

***CONSOLIDATION OF CERTAIN SPEs:  
PROPOSED INTERPRETATION OF  
ARB NO. 51***

July, 2002

# *Introduction*

- FASB's Consolidations Project
  - Project has a long history
  - ED Interpretation issued 6/28/02
  - Comments due by 8/30/02 – no later!
  
- Objective of this discussion
  - Foster discussion of this important accounting issue
  - Discuss general requirements
  - Discuss effect on common SPE transactions in separate web conferences
    - Securitizations
    - Leasing arrangements

# ***Substantive Operating Enterprises (SOE) Vs. SPEs***

## SOE

## SPE

Definition:

- Conducts business operations
- Sufficient equity to finance operations
- Employees
- Issues financial statements

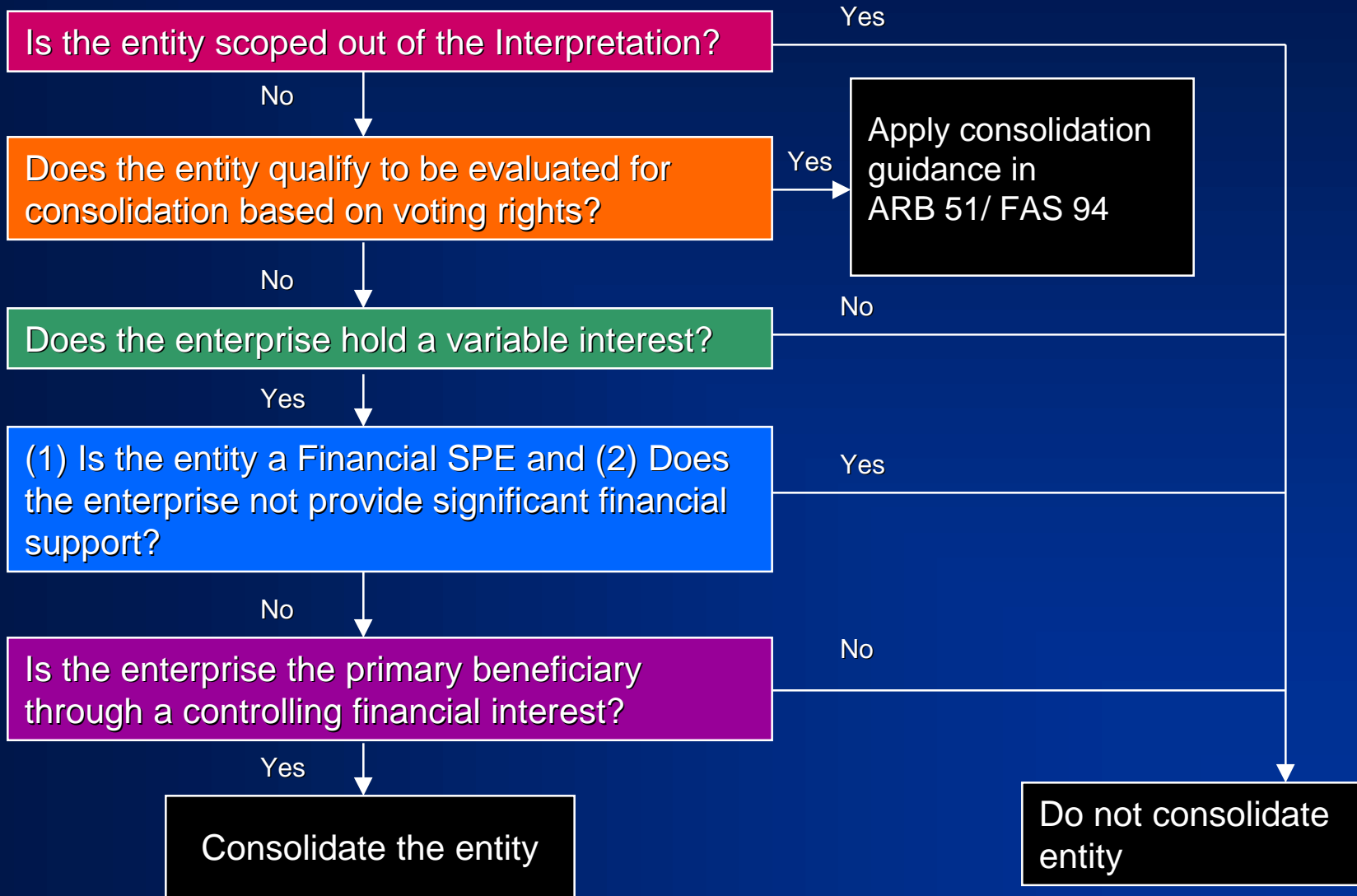
- Entities that are not SOEs

Examples:

