

Heads Up

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FASB Amends the Consolidation Guidance Related to Variable Interest Entities.

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On June 12, 2009, the FASB issued Statement 167,¹ which amends the consolidation guidance applicable to variable interest entities (VIEs). The amendments will significantly affect the overall consolidation analysis under Interpretation 46(R).² While the Board's discussions leading up to the issuance of Statement 167 focused extensively on structured finance entities, the amendments to the consolidation guidance affect all entities and enterprises currently within the scope of Interpretation 46(R), as well as qualifying special-purpose entities (QSPEs) that are currently excluded from the scope of Interpretation 46(R). Accordingly, an enterprise will need to carefully reconsider its previous Interpretation 46(R) conclusions, including (1) whether an entity is a VIE, (2) whether the enterprise is the VIE's primary beneficiary, and (3) what type of financial statement disclosures are required.

Statement 167 is effective as of the beginning of the first fiscal year that begins after November 15, 2009 (calendar-year-end companies must adopt the standard as of January 1, 2010), and early adoption is prohibited.

The table below summarizes the more significant provisions of Statement 167 and compares them with those of Interpretation 46(R) before the adoption of Statement 167. The table is followed by a more detailed discussion of these amendments. Responses to various implementation questions are provided in the [appendix](#).

Decision	Statement 167	Interpretation 46(R)
Scope exemption for QSPEs	The concept of a QSPE is removed from Statement 140. ³ Accordingly, the scope exemption for QSPEs is removed from Interpretation 46(R). As a result, transferors, sponsors, and investors in QSPEs will need to consider the consolidation and disclosure provisions in Statement 167.	QSPEs are generally exempt from the scope of Interpretation 46(R).
Determining the primary beneficiary of a VIE	The consolidation model is based on power and economics. The primary beneficiary of a VIE is the enterprise that has (1) the power to direct the activities of the VIE that most significantly impact the VIE's economic performance and (2) the obligation to absorb losses of the VIE that could potentially be significant to the VIE or the right to receive benefits of the VIE that could potentially be significant to the VIE.	Determination of the primary beneficiary of a VIE is based on risks and rewards. The enterprise that absorbs a majority of the expected losses of the VIE, receives a majority of the expected residual returns of the VIE, or both, is the primary beneficiary and is required to consolidate the VIE.

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 Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* — a replacement of FASB Statement No. 125.

The FASB decided to eliminate the concept of a QSPE and remove the scope exemption from Interpretation 46(R).

Decision	Statement 167	Interpretation 46(R)
Shared power	If an enterprise determines that power is shared among multiple unrelated parties involved with a VIE such that no party has the power to direct the activities of a VIE that most significantly impact the entity's economic performance, no party consolidates the VIE. Power is only considered shared if (1) two or more unrelated parties together have the power to direct the VIE's most significant activities and (2) decisions about those activities require the consent of each of the parties sharing power.	The consolidation model does not focus on power; rather, it focuses on which enterprise absorbs the majority of the expected losses or receives the majority of the expected residual returns.
Consideration of kick-out, participating, and protective rights	Kick-out rights and participating rights are ignored in (1) the determination of whether the entity is a VIE and (2) the identification of the VIE's primary beneficiary, unless the rights are held by a single enterprise (including its related parties and de facto agents). Protective rights held by other parties do not prevent an enterprise from having power.	Kick-out rights are considered in the determination of whether the entity is a VIE, even if the rights are held by multiple parties, provided those rights are substantive.
Reconsideration of the primary beneficiary	An enterprise must continually reconsider which interest holder is the VIE's primary beneficiary. The troubled debt restructuring (TDR) exemption is removed.	An enterprise must only reconsider which interest holder is the VIE's primary beneficiary if certain triggering events occur (i.e., reconsideration events). A TDR is excluded as an event that would result in the reconsideration of the primary beneficiary.
Reconsideration of a VIE	An additional event requires reconsideration of an entity's status as a VIE and removes the TDR exemption. An enterprise must reassess an entity's status if the equity interest holders lose the power from the voting rights of those investments to direct the entity's most significant activities.	An interest holder must reconsider whether an entity is a VIE if certain specified triggering events occur. A TDR is excluded as an event that would result in the reconsideration of the entity's status as a VIE.
Fees paid to decision makers or service providers	Kick-out rights or customary cancellation provisions are not considered in the determination of whether fees paid to decision makers or service providers are variable interests. Additional modifications have been made to the requirements.	Fees paid in a fiduciary arrangement are not considered variable interests if certain conditions are met, including the existence of substantive kick-out rights in a decision-maker agreement and the existence of customary cancellation provisions in a service-provider arrangement.
Presentation requirements	The primary beneficiary is required to separately present on the face of the balance sheet (1) assets of consolidated VIEs that can only be used to settle obligations of those VIEs and (2) liabilities of consolidated VIEs for which creditors do not have recourse to the general credit of the primary beneficiary.	An enterprise is not required to present elements of a consolidated VIE separately on the face of the balance sheet.

