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Heads Up

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# FASB Exercises Its Kick-Out Right

# Board Votes to Defer Statement 167 for Interests in Certain Entities

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At its November 11, 2009, Board meeting, the FASB tentatively decided to defer the effective date of Statement 167[1] for a reporting enterprise's interest in certain entities. This proposed deferral is meant to address constituent concerns that applying the current requirements under Statement 167 will distort the financial statements of asset managers. The proposed deferral is also meant to address concerns that the IASB's proposed consolidation model may result in a different consolidation conclusion for asset managers. The Board also agreed to provide a deferral for money market mutual funds. Finally, the Board agreed to amend certain provisions of paragraph B22 of Interpretation 46(R),[2] as amended by Statement 167, to change how a decision maker or service provider determines whether its fee is a variable interest.

The Board indicated that it will issue a proposed Accounting Standards Update (ASU) in the next 10 days that incorporates these tentative decisions. The proposed ASU, which will have a 30-day comment period, will be posted to the FASB's Website. After the conclusion of the comment period, the Board will review the comment letters, redeliberate the issues, and issue a final ASU. Therefore, changes in guidance could occur between issuance of the proposed ASU and the final ASU. The FASB staff indicated that it would attempt to finalize the guidance by the middle of January 2010.

This proposed deferral is meant to address constituent concerns that applying the current requirements under Statement 167 will distort the financial statements of asset managers.

**Editor's Note:** The Board instructed the FASB staff to make certain drafting changes to the guidance that was discussed at the Board meeting. Accordingly, the language in the proposed ASU could differ from the language noted in this *Heads Up*.

## Deferral of Statement 167 for Interests in Certain Entities

The Board decided to indefinitely defer the application of Statement 167 for a reporting enterprise's interest in entities that meet all of the following conditions:

1. The entity has all of the attributes specified in paragraph 15-2 of ASC 946-10[3] or, if one or more of the attributes specified in ASC 946-10-15-2 are not present, is an entity for which it is industry practice to issue financial statements in accordance with guidance that is consistent with the measurement principles in Topic 946.
2. The reporting entity does not have an obligation to fund losses of the entity that could potentially be significant to the entity. Evaluation of this condition should take into account any implicit or explicit guarantees by the reporting entity.

[1] FASB Statement No. 167, *Amendments to FASB Interpretation No. 46(R).*
[2] FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities* — an interpretation of ARB No. 51.
[3] FASB Accounting Standards Codification Subtopic 946-10, *Financial Services — Investment Companies: Overall* (formerly the AICPA Audit and Accounting Guide, *Investment Companies*).

3. The reporting entity does not have an interest in the entity that absorbs a disproportionate share of the entity's actual losses to other equity investors.

The FASB staff indicated that mutual funds, hedge funds, private equity funds, and venture capital funds are examples of entities that may meet the conditions for deferral. The FASB staff also indicated that securitization entities, asset-backed financing entities, or entities formerly classified as qualifying special-purpose entities (QSPEs) would not meet these conditions. In addition, the staff stated that the structures in Appendix C of Interpretation 46(R), as amended by Statement 167, would not be eligible for the deferral (including collateralized debt obligation structures (CDOs)). The deferral period is indefinite; however, the staff indicated it was designed to allow the FASB and IASB to jointly develop guidance for these entities, including guidance that would further clarify whether an enterprise is serving as an agent. For entities subject to the deferral, the reporting enterprise would continue to apply the variable interest entity model in ASC 810-10 (before its amendment by Statement 167) or other applicable consolidation guidance such as ASC 810-20[4] (formerly EITF Issue 04-5[5]) when evaluating the entity for consolidation.

Note that the deferral is based, in part, on whether the entity being evaluated for consolidation has all of the attributes specified in paragraph 15-2 of ASC 946-10 regardless of whether the entity was previously considered to be in the scope of the AICPA's Audit and Accounting Guide, *Investment Companies*. For example, the FASB staff stated that this would mean certain mortgage real estate investment trusts (REITs) may be eligible for the deferral.

The FASB staff indicated that mutual funds, hedge funds, private equity funds, and venture capital funds are examples of entities that may meet the conditions for deferral.

The deferral is based on the entity being evaluated for consolidation, not the enterprise performing that evaluation. This could result in an enterprise applying Statement 167 to certain entities (e.g., a former QSPE), but not applying it to other entities (e.g., a mutual fund).

**Editor's Note:** The Board questioned the staff on the intent of the third condition and asked whether a clawback feature would prevent a private equity investment manager that receives a 20 percent performance-based fee from being eligible for the deferral. The staff indicated that a clawback feature alone would not prevent the investment manager from receiving the deferral for that entity. The staff indicated that the intent of this condition would be clarified in the proposed ASU.

## Deferral for Money Market Mutual Funds

The Board decided to indefinitely defer the application of Statement 167 for a reporting enterprise's interest in a mutual fund that is required to comply or operates in accordance with the requirements in Rule 2a-7 of the Investment Company Act of 1940 because of legal or statutory requirements. These entities would be subject to the deferral even if the money market fund manager has an explicit or implicit obligation to absorb losses of the fund. Therefore, this guidance would allow the deferral for money market funds even when the investment manager provided support to prevent the fund from "breaking the buck."

## Changes to Paragraph B22

The Board decided to propose the following changes to paragraph B22 of Interpretation 46(R), as amended by Statement 167:

1. The introduction to paragraph B22 would clarify that an enterprise would consider related parties when assessing all of the conditions in paragraph B22.
2. Paragraph B22(c) would require an evaluation of whether an enterprise's other interests in the entity *could* absorb a more than an insignificant amount of the entity's expected losses or residual returns. (The guidance in paragraph B22(c) currently

[4] FASB Accounting Standards Codification Subtopic 810-20, *Consolidation: Control of Partnerships and Similar Entities.*

[5] EITF Issue No. 04-5, "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."

requires an evaluation of whether an enterprise's other interests *would* absorb a more than insignificant amount of the entity's expected losses or residual returns.)

The FASB was concerned that reporting enterprises were only considering their related-party interests when evaluating paragraph B22(c); however, the Board's intent was that an enterprise's related parties would be considered in an enterprise's evaluation of *all* the conditions in paragraph B22. In addition, the Board stated that the evaluation performed under paragraph B22(c) should be consistent with the evaluation performed under paragraph 14A(b) of Interpretation 46(R), as amended by Statement 167. Accordingly, the FASB indicated that paragraph B22(c) would be amended to state that the "quantitative approach prescribed in paragraph 8 of [Interpretation 46(R)] is not required and shall not be the sole determinant as to whether an enterprise has these obligations or rights."

The Board's intent was that an enterprise's related parties would be considered in an enterprise's evaluation of all the conditions in paragraph B22.

**Editor's Note:** For entities not eligible for the deferral of Statement 167, the FASB's proposed revisions to paragraph B22 may result in more decision makers and service providers concluding that their fee represents a variable interest because probability would not be considered in the revised B22(c) assessment.

For additional interpretive guidance on the application of Statement 167, Deloitte's June 16 and October 20, 2009, *Heads Up* newsletters.

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