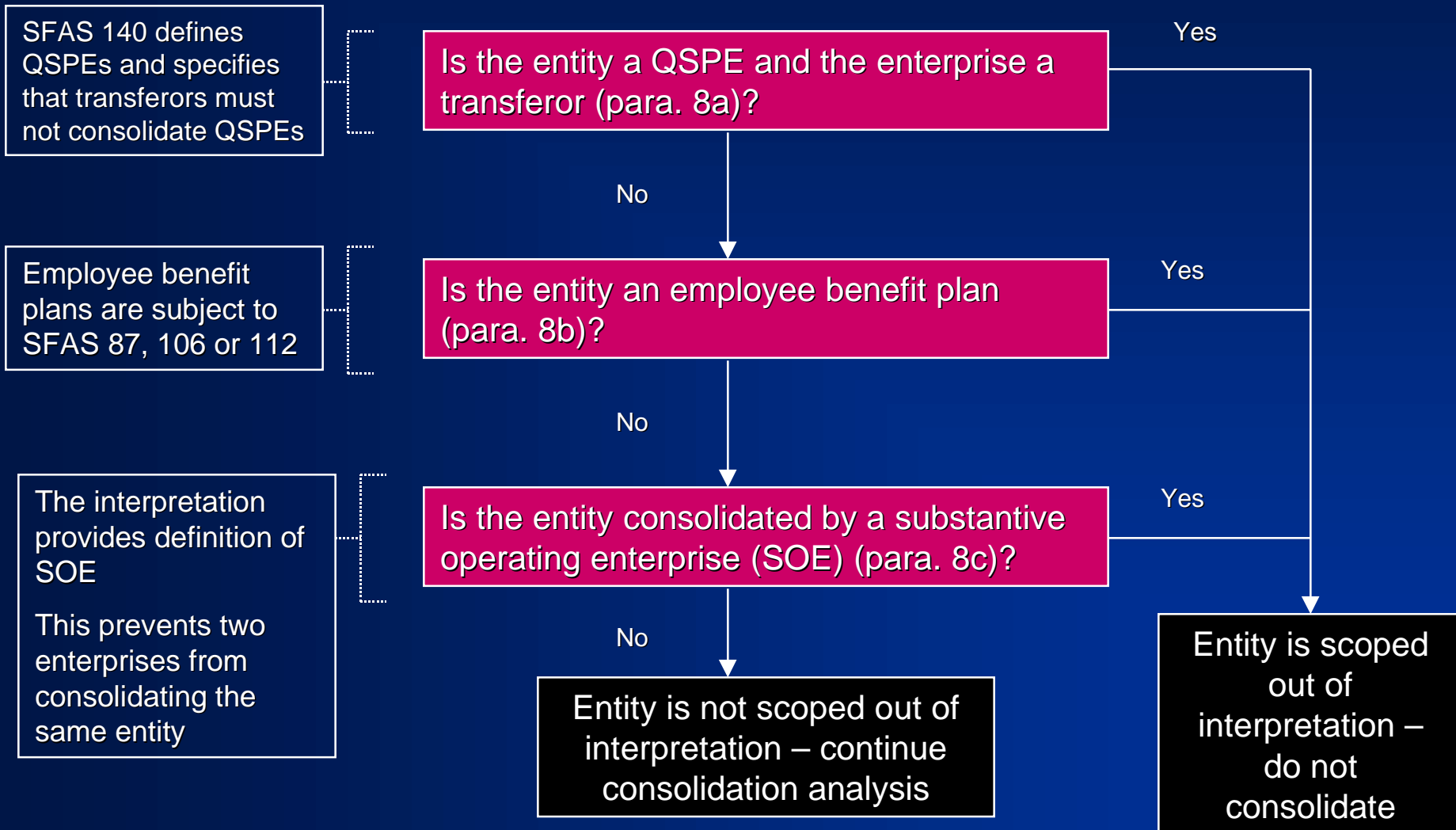
- Businesses under EITF 98-3 that are not start-ups