Scope Exemption for QSPEs

An enterprise that transfers financial assets to a securitization vehicle that meets the definition of a QSPE is currently exempted from certain derecognition requirements under Statement 140. This exemption is based on the premise that QSPEs are passive pass-through entities with limited decision-making abilities. In addition, under the scope exception in Interpretation 46(R) for QSPEs, the transferred assets are generally not required to be consolidated by any enterprise involved with the QSPE, including the transferor. However, a number of questions have been raised about the passivity conditions required for a QSPE (e.g., whether a special-purpose entity (SPE) can maintain its qualifying status when responding to unexpected events, such as the recent credit crisis). Accordingly, the FASB decided to eliminate the concept of a QSPE and remove

the scope exemption from Interpretation 46(R). Therefore, under Statement 167, all enterprises involved with QSPEs are required to evaluate whether they should consolidate the QSPE. In addition, all enterprises with a variable interest in a QSPE will need to consider the disclosure requirements in Interpretation 46(R). For more information about the FASB's amendments to the derecognition guidance in Statement 140, see [Deloitte's June 16, 2009, Heads Up](#) on Statement 166.⁴

Determining the Primary Beneficiary of a VIE

Statement 167 modifies the approach for determining the primary beneficiary of a VIE. Under the current Interpretation 46(R) model, it is often necessary to perform a quantitative analysis to determine which variable interest holder in a VIE absorbs a majority of the entity's expected losses or receives a majority of its residual returns and is therefore considered the primary beneficiary. In response to concerns regarding the difficulty of applying this quantitative approach and its inherent subjectivity, the FASB decided to adopt a qualitative approach in Statement 167.

Under Statement 167, the evaluation of whether an enterprise is the primary beneficiary of a VIE is based on a qualitative assessment. An enterprise determines qualitatively whether it has (1) the **power** to direct the activities of the VIE that most significantly impact the entity's economic performance and (2) the obligation to absorb losses of the VIE or the right to receive benefits from the VIE that could **potentially** be significant to the VIE. If an enterprise has both of these characteristics, the enterprise is considered the primary beneficiary and must consolidate the VIE. If the enterprise determines it has only one, or neither, of these characteristics, the enterprise is not the primary beneficiary.

Statement 167 contains a number of examples illustrating the application of the new consolidation model.

Editor's Note: Entities with a limited number of activities (e.g., securitization vehicles) will typically have fewer activities that most significantly impact the economic performance of a VIE than would, for example, operating entities, which may have a wide range of activities that need to be analyzed. An entity will need to use judgment to identify the activities that most significantly impact the economic performance of the VIE and to determine the party that controls those activities.

The assessment of whether an enterprise has the obligation to absorb losses of the VIE or the right to receive benefits from the VIE that could potentially be significant should be based on facts and circumstances. The mere possibility that an enterprise could absorb losses or receive benefits that could be significant to the VIE may cause the second condition to be met even if the possibility that the enterprise will have an economic exposure to the VIE is currently considered remote. However, the more remote it is that the enterprise could absorb losses or receive benefits, presumably the less likely it will be that the enterprise would have the power to direct the activities that most significantly impact the VIE's economic performance. The FASB did not provide guidance on the determination of "significant," but Statement 167 acknowledges that an enterprise's exposure to the expected variability of the VIE should "not be the sole determinant as to whether an enterprise has these obligations or rights."

In addition, Statement 167 requires that when an enterprise concludes that neither it nor one of its related parties has both of these characteristics but, as a group, the enterprise and its related parties (including the de facto agents) have those characteristics, then the party, within the related-party group, that is most closely associated with the VIE is the primary beneficiary.

Shared Power

Statement 167 requires that if the power to direct the most significant activities of a VIE is shared among multiple unrelated parties, no party should consolidate the VIE. However, power is only considered shared if (1) two or more unrelated parties together have the power to direct the activities of a VIE that most significantly impact the entity's economic

Statement 167
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of a VIE.

⁴ FASB Statement No. 166, *Accounting for Transfers of Financial Assets* — an amendment of FASB Statement No. 140.

When determining the primary beneficiary of a VIE under Statement 167, an enterprise should ignore the right of third parties to remove a variable interest holder unless the right is held by a single enterprise (including its related parties and de facto agents).

performance and (2) decisions about each of those activities require the consent of all of the parties sharing power. A typical arrangement in which power is considered shared is a joint venture in which all of the joint venture's significant activities require unanimous consent of the venturers.

If multiple unrelated parties have power over significant activities that are **different in nature** and consent regarding all of those activities is not required, then the party with the power over the activities that **most** significantly impact the VIE's economic performance is considered to have power over the entity. If the party with that power also has the obligation to absorb losses of the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE, that party would be the primary beneficiary. For example, if one party is responsible for the significant activities related to manufacturing a product and another unrelated party is responsible for the significant activities related to the product's distribution, and consent of both parties is not required on the decisions about each of those activities, each enterprise will need to determine which activity most significantly impacts the VIE's economic performance. If the activities related to manufacturing are most significant to the economic performance of the VIE, the enterprise with power over those activities is considered to have power over the VIE. An enterprise must use judgment in making this determination; however, when multiple unrelated parties have power over significant activities that are different in nature, one party should always be identified as the party having power over the most significant activities of the VIE. If this party also has the obligation to absorb losses of the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE, that party would be the primary beneficiary. Statement 167 notes that "as the number of activities of an entity increases, it will be more likely that one decision maker (or governing body) will exist or that decisions about those activities would require the consent of the enterprises involved with the entity."

If multiple unrelated parties have power over the **same** activity or activities that most significantly impact the economic performance of the VIE and consent regarding the activity or activities is not required, the party with power over the **majority** of the significant activity or activities is considered to have power over the VIE. If this party also has the obligation to absorb losses of the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE, that party is the primary beneficiary. If no party has power over the majority of the same significant activity or activities, there is no primary beneficiary.

See the [appendix](#) below for a flow chart illustrating these requirements.

