

## Heads Up

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The ASU will defer the effective date of Statement 167 for a reporting enterprise's interest in certain entities and for certain money market mutual funds.

## Survey Says? Defer!

# FASB Votes to Finalize Deferral of Statement 167 for Certain Investment Funds

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On January 27, 2010, the FASB voted to finalize Accounting Standards Update (ASU) *Amendments to Statement 167 for Certain Investment Funds*. The key provisions of the ASU that were discussed at the FASB's meeting, and anticipated changes to the exposure draft, are discussed below. The FASB indicated that it will attempt to issue the final ASU in mid-February.

The ASU will defer the effective date of Statement 167<sup>1</sup> for a reporting enterprise's interest in certain entities and for certain money market mutual funds. It addresses concerns that the joint consolidation model under development by the FASB and the IASB may result in a different consolidation conclusion for asset managers and that an asset manager consolidating certain funds would not provide useful information to investors. The ASU will also amend certain provisions of paragraph B22 of Interpretation 46(R),<sup>2</sup> as amended by Statement 167, to change how a decision maker or service provider determines whether its fee is a variable interest.

The ASU will be effective as of the beginning of the first annual period that begins after November 15, 2009, and for interim periods within that first annual reporting period. The effective date coincides with the effective date of Statement 167. Early application is not permitted.

**Editor's Note:** The final wording of the ASU may differ from the language discussed at the January 27 FASB meeting and in this *Heads Up*. Readers should refer to the FASB's Web site when the final ASU is posted.

## Key Provisions

The ASU will defer the application of Statement 167 for a reporting enterprise's interest in an entity if all of the following conditions are met:

- The entity either has all of the attributes specified in paragraphs 15-2(a)–(d) of ASC 946-10<sup>3</sup> or it is an entity for which it is industry practice to apply guidance that

<sup>1</sup> FASB Statement No. 167, *Amendments to FASB Interpretation No. 46(R)*.

<sup>2</sup> FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities* — an interpretation of ARB No. 51.

<sup>3</sup> FASB Accounting Standards Codification Subtopic 946-10, *Financial Services — Investment Companies: Overall*. ASC 946-10-15-2 states that such attributes are as follows:

- a. Investment activity. The investment company's primary business activity involves investing its assets, usually in the securities of other entities not under common management, for current income, appreciation, or both.
- b. Unit ownership. Ownership in the investment company is represented by units of investments, such as shares of stock or partnership interests, to which proportionate shares of net assets can be attributed.
- c. Pooling of funds. The funds of the investment company's owners are pooled to avail owners of professional investment management.
- d. Reporting entity. The investment company is the primary reporting entity.

is consistent with the measurement principles in ASC 946 for financial reporting purposes.

- The reporting enterprise does not have an obligation to fund losses of the entity that could potentially be significant to the entity. In evaluating this condition, entities should consider implicit or explicit guarantees provided by the reporting enterprise and its related parties, if any.
- The entity is not a securitization entity, an asset-backed financing entity, or an entity that was formerly considered a qualifying special-purpose entity.

**Editor’s Note:** At the January 27 meeting, the FASB staff discussed the fact that most investment management vehicles are structured as limited partnerships, with the general partner having unlimited liability for the obligations of the partnership. However, the staff noted that many investment companies establish a limited liability corporation (LLC) to serve as the general partner, which limits the liability of the investment company. The staff noted that the final ASU will clarify that the legal protection provided by the LLC may allow the reporting entity to conclude that it does not have an obligation to fund losses of the entity that could potentially be significant to the entity.

Examples of entities that may satisfy these conditions include, but are not limited to, mutual funds, hedge funds, private equity funds, mortgage real estate investment funds, and venture capital funds. The FASB noted that the examples in the implementation guidance in Statement 167 would not be modified as a result of the ASU’s amendments, and that an entity that has characteristics that are consistent with those of a variable interest entity (VIE) outlined in Statement 167’s implementation guidance should not be subject to the deferral. At the January 27 meeting, the FASB also stated that it believes that the scope of the deferral is clear and that no significant changes will be made to the overall scope of the deferral.

The ASU indicates that an entity that initially meets the deferral requirements may subsequently cease to qualify for the deferral as a result of changes in facts and circumstances. In such a situation, the reporting enterprise’s interest in the entity would no longer qualify for the deferral and Statement 167 would need to be applied. The FASB staff indicated that the final ASU will clarify that if the application of Statement 167 results in the consolidation of an entity that initially met the deferral requirements, the transition provisions of Statement 167 would not apply to the initial consolidation of that entity; rather, the initial measurement guidance in Statement 167 would apply.

**Editor’s Note:** Although the Board stated that the final ASU will not define an “asset-backed financing entity,” the Basis for Conclusions of the exposure draft noted that an entity with multiple levels of subordinated investors, such as a collateralized debt obligation (CDO) or collateralized loan obligation (CLO) for which the primary purpose of the capital structure of the entity is to provide credit enhancement to senior interest holders, would not qualify for the deferral. The Board considers entities with this type of capital structure to be asset-backed financing entities. We do not anticipate that this will change in the final ASU, which will generally result in CDO and CLO structures not qualifying for the deferral.

The ASU will also defer the application of Statement 167 for a reporting enterprise’s interest in an entity that is required to comply or operates in accordance with the requirements that are similar to those in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds. These entities will be subject to the deferral even if the money market fund manager has an explicit or implicit obligation to absorb losses of the fund.

The ASU will also amend paragraph B22 of Interpretation 46(R), as amended by Statement 167. The exposure draft indicated that a quantitative calculation is not required, and should not be the sole determinant, in making an assessment under paragraph B22(c). The FASB staff indicated that the final ASU will add a similar concept to paragraph B22(f).

The ASU indicates that an entity that initially meets the deferral requirements may subsequently cease to qualify for the deferral as a result of changes in facts and circumstances.

**Editor’s Note:** This addition is consistent with our understanding that the conditions in paragraphs B22(c) and (f) require a consideration of the variability absorbed by a decision maker’s or service provider’s fee and other interests (both individually and in the aggregate).

Finally, the exposure draft indicated that related parties “should be considered” in the evaluation of the conditions in paragraph B22. The FASB staff indicated that the final ASU will clarify that, in the evaluation of the conditions in paragraph B22, any interest in the entity that is held by a related party of an entity’s decision maker(s) or service provider(s) is treated as the decision maker’s or service provider’s own interest. In addition, the FASB staff indicated that the final ASU will state that under paragraph B22, employee benefit plans should not be considered a related party of the decision maker or service provider.

## Disclosures

Public entities are currently required to provide additional disclosures in their annual and quarterly financial statements about their interests in VIEs. Nonpublic companies were exempt from providing these disclosures; however, Statement 167 requires similar disclosures for all public and nonpublic entities. The FASB staff reiterated that the amendments in the final ASU will not defer the disclosure requirements in Statement 167. Accordingly, both public and nonpublic companies will need to provide the disclosures required by Statement 167 for all VIEs in which they hold a variable interest, including VIEs that qualify for the deferral. However, the FASB staff did indicate that the final ASU will clarify that if a reporting enterprise qualifies for the deferral, the enterprise would use the guidance in Interpretation 46(R), before its amendment by Statement 167, to determine whether the entity is a VIE, whether the reporting enterprise is the primary beneficiary, and whether the reporting enterprise has a variable interest.

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