- Securitization vehicles
- Single asset lessors
- R&D ventures

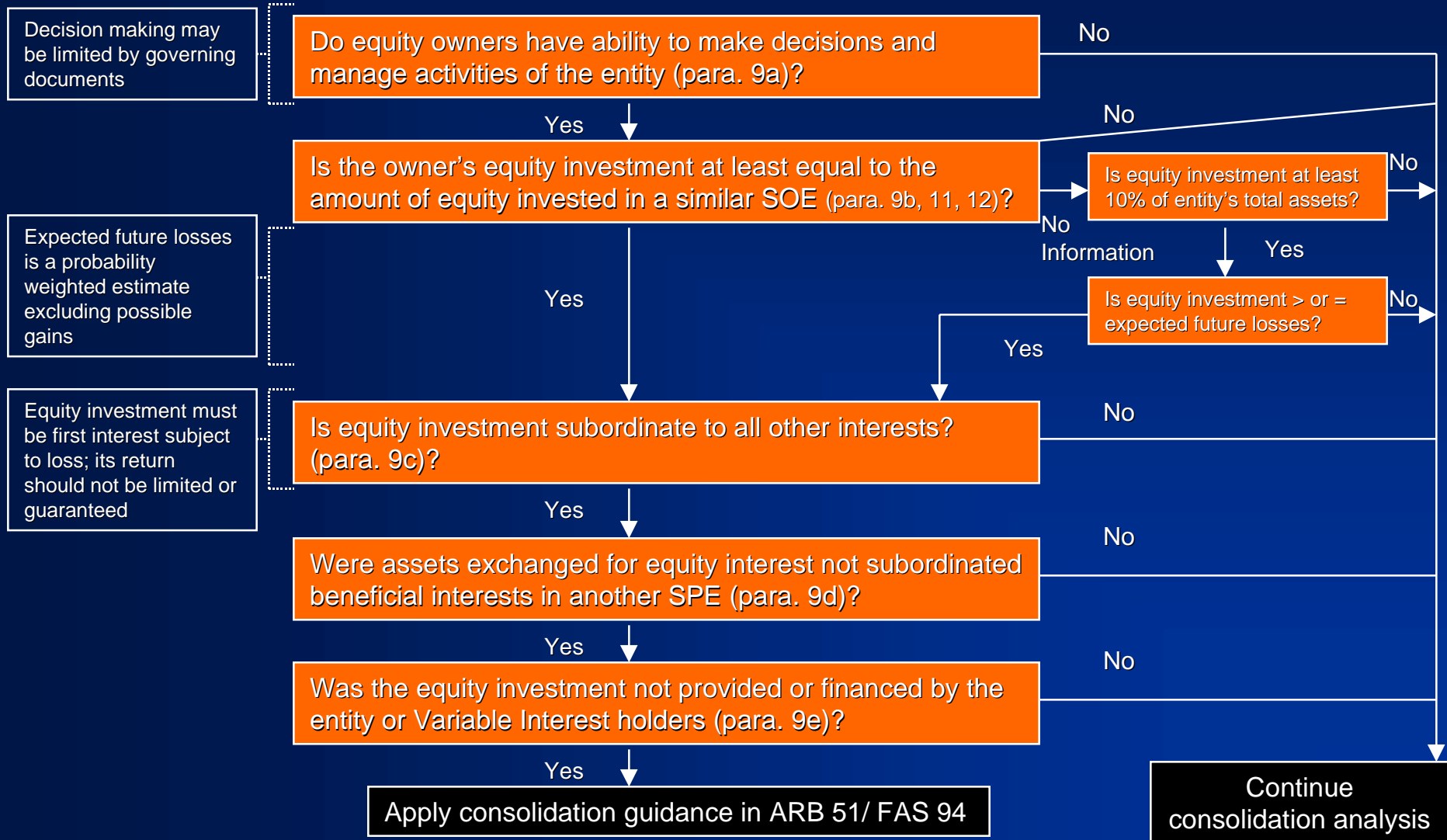
# *Proposed Consolidation Model for SPEs*



