic. Readers seeking additional information about a topic should review the information referred to in the hyperlinks and not rely on the descriptions included in this communication.

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The proposed Interpretation would not require consolidation by:

- A transferor of assets to a qualifying SPE under Statement of Financial Accounting Standards (SFAS) No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*
- An employer that sponsors an employee benefit plan under the provisions of SFAS No. 87, *Employers' Accounting for Pensions*, SFAS No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, and SFAS No. 112, *Employers' Accounting for Postemployment Benefits*.

Effective Date and Other Matters

The provisions of the proposed Interpretation would be effective immediately for all SPEs created after the date the final Interpretation is issued. Parties involved with SPEs that existed before the date of issuance ("pre-existing SPEs") would be required to apply the provisions to the pre-existing SPEs as of the beginning of the first fiscal period after March 15, 2003. Thus, calendar year-end companies that prepare quarterly financial statements would need to apply the provisions as of April 1, 2003.

Comments on the Exposure Draft should be received by the FASB by August 30, 2002.

The Exposure Draft can be obtained on the FASB's website at http://www.fasb.org/draft/ed_prop_interp_spe.pdf.

Note: Conclusions of the FASB are subject to change at future Board meetings and generally do not affect current accounting requirements until an official position (Statement or Interpretation) is issued. Official positions of the FASB are determined only after extensive deliberation and due process, including a formal vote by written ballot to issue a Statement or Interpretation.

Further information about the FASB can be obtained on the FASB's website, <http://www.fasb.org>.

GASB Proposes Standard on Disclosure of Certain Risks

On June 28, 2002, the Governmental Accounting Standards Board (GASB or "the Board") issued an Exposure Draft of a proposed GASB Statement, *Deposit and Investment Risk Disclosures*, for public comment.

The Exposure Draft, which would amend GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*, would require the financial statements of a governmental entity to disclose:

- Credit-risk information, including quality information issued by rating agencies
- Interest-rate information, including maturity information for investment securities, such as weighted average maturities or specification identification of the securities
- Basis for sensitivity of investments that are highly sensitive to changes in interest rates
- Foreign-investment information, including the foreign investment's denomination
- Deposit and investment policies related to disclosed risks.

A final Statement would be effective for fiscal years beginning after June 15, 2004.

Comments on the Exposure Draft should be received by the GASB by September 27, 2002. Further information about the Exposure Draft, including details for ordering copies, can be obtained on the GASB's website at <http://www.gasb.org/news/nr070102.html>.

GASB Points Out Error in Statement 39 on Component Units

The GASB has announced that an error during the final stages of production on Statement No. 39, *Determining Whether Certain Organizations Are Component Units*, an amendment of GASB Statement No. 14, caused the phrase "or its component units" to be inadvertently dropped from paragraph 5 of the standard. As corrected (in bold), the second criterion listed in that paragraph is, "The primary government, **or its component units**, is entitled to, or has the ability to otherwise access, a majority of the economic resources received or held by the separate organization."

GASB has asked that those who have copies of Statement No. 39 make the modification by hand in their copies. Further information about this matter, including details for correcting the error by hand or, alternatively, for receiving a "peel-and-stick" overlay, can be obtained on the GASB's website at http://www.gasb.org/tech/GASB_39_error.html.

Note: Conclusions of the GASB are subject to change at future Board meetings and generally do not affect current accounting requirements until an official position (Statement or Interpretation) is issued. Official positions of the GASB are determined only after extensive deliberation and due process, including a formal vote by written ballot to issue a Statement or Interpretation.

Further information about the GASB can be obtained on the GASB's website, <http://www.gasb.org>.

SEC Requires Principal Officers of Large Companies to Certify Certain Reports

On June 27, 2002, the U.S. Securities and Exchange Commission (SEC) issued Order No. 4-460, which requires the principal executive officer and principal financial officer of public companies with reported annual revenues of more than \$1.2 billion to certify that their most recent reports filed with the SEC are both complete and accurate. According to the SEC's press release, "Officers who make false certifications will face personal liability."