Consideration of Kick-Out, Participating, and Protective Rights

When determining the primary beneficiary of a VIE under Statement 167, an enterprise should ignore the right of third parties to remove a variable interest holder unless the right is held by a single enterprise (including its related parties and de facto agents). However, if a single enterprise has the right to unilaterally remove the enterprise that directs the entity's most significant activities, that right, in and of itself, may support the fact that the enterprise with the kick-out rights has power over the entity.

In addition, an enterprise should only consider participating rights when identifying the primary beneficiary if these rights are held by a single enterprise (including its related parties and de facto agents). Although the FASB did not list the rights that should be considered participating rights (because such a determination will depend on facts and circumstances), only participating rights that relate to the most significant activities of the VIE should be considered in the analysis. Participating rights do not in isolation identify the party with the power to direct the VIE's most significant activities, but they may assist in identifying the primary beneficiary when they are considered in conjunction with other rights.

Statement 167 requires that an enterprise continually reconsider its conclusion regarding which interest holder is the VIE's primary beneficiary.

Editor's Note: When deliberating the new consolidation model, several Board members expressed concern that kick-out rights are typically not substantive and, therefore, should not be included in the determination of the primary beneficiary. The Board indicated that kick-out rights held by multiple unrelated parties should be excluded from the consolidation analysis because they are typically not exercised, notwithstanding their "substantive" accounting designation, and that allowing the inclusion of these rights in the consolidation analysis could potentially lead to structuring opportunities.

Statement 167 also requires that kick-out rights and participating rights be ignored in the determination of whether an entity is a VIE unless these rights are held by a single enterprise (including its related parties and de facto agents). For example, if an investment manager that directs the entity's most significant activities does not hold any equity at risk (or its equity at risk is considered inconsequential or its decision-making ability is not provided by its equity at risk) and the investment manager can only be removed by the multiple unrelated equity holders acting collectively, the entity may be considered a VIE because the equity holders at risk will not possess the power to direct the activities of the entity that most significantly impact the entity's economic performance.

Protective rights held by other parties do not prevent an enterprise from having the power to direct the activities of a VIE that most significantly impact the entity's economic performance even if they are held by a single enterprise (including its related parties and de facto agents).

Reconsideration of the Primary Beneficiary

Statement 167 requires that an enterprise continually reconsider its conclusion regarding which interest holder is the VIE's primary beneficiary. Currently, Interpretation 46(R) requires that an enterprise reconsider its determination of the primary beneficiary only when (1) there is a change in the VIE's governing documents or contractual arrangements that reallocates expected losses or expected residual returns, (2) the primary beneficiary disposes of all or part of its variable interests to unrelated parties or the VIE issues new variable interests to parties other than the primary beneficiary and its related parties, or (3) the enterprise acquires additional variable interests in the VIE. In addition, under an exemption currently in Interpretation 46(R), a troubled debt restructuring is not an event that would require the reconsideration of an entity's primary beneficiary.

Editor's Note: Because continual reconsideration is required, the enterprise will need to determine when, during the reporting period, the change in primary beneficiary occurred. If an enterprise determines that it is no longer the primary beneficiary of a VIE, it would need to deconsolidate that particular VIE on the date that the circumstances changed resulting in the enterprise no longer meeting the conditions for consolidation. This is particularly important in the determination of what amounts should and should not be included in the consolidated income statement related to the operations of the VIE.

Reconsideration of a VIE

The FASB decided that Statement 167 should include a reconsideration event that requires an enterprise to reassess whether an entity is a VIE when the holders of the entity's equity investment at risk, as a group, lose the power, from voting rights or similar rights of those investments, to direct the activities that most significantly impact the entity's economic performance. Accordingly, in addition to the four reconsideration events currently in Interpretation 46(R), the FASB decided to add this as an additional reconsideration event. Statement 167 also removes the exemption that a troubled debt restructuring is not considered an event that would require the reconsideration of an entity's status as a VIE.

Statement 167 requires an enterprise to present separately on the face of its balance sheet the (1) assets of consolidated VIEs that can only be used to settle obligations of those VIEs and (2) liabilities of consolidated VIEs for which creditors do not have recourse to the general credit of the primary beneficiary.

Fees Paid to Decision Makers or Service Providers

Statement 167 removes the requirement under Interpretation 46(R) to consider kick-out rights in the analysis of whether fees paid to a decision maker are considered a variable interest. In addition, the requirement to consider customary cancellation provisions for fees paid to a service provider has been eliminated. The remaining requirements for assessing whether arrangements with decision makers and service providers are variable interests were retained with some modifications. Specifically, related parties that are employees of the decision maker are no longer considered in this analysis (unless they are used to circumvent the provisions of Statement 167) and the threshold used in the assessment has been changed to "insignificant."

The FASB decided to replace the terms "trivial" and "not large" with the term "insignificant" because of concern that the phrase "more than trivial," which is currently in Interpretation 46(R), has been interpreted in practice to mean "anything more than zero." As a result, a decision maker's fees can still absorb some variability and not be considered a variable interest as long as the variability is insignificant and the other conditions are met. If an arrangement with a decision maker or service provider meets all six conditions in Statement 167 (paragraph B22), fees paid to the decision maker or service provider would typically not be considered a variable interest. However, if any of the six conditions are not met, then the arrangement with the decision maker or the service provider should be considered a variable interest and the qualitative evaluation of the VIE's primary beneficiary should be performed by that decision maker or service provider.

Presentation Requirements

Statement 167 requires an enterprise to present separately on the face of its balance sheet the (1) assets of consolidated VIEs that can only be used to settle obligations of those VIEs and (2) liabilities of consolidated VIEs for which creditors do not have recourse to the general credit of the primary beneficiary. This information is required to be presented on a gross basis (i.e., the liabilities would not be offset against the assets of the VIEs on the face of the balance sheet, unless permitted by other GAAP, for example Interpretation 39⁵). Historically this information was required to be disclosed in the footnotes to the financial statements.