# Is the Entity Scoped Out of the Interpretation?



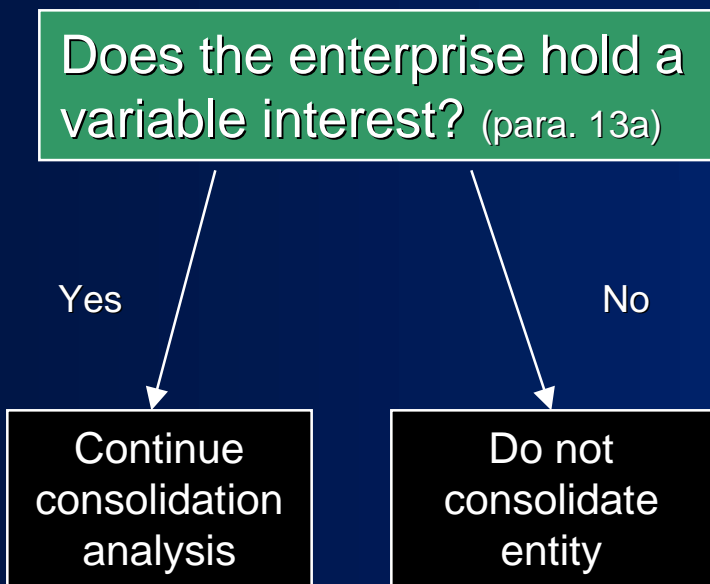
# Does the Entity Qualify to Be Evaluated for Consolidation Based on Voting Rights?



## ***Qualifying for ARB 51/ FAS 94***

- **D&T Observations:**
  - **Equity of the entity**
    - Must be equity in legal form (?)
    - Voting rights not shared with non-owners
  - **Size of the equity**
    - Do comparable SOE's exist?
    - Assessment is continuous
    - Losses may require more equity contributions
  - **Equity absorbs first loss**
    - RVGs, TRSs, recourse are problems
  - **Equity owners**
    - Owners cannot hold other interests (e.g., subordinated debt)

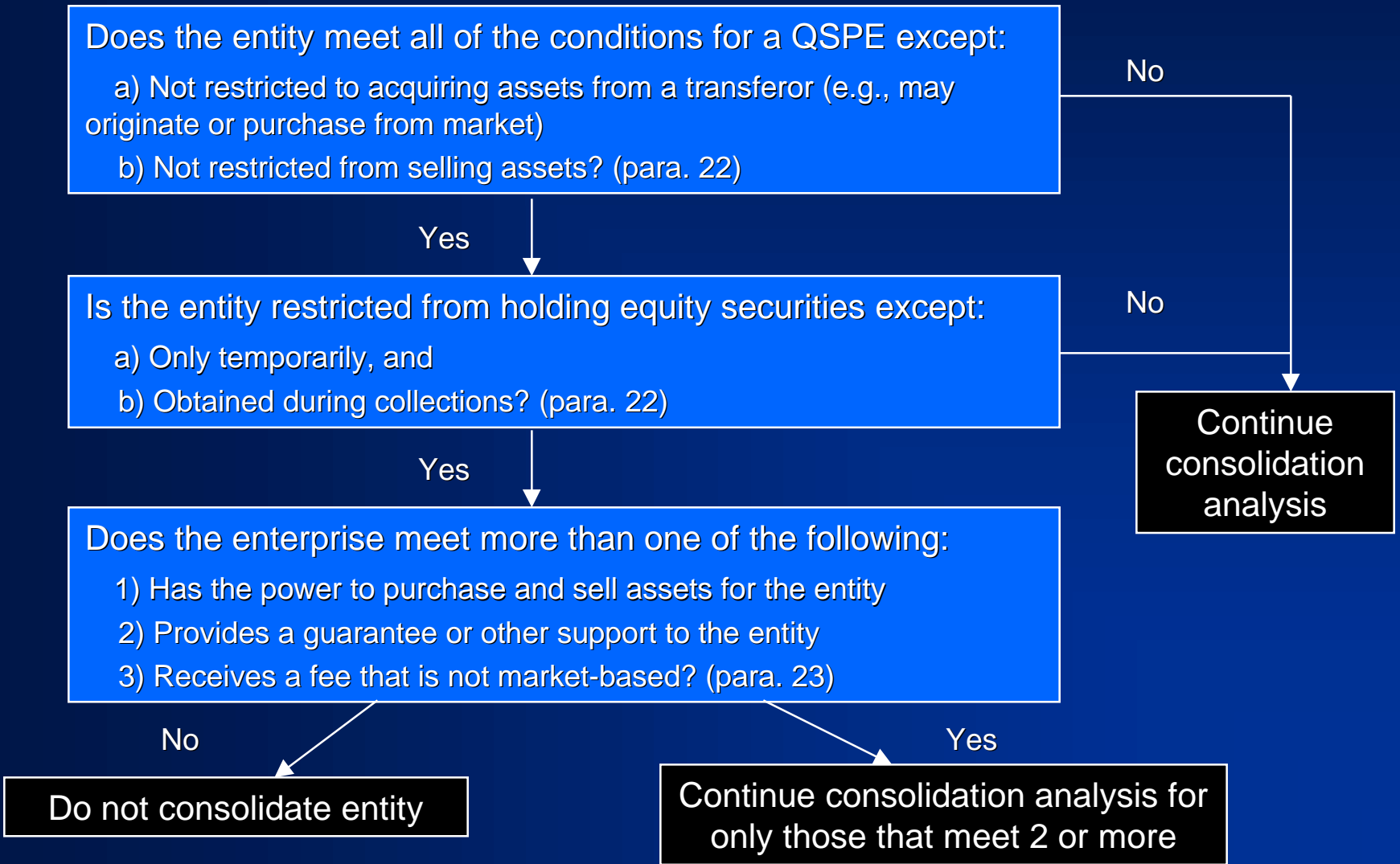
# *Does the Enterprise Hold a Variable Interest (VI)?*