Specifically, the Order requires that these officers each file a separate, sworn written statement with the SEC in which they personally attest that their company's covered reports are materially truthful and complete or explain why such a statement would be incorrect. In either case, the statement must include a declaration as to whether its contents have been reviewed with the company's audit committee (or with the independent members of the company's board of directors if there is no audit committee).

The covered reports, including any amendments, consist of the most recent annual report on Form 10-K and any of the following that are filed with the SEC after the most recent 10-K:

- Reports on Form 10-Q
- Reports on Form 8-K
- Definitive proxy materials.

The principal officers are required to file their sworn statements with the Commission no later than its close of business on the first date that their company is required to file a Form 10-K or Form 10-Q on or after August 14, 2002. The SEC intends to make the certifications available to the public on the SEC website.

Information about the Order can be accessed on the SEC's website, as follows:

- Press release: <http://www.sec.gov/news/press/2002-96.htm>
- Order No. 4-460: <http://www.sec.gov/rules/other/4-460.htm>
- List of companies covered by the Order: <http://www.sec.gov/rules/other/4-460list.htm>
- "Frequently Asked Questions" about the Order: <http://www.sec.gov/rules/other/4-460faqs.htm>

Further information about the SEC can be obtained on the SEC's website, <http://www.sec.gov>.

IASB Announces Upcoming Projects

The International Accounting Standards Board (IASB) has announced that its work program over the next 12 months will include a new technical project on revenue and liabilities, as well as research projects (some in collaboration with national standard-setting bodies) on:

- The application of international accounting standards to small and medium-sized entities and in emerging economies
- Lease accounting
- Accounting concepts, including a strategic review of the basic elements of accounting
- Aspects of accounting for financial instruments.

The next meeting of the IASB will be held on July 16-19, in London. Further information about the IASB can be obtained on the IASB's website at <http://www.iasb.org.uk/> and on Deloitte & Touche's IAS Plus website at <http://www.iasplus.com/index.htm>.

Senate Passes Bill to Improve Investor Protection and Oversee Accounting Profession

On July 15, 2002, the United States Senate passed by a vote of 97-0, a bill intended to increase investor protection and to oversee the accounting profession. Senate Bill S.2673, "Public Company Accounting Reform and Investor Protection Act of 2002" will need to be reconciled with the House of Representatives Bill H.R. 3763, "Corporate and Auditing Accountability, Responsibility, and Transparency Act of 2002" that was passed April 24, 2002, before a final bill can be voted upon by both houses of Congress.

Copies of the two bills can be found at:

- Senate Bill: <http://thomas.loc.gov/cgi-bin/query/z?c107:S.2673>:
- House Bill: <http://thomas.loc.gov/cgi-bin/query/z?c107:H.R.3763>:

President Bush Outlines Plan for Improvements in Corporate Responsibility

In a July 9, 2002 speech to a group of business leaders in New York City, President George W. Bush called for a new ethic of responsibility in America's corporate community and outlined proposed initiatives to encourage that responsibility and to expose and punish acts of corruption.

Specifically, the President said he would seek to:

- Gain passage of new criminal penalties and enforcement provisions to punish those who refuse to adhere to the rules and, thus, threaten to undermine the integrity of financial markets.
- Strengthen laws that criminalize document shredding and other forms of obstruction of justice.
- Empower the SEC to freeze improper payments to corporate executives while the executives and/or company is under investigation.
- End the practice of allowing corporate officers to receive loans from their companies.
- Prevent corporate officers from profiting from erroneous financial statements, and ban officers who abuse their power from serving in any corporate leadership positions.
- Require corporate leaders to publicly report, in a timely manner, their purchases and sales of their company's stock.
- Challenge chief executive officers to comply with the spirit of existing disclosure rules by explaining prominently, and in plain English, how their compensation packages are in the best interests of their company's shareholders.
- Urge Congress to take immediate action to pass funding increases so that the SEC can hire additional enforcement officers and provide the SEC with state-of-the-art technology.
- Call on the nation's stock markets to require that (1) a majority of a company's directors be independent, (2) all members of a company's audit committee, nominating committee, and compensation committee be independent, and (3) shareholders approve their company's stock option plans.

The complete text of President Bush's speech can be obtained on the White House's website, <http://www.white-house.gov/>.

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