Disclosure Requirements

Statement 167 adds disclosure requirements that address user concerns regarding a lack of transparency about an enterprise's involvement with VIEs. The disclosure requirements are generally consistent with those in FSP FAS 140-4 and FIN 46(R)-8,⁶ but they apply both to public entities and to nonpublic entities. Upon an entity's adoption of Statement 167, the FSP's requirements are nullified.

The disclosure requirements in Statement 167 focus on an enterprise's involvement with VIEs and the judgments it used in its consolidation analysis. For example, financial statement preparers are required to disclose their method for determining whether they are the primary beneficiary of a VIE, including the significant judgments and assumptions they made and whether the consolidation conclusion has changed in the most recent financial statements.

Disclosure is also required of (1) the details of any financial or other support provided to a VIE that the enterprise was not previously contractually required to provide and (2) the primary reasons the support was provided. The primary beneficiary of a VIE should also disclose the terms of any arrangements, including both explicit arrangements and implicit variable interests, that could require the enterprise to provide future support to the VIE.

⁵ FASB Interpretation No. 39, *Offsetting of Amounts Related to Certain Contracts*— an interpretation of APB Opinion No. 10 and FASB Statement No. 105.

⁶ FASB Staff Position (FSP) No. FAS 140-4 and FIN 46(R)-8, "Disclosures by Public Entities (Enterprises) About Transfers of Financial Assets and Interests in Variable Interest Entities."

If an enterprise is required to consolidate a VIE upon the initial adoption of Statement 167, the assets, liabilities, and noncontrolling interests of the VIE should be measured at their carrying amounts as if Statement 167 had been applied from the inception of the VIE.

In addition, any enterprise that holds a variable interest but is not the VIE's primary beneficiary must disclose the "carrying amounts and classification of the assets and liabilities in the [enterprise's] statement of financial position" that relate to the VIE and reconcile these amounts to the enterprise's maximum exposure to loss from such interest(s).

Finally, Statement 167 requires that if an enterprise determines that the power to direct a VIE's most significant activities is shared between multiple parties, the enterprise must disclose the significant factors considered and judgments made in that determination.

Transition Requirements

If an enterprise is required to consolidate a VIE upon the initial adoption of Statement 167, the assets, liabilities, and noncontrolling interests of the VIE should be measured at their carrying amounts as if Statement 167 had been applied from the inception of the VIE. Any difference between the net amounts required to be recognized and the amount of any previously recognized interests should be reflected as a cumulative-effect adjustment to retained earnings. If determining the carrying amounts of these items is not practicable, they may be measured at fair value. For VIEs that are securitization vehicles or other forms of asset-backed financing vehicles (and the assets of the entity can only be used to pay the entity's obligations), their assets and liabilities that have a principal balance may be recognized at either fair value or at their unpaid principal balances on the date of adoption.

An enterprise may also elect the fair value option under Statement 159⁷ for the financial assets and liabilities it is required to consolidate as a result of the initial adoption of Statement 167, provided this election is made for all of the eligible financial assets and liabilities of the VIE (i.e., if an enterprise is required to consolidate more than one VIE as a result of adopting Statement 167, it can elect the fair value option entity by entity; however, the election must cover all of the financial assets and liabilities of each VIE for which the fair value option is elected).

If initial application of Statement 167 results in deconsolidation of a VIE, any retained interest in the VIE should be measured at its carrying value as if Statement 167 had been applied from the inception of the VIE.

Editor's Note: The Federal Reserve issued a press release stating that it is "reviewing regulatory capital requirements associated with the adoption of [Statement 167]." The press release notes that the Federal Reserve is "considering a broad range of factors including the maintenance of prudent capital levels, the record of recent bank experiences with off-balance sheet vehicles, and the results of the recent Supervisory Capital Assessment Program (SCAP)." The press release also states that "banking organizations should take into account [the full impact of this standard in their internal capital planning processes to] assess whether additional capital may be necessary."

Convergence With the IASB

Although consolidation is a FASB and IASB convergence project, the FASB believed that an immediate improvement to the consolidation model was necessary and consequently issued Statement 167. The IASB recently issued an exposure draft on consolidation and is expected to issue a final standard in 2010. The FASB is then expected to expose for public comment the IASB's final consolidation standard, which, if adopted by the FASB, would ultimately replace ARB 51⁸ and Interpretation 46(R).

⁷ FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* — including an amendment of FASB Statement No. 115.

⁸ Accounting Research Bulletin No. 51, *Consolidated Financial Statements*.

Appendix — Implementation Questions and Answers

Transition

Are enterprises required to reconsider their previous conclusions under Interpretation 46(R) upon the adoption of Statement 167?

Upon the adoption of Statement 167, enterprises are required to reconsider their previous consolidation conclusions. Such reconsideration should include, but not be limited to, whether:

- Consolidation is no longer appropriate or whether it is appropriate now.
- Entities with which they are involved are now VIEs or no longer VIEs according to the changes in paragraph 5(b)(1).
- Additional disclosures are required based on the removal of the exemption from providing disclosures for variable interests that are not significant.
- Service contracts or decision-maker fees are considered variable interests.
- The fair value option will be elected for VIEs that the enterprise is required to consolidate as a result of the adoption of Statement 167.

Has Statement 167 amended the scope of Interpretation 46(R)?