## Definition of VI: (para. 7 & 18)

- Means of providing financial support to the entity
- Holders gain or lose from activities and events that change value of the entity's net assets
- Examples:
  - Voting equity interests
  - Subordinated debt
  - Guarantees / credit enhancements
  - Derivatives
  - Certain service contracts (para. 19)

# ***Is the Entity a FSPE and Does the Enterprise Not Provide Significant Financial Support?***



## ***QSPE Criteria in SFAS 140 That Are Also Conditions for a FSPE***

- SPE is demonstrably distinct from transferor
- Permitted activities are limited, entirely specified at inception, and only changed by third-party beneficial interest (BI) holders
- SPE may only hold:
  - Passive financial assets
  - Passive derivatives that pertain to third-party non-derivative BIs
  - Guarantees
  - Servicing rights
  - Nonfinancial assets from collections, temporarily
  - Collected cash and investments pending distribution

# *Is the Enterprise the Primary Beneficiary through a Controlling Financial Interest?*

## Measuring VIs:

- Relative size of VI should be determined by comparing expected future losses from the interests (para. 20)
- If expected future losses are similar, the subordinate interest is given more weight (para. 20)
- If neither is subordinate, the interest subject to the dominant risk is given more weight (para. 21)

Does the enterprise have all or a majority of the VIs? (para. 13b, 13c)

No

Does the enterprise have a VI that is both:  
a) A significant portion of the total VIs, and  
b) Significantly more than the VIs held by any other individual party? (para. 13c)

No

The enterprise is not the primary beneficiary – do not consolidate the entity

Yes

Yes

The enterprise is the primary beneficiary – consolidate the entity

## *Variable Interests*

- Enterprises must treat VIs held by certain others as its own in determining if it's the primary beneficiary (PB)
  - Related parties (SFAS 57)
  - Agents and defacto agents
  - Consolidated SPEs
  - Parties that cannot operate without significant support from the enterprise
  - Parties that received its VI as a contribution from the enterprise
  
- If combined VI of two or more parties is the PB, the following hierarchy determines which party consolidates:
  - The party that is an SOE
  - The principal (not the agent)
  - Has activities most closely associated with the entity
  - Has largest VI

## *Other Provisions*

- Silos:
  - If the enterprise's rights and obligations are restricted to specifically identified assets and creditor's interests apply equally to assets--  
Then treat the identified assets and portions of liabilities as a separate SPE
- Examples:
  - Multi-seller commercial paper conduit
  - Multi-seller lessor

## Other Provisions

- Continuous assessment:
  - Must assess consolidation at each reporting date
  - If subsequently must consolidate, initially record all items at fair value
    - Similar to paragraph 55 of SFAS 140 and EITF 02-9
  - Restatements of prior periods is prohibited



# *Disclosures*

- PB should disclose:
  - Carrying amount and classification of the entity's assets that collateralize the entity's obligations
  - Restrictions on recourse from entity's creditors to the PB
  
- Other enterprises that provide services to the entity should disclose:
  - Assets and liabilities of the entity and purpose of the entity

# *Effective Date and Transition*

## ➤ Effective date

- Apply immediately to entities created after final interpretation is issued
- For all other entities, apply as of beginning of first fiscal period beginning after 3/15/03 (e.g., 4/1/03 for calendar year-end companies)
- Early application is encouraged

## ➤ Transition

- If must consolidate –
  - initially recognize assets, liabilities and minority interests at fair value
  - Difference between fair values and net book value reported similar to cumulative effect
- Proforma disclosure for prior periods is encouraged