Statement 167 eliminates the QSPE concept from Statement 140; accordingly, the scope exemptions for QSPEs in paragraphs 4(c) and 4(d) of Interpretation 46(R) are eliminated. A determination will therefore need to be made about whether QSPEs that previously qualified for the exemptions are VIEs and thus may be required to be consolidated. However, an entity that previously qualified for the QSPE scope exemption may qualify for the exemption in paragraph 4(g) if (1) after the enterprise makes an exhaustive effort it is unable to obtain the information required to complete its consolidation analysis and (2) the entity was created before December 31, 2003. None of the other scope exemptions in Interpretation 46(R) have been modified.

In addition, an entity that did not previously qualify for a scope exemption may not reassess whether it now qualifies simply as a result of the adoption of Statement 167.

What should enterprises consider when modifying arrangements, contracts, or transactions with a VIE before the effective date of Statement 167?

In Statement 167, the FASB added specific guidance to emphasize that when applying Statement 167, enterprises should only consider substantive terms, transactions, and arrangements. The Board thought that this language was necessary to avoid situations in which the form of an entity may indicate that an entity is not a VIE or that an enterprise is not a primary beneficiary when the substance of the arrangement may indicate otherwise. Further, paragraph A35 of the Basis for Conclusions states, "In the Board's view, the level of skepticism about an enterprise's lack of power should increase as the disparity between an enterprise's economic interest and its power increases."

Therefore, an enterprise should make sure that the inclusion (or exclusion) of terms, transactions, and arrangements, whether contractual or noncontractual, are substantive. When applying the provisions of Statement 167, an enterprise should disregard any nonsubstantive term, transaction, or arrangement that does not truly impact the enterprise's power or rights to receive benefits or obligations to absorb losses. Enterprises should apply judgment, based on consideration of all the fact and circumstances, to distinguish substantive terms, transactions, and arrangements from nonsubstantive terms, transactions, or arrangements.

On May 28, 2009, at a public conference, James Kroeker (acting chief accountant in the SEC's Office of the Chief Accountant) stated that the SEC staff has become aware of the possibility that an enterprise may attempt to avoid consolidation of a special-purpose vehicle by providing stated power to another party while retaining the substantive risks and rewards of ownership. He indicated that the SEC staff is highly skeptical of the suggested accounting result and would consider involving the Division of Enforcement if it becomes aware that such arrangements are executed. Further, as referenced above, the FASB has stated in Statement 167 that heightened skepticism would be necessary in such circumstances.

What disclosures are required in a public enterprise's financial statements issued before the adoption of Statement 167?

[SEC Staff Accounting Bulletin Topic 11.M, "Disclosure of the Impact That Recently Issued Accounting Standards Will Have on the Financial Statements of the Registrant When Adopted in a Future Period" \(SAB 74\)](#), requires SEC registrants to disclose the effect of new pronouncements issued but not yet effective. SAB 74 requires disclosure of how the registrant expects to be affected by the standard's adoption. The SEC staff will expect robust disclosures in calendar-year-reporting registrants' 2009 Forms 10-K because

the filing deadline is after the date of initial application of Statement 167. In addition, the disclosure requirements of SAB 74 apply to interim financial statements filed before the adoption of Statement 167. The following SAB 74 disclosures should generally be considered:

- A brief description of Statement 167 and the date on which the registrant is required to adopt it.
- The methods of adoption allowed by the standard and the method the registrant is expected to use, if determined.
- The impact that adoption of the standard is expected to have on the financial statements of the registrant, unless unknown or not reasonably estimable, in which case this should be stated.
- The potential impact of other significant matters that the registrant believes might result from the adoption of the standard (e.g., technical violations of debt covenant agreements, violation of capital requirements).

Does Statement 167 affect an enterprise's consolidation assessment under ARB 51?

The identification of a VIE's primary beneficiary under Statement 167 is based, in part, on an assessment of which enterprise has power over the VIE and may not be consistent with the criteria for assessing control under ARB 51. Before applying ARB 51, an enterprise should determine whether the entity it is involved with is a VIE and subject to Statement 167. In addition, Statement 167 did not amend the consolidation requirements in ARB 51.

Variable Interests and Variable Interest Entities

Does Statement 167 affect an enterprise's determination of whether an interest in an entity is a variable interest?

Statement 167 modifies the guidance on when decision-maker and service-provider arrangements are considered variable interests; however, Statement 167 does not modify (and carries forward) how variable interests in an entity are identified under the guidance in FSP FIN 46(R)-6.⁹

How does Statement 167 affect how an enterprise determines whether an entity is a VIE?

Statement 167 amends paragraph 5(b) of Interpretation 46(R), which focuses on whether the holders of the equity at risk lack the characteristics of a controlling financial interest. Specifically, the amended requirements in paragraph 5(b)(1) focus on whether the holders of the equity at risk have the power to direct the activities of the entity that most significantly impact the entity's economic performance.

Before adoption of Statement 167, equity holders are generally deemed to control the activities of the entity if the ability to remove the decision maker meets the criteria of substantive kick-out rights. In contrast, Statement 167 requires that for kick-out rights to be considered, they need to be held by a single party (including related parties and de facto agents) and be considered substantive. Accordingly, a partnership would be considered a VIE if the general partner (decision maker) that is not an equity holder and whose service contract represents a variable interest can only be removed by the collective action of multiple unrelated limited partners. Key considerations in the consolidation assessment are (1) whether the decision maker holds equity at risk that provides it with its decision making abilities, (2) whether kick-out rights are held by a single party, and (3) whether the decision maker's service contract is a variable interest.

Under paragraph 5(b) of Interpretation 46(R), does there need to be a minimum amount of equity held by an investment manager or general partner for its interest to be considered part of the equity at risk?

For the equity investment of an investment manager or general partner to be considered at risk, it must be determined to be more than "inconsequential." In making this assessment enterprises may consider the following:

- The investment manager's or general partner's investment in the entity relative to the value of other investments providing a similar return. For example, if the investment manager or general partner invests \$1 thousand in a \$10 million fund, and the minimum investment required for all other participants is \$500 thousand, the investment manager's or general partner's investment may be considered inconsequential.
- The design of the entity. If the entity appears to be designed (or redesigned) to produce a desired accounting result (e.g., to specifically avoid the provisions of Statement 167 or to cause an entity or enterprise to fall within the scope of Statement 167), additional skepticism should be used in arriving at a conclusion.
- Other factors. Considerations such as the legal and tax implications and the extent to which they drive the amount invested by an investment manager's or general partner's interest, as well as whether the investment manager or general partner is a related party of other investors in the entity, should also be taken into account.

⁹ FASB Staff Position (FSP) No. FIN 46(R)-6, "Determining the Variability to Be Considered in Applying FASB Interpretation No. 46(R)."

Could an enterprise ever be required to perform a quantitative expected-loss calculation to support its conclusion that equity of the VIE is sufficient?

Although Statement 167 eliminates the requirement that an enterprise perform a quantitative analysis to identify the primary beneficiary of a VIE, the enterprise may still be required to perform a quantitative analysis when determining whether an entity is a VIE. It may need to perform a quantitative analysis to determine whether the total equity investment at risk is insufficient to permit the entity to finance its activities without additional subordinated financial support, which would indicate that the entity is a VIE. However, the quantitative analysis is only required when a reasonable conclusion about the sufficiency of the entity's equity at risk cannot be reached solely on the basis of a qualitative analysis. Note also that while the primary-beneficiary analysis is no longer based on a quantitative expected-loss computation, Statement 167 indicates that a party's economic exposure to an entity may provide information helpful to assessing the reasonableness of the conclusion about which party has control of the entity.

Assessment of Control

How are the risks to which an entity is designed to be exposed relevant in the consolidation assessment?

When identifying the primary beneficiary of the VIE, the enterprise should identify the purpose and design of the VIE, including the risks that the entity was designed to create and pass through to its variable interest holders. The enterprise should understand how each risk affects the entity's economic performance and identify the activities related to each risk. The identification of the primary beneficiary is based on an evaluation of which variable interest holder has the power to direct the activities identified that most significantly impact the entity's economic performance. In each of the examples in Statement 167's implementation guidance, the initial step in the identification of the primary beneficiary is an evaluation of the purpose and design of the entity, including the identification of the risks the entity was designed to create and pass through to the variable interest holders. For instance, in Example 1 (regarding a commercial mortgage-backed security), the enterprise identifies that the entity is exposed to the credit risk associated with the possible default by the borrowers. Ultimately, the entity's economic performance is most significantly impacted by the credit performance of the entity's underlying assets; the variable interest holder with the power to direct the activities related to managing the entity's assets that are delinquent or in default is the primary beneficiary.

Does every risk that the entity was designed to create have related activities?

As noted in the discussion above, the identification of the risks that an entity was designed to create and pass through to its variable interest holders is an integral step in the identification of the entity's primary beneficiary. However, in the identification of which enterprise has the power to direct the activities of the VIE that most significantly impact the VIE's economic performance, there may be risks that the entity is exposed to that do not have direct activities related to them. This is illustrated in Examples 5 and 6 of Statement 167's implementation guidance, in which one of the risks that the entity was designed to create and pass through is prepayment risk. In both of these examples, there are no variable interest holders that have the power to direct activities related to this risk, and such risk does not receive any further consideration in the primary beneficiary analysis.

Paragraph 2A of Statement 167 requires that any terms, transactions, and other arrangements, whether contractual or noncontractual, that are deemed nonsubstantive should be ignored in the consolidation analysis. Accordingly, for kick-out rights to be considered in the accounting analysis, in addition to being held by a single enterprise (including its related parties and de facto agents), such rights need to be deemed substantive. How should the enterprise determine whether kick-out rights are substantive?

Statement 167 removes the guidance currently in Interpretation 46(R) on determining whether kick-out rights are substantive. Although there is no such guidance in Statement 167, the rights would generally be considered substantive if there are no significant barriers to the exercise of the rights. Interpretation 46(R) states:

Barriers to exercise include, but are not limited to:

- (1) Kick-out rights subject to conditions that make it unlikely they will be exercisable, for example, conditions that narrowly limit the timing of the exercise
- (2) Financial penalties or operational barriers associated with replacing the decision maker that would act as a significant disincentive for removal
- (3) The absence of an adequate number of qualified replacement decision makers or inadequate compensation to attract a qualified replacement
- (4) The absence of an explicit, reasonable mechanism in the contractual arrangement, or in the applicable laws or regulations, by which the parties holding the rights can call for and conduct a vote to exercise those rights
- (5) The inability of parties holding the rights to obtain the information necessary to exercise them.

The assessment of whether kick-out rights are substantive should be based on a consideration of all relevant facts and circumstances.

When there is a change in the primary beneficiary, can an enterprise use a convenience date (month-end or quarter-end) as the date from which it starts consolidating the VIE?

Because continual reconsideration of the primary beneficiary conclusion is required, if the conclusion changes during a reporting period, the enterprise will need to determine when, in the reporting period, the change occurred. For example, if an enterprise determines that it is no longer the primary beneficiary of a VIE, it would need to deconsolidate that particular VIE on the date the circumstances changed resulting in the enterprise no longer meeting the conditions for consolidation. This is particularly important in the determination of what amounts from the operations of the VIE should and should not be included in the income statement of the enterprise. An enterprise may consider identifying events and circumstances that may occur and could trigger a change in the primary beneficiary to more timely identify when a change in the primary beneficiary occurs.

Does Statement 167 require that every VIE have a primary beneficiary?

There may be situations in which an enterprise determines that neither it nor any of the other interest holders are the VIE's primary beneficiary. For example, this could occur if a decision maker has the power to direct the activities of the VIE that most significantly impact the entity's economic performance but the decision maker either does not have a variable interest in the VIE (under the criteria in paragraph B22) or its obligation to absorb losses of the VIE or its right to receive benefits from the VIE could not potentially be significant to the VIE. The specific facts need to be carefully evaluated in every situation.

Shared Power

Paragraph 2A of Statement 167 requires that any terms, transactions, and other arrangements, whether contractual or noncontractual, that are deemed nonsubstantive should be ignored in the consolidation analysis. Accordingly, for power to be considered shared, the arrangement to obtain consent needs to be considered substantive. When is the requirement to obtain consent considered substantive?

The requirement to obtain consent is considered substantive when the consent is required for **all** of the activities that most significantly impact the entity's economic performance. When the consent relates only to activities that are unimportant or only to certain of the significant activities, the consent would not be considered substantive and power would not be considered shared. In addition, an enterprise would need to closely analyze the governance provisions of an entity to understand whether the consent requirements are substantive (e.g., the consequences if consent were not given).

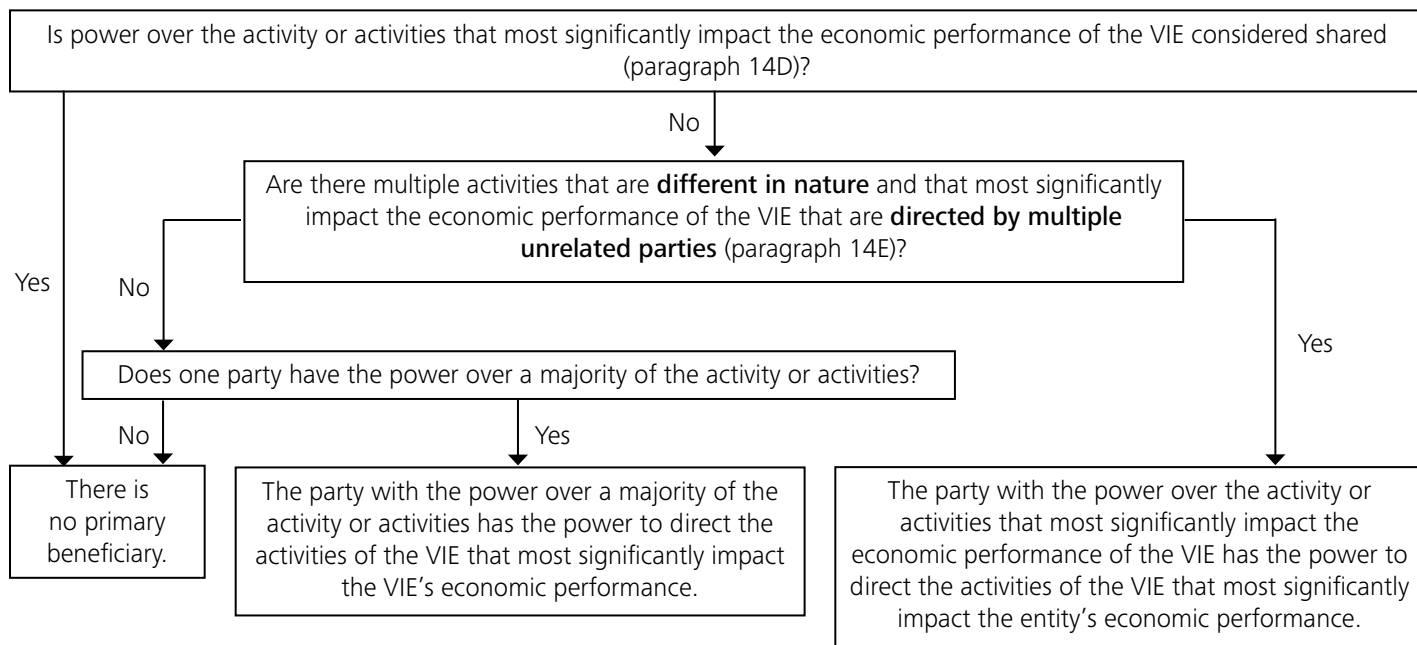
How should an enterprise's evaluation differ when a VIE has one significant activity performed by multiple parties, as opposed to a VIE with multiple unrelated parties each performing different significant activities?

Statement 167 requires that if multiple unrelated parties are responsible for different significant activities, and the decisions relating to those activities do not require the consent of each party, the enterprise must determine whether it has the power to direct the activities that have the **most** significant impact on the economic performance of the entity. One of the parties will be identified as having power over the VIE. The FASB believes that "as the number of activities of an entity increases, it will be more likely that one decision maker (or governing body) will exist or that decisions about those activities would require the consent of the enterprises involved with the entity."

When multiple unrelated parties are responsible for the same significant activity or activities that most significantly impact the economic performance of the VIE and consent is not required, the party with power over the majority of the significant activity or activities has power over the VIE. The determination of which party has power over the majority of the significant activities will require judgment and an evaluation of all facts and circumstances. The party that has power must also have the obligation to absorb losses of the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE to be considered the primary beneficiary.

There may also be situations in which the parties involved with an entity have power over different significant activities and portions of the same significant activities. In these cases, a detailed analysis (as illustrated in Example 8 of Statement 167's implementation guidance) is required in the determination of whether the enterprise's power over certain significant activities, along with its power over portions of other significant activities, identify it as having the power to direct the activities of the VIE that most significantly impact the VIE's economic performance.

The following flowchart illustrates how the primary beneficiary is determined when multiple parties have power over the significant activities.



In this flowchart, the party that is determined to have power over the activity or activities would be considered the primary beneficiary if that party has the obligation to absorb losses of the VIE or right to receive benefits from the VIE that could potentially be significant to the VIE.

Exposure to Losses and Residual Returns

If an enterprise holds a variable interest in a VIE, will it always have the obligation to absorb losses of the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE?

If an interest meets the definition of a variable interest, the interest will usually represent the obligation to absorb losses of the VIE or a right to receive benefits from the VIE that could potentially be significant to the VIE. However there may be situations in which a party with a variable interest will not have a right to receive benefits from the VIE or the obligation to absorb losses of the VIE that could potentially be significant to the VIE. For example, a service provider's right to receive a fixed fee may represent a variable interest but will not always represent a benefit or obligation that could potentially be significant to the VIE. This is discussed in the Basis for Conclusions in Statement 167, which notes that "the servicer may be able to conclude, on the basis of the magnitude of the fixed percentage, that the fee could not ever potentially be significant to the entity because the fee would remain a constant percentage of the entity's assets."

Joint Ventures

How do the modifications in Statement 167 to the de facto agent requirements affect the analysis of the primary beneficiary in a joint venture arrangement?

When identifying a VIE's primary beneficiary, the enterprise is required to consider all of its variable interests and other involvements (including that of related parties and de facto agents) with the VIE. Accordingly, an enterprise may determine that together with its de facto agents, it has a controlling financial interest in a VIE and that one of the entities in the related-party group is the primary beneficiary.

Before adoption of Statement 167, paragraph 16(d)(1) of Interpretation 46(R) states that a de facto agency is present when a party has agreed that it cannot sell, transfer, or encumber its interests in the entity without the prior approval of the enterprise, but only if such approval prevents the other party's ability to manage its economic interest in the VIE. Accordingly, in a typical joint venture arrangement, in which a transfer restriction is imposed on all of the venturers to maintain the structure of the joint venture, this has generally resulted in the enterprise assessing the joint venturers as a related-party group to determine the primary beneficiary.

However, Statement 167 provides an exemption to the de facto agent requirements in which the transfer restrictions "are based on mutually agreed upon terms by willing, independent parties" and the rights are substantive. Although the enterprise will still need to determine whether it is the primary beneficiary of the VIE under Statement 167, the enterprise may not be required to consider the other enterprises as de facto agents in its analysis.

Disclosures and Presentation

How will the disclosure requirements change as a result of the issuance of Statement 167?

FSP FAS 140-4 and FIN 46(R)-8 was issued in December 2008 to accelerate the requirement for **public** companies to provide additional disclosures on an enterprise's involvement with VIEs. Under Statement 167, these disclosure requirements will also apply to nonpublic companies. Statement 167 adopted the FSP's disclosure requirements with some modifications and amends paragraphs 22A–22D and paragraphs 23–25 of Interpretation 46(R). Some of the more significant changes from the FSP include:

- Significant factors an enterprise considers and judgments it makes in determining that power to direct the significant activities of a VIE is shared must be disclosed, if applicable.
- Although both the FSP and Statement 167 require an enterprise to make additional disclosures when it is the primary beneficiary of a VIE, the FSP provides that when a VIE would be consolidated under both ARB 51 and Interpretation 46(R), the additional disclosures are not required unless the activities of the VIE are primarily related to securitizations or other forms of asset-backed financings or single-lessee leasing arrangements. The exemption in Statement 167 focuses on whether the entity is a business; therefore, the disclosures in Statement 167 could be required for holding companies that are wholly owned subsidiaries and do not meet the definition of a business, even if the consolidation requirements are met under both ARB 51 and Interpretation 46(R).
- Statement 167 requires the enterprise to disclose the impact of the adoption of the Statement. These disclosures primarily focus on the transition method that the entity followed and the assets and liabilities that were consolidated as a result of the Statement's adoption.
- If the enterprise elects the fair value option upon the initial consolidation of a VIE, the enterprise will be required to disclose why it elected the fair value option for certain entities and not for others. (Note that the transition guidance in Statement 167 provides that the fair value option must be made entity by entity, i.e., the election must cover all of the financial assets and liabilities of each VIE for which the fair value option is elected.)

How should an entity present the assets and liabilities of a consolidated VIE in its financial statements?

Statement 167 requires that an enterprise separately present on the face of its statement of financial position (1) the assets of a consolidated VIE that can be used only to settle specific obligations of the VIE and (2) liabilities of a consolidated VIE for which creditors (or beneficial interest holders) do not have recourse to the general credit of the primary beneficiary. In addition, the Basis for Conclusions, states that the "Board considered, but rejected, a single line-item display of those assets and liabilities." Accordingly the assets of the VIE (which may include for example, cash, receivables, investments, or fixed assets) should be broken out. In addition, Statement 167 does not require the changes in the assets and liabilities to be separately reflected in the statement of cash flows or in the statement of operations.

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