



New Developments Summary

FASB defers Statement 167 for interests in certain investment funds and makes a clarification

Summary

On February 26, 2010, the FASB issued Accounting Standards Update [\(ASU\) 2010-10, Amendments for Certain Investment Funds](#), to provide a limited partial deferral of the effective date of FASB Statement 167, *Amendments to FASB Interpretation 46(R)* (included in *FASB Accounting Standards Codification*TM (ASC) 810-10, *Consolidation*, "Variable Interest Entities" subsections). ASU 2010-10 also clarifies how to determine whether fees paid to a decision maker or service provider are variable interests.

ASU 2010-10 does not defer the effective date of the disclosure provisions in ASC 810-10-50, as amended by Statement 167. ASU 2010-10 defers the effective date of the recognition and measurement provisions in ASC 810-10 that were amended by Statement 167 for a reporting entity's interest in an investment fund entity in which either:

- The investment fund entity is required to comply with or operate in accordance with requirements that are similar to those included in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds.
- The investment fund entity meets all of the attributes in ASC 946, *Financial Services – Investment Companies*, 10-15-2, to be an investment company and the reporting entity does not have an obligation to fund potentially significant losses of the investment fund entity.
- The investment fund entity follows the practice of its industry to issue financial statements using guidance consistent with the measurement principles for investment companies in ASC 946 and the reporting entity does not have an obligation to fund potentially significant losses of the investment fund entity.

Reporting entities that are eligible for the deferral would continue to apply the guidance in ASC 810-10 that was applicable prior to the amendments in Statement 167 and ASU 2010-10, except for the disclosure provisions.

The amended guidance in ASU 2010-10 is effective for fiscal years beginning after November 15, 2009 and for interim periods within those years. This coincides with the effective date of Statement 167.

Contents

A. Background.....	2
B. Deferral of the effective date for a reporting entity's interest in certain investment funds.....	3
Applicability of deferral to a reporting entity's interest in money market funds	3
Applicability of deferral to a reporting entity's interest in other investment funds	3
Attributes of the investment fund entity.....	4
Examples of other investment fund entities that are not eligible for the deferral	4
Examples of other investment fund entities that may be eligible for the deferral.....	4
Obligation to fund potentially significant losses of the investment fund entity	5
Consideration of the legal structure of the reporting entity's interest	5
Consideration of the purpose and design of the investment fund entity	5
Subsequent reevaluation of deferral status.....	5
C. Fees paid to decision makers / service providers	6
D. Disclosures	6
E. Effective date	6

A. Background

On February 26, 2010, the FASB issued Accounting Standards Update ([ASU 2010-10](#), *Amendments for Certain Investment Funds*), to address concerns that were raised about applying the guidance in FASB Statement 167, *Amendments to FASB Interpretation 46(R)* (included in *FASB Accounting Standards Codification*TM (ASC or Codification) 810-10, *Consolidation*, “Variable Interest Entities” subsections). Specifically, constituents raised concerns that the guidance in ASC 810-10, as amended by Statement 167, would require increased consolidation of investment funds by investment managers, a practice that would:

- Reduce the usefulness of the investment managers' financial statements
- Potentially be different than the consolidation conclusions reached under the IASB's Exposure Draft 10, *Consolidated Financial Statements*

To address those concerns, the FASB issued ASU 2010-10 to provide a partial indefinite deferral of the effective date of the guidance in ASC 810-10, as amended by Statement 167, for a reporting entity's interest in certain investment funds while the IASB and FASB develop guidance as part of their ongoing joint consolidation project.

Codification of guidance on consolidation of VIEs

In the Codification, there may be several “pending content” versions of a paragraph – that is, new guidance – and several versions of archived material. The ASU number, date, and the transition paragraph, if any, help identify the version of guidance that is relevant for a specific situation. Guidance on consolidation of variable interest entities (VIEs) has been codified as follows:

- The guidance in FASB Interpretation 46 (revised December 2003), *Consolidation of Variable Interest Entities*, and related FASB Staff Positions (FSPs) and other guidance, is codified in ASC 810-10 “Variable Interest Entities” subsections.

- On December 28, 2009, the FASB issued ASU 2009-17, *Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities*, to codify in ASC 810-10 the amendments to Interpretation 46R contained in Statement 167.
- On February 26, 2010, the FASB issued ASU 2010-10 to partially defer the effective date of Statement 167 for a reporting entity's interest in certain investment funds and to amend the pending content in ASC 810-10 (resulting from Statement 167) on determining whether fees paid to a decision maker or service provider are variable interests.

The pending content from both Statement 167 and ASU 2010-10 is linked to transition paragraph ASC 810-10-65-2.

B. Deferral of the effective date for a reporting entity's interest in certain investment funds

ASU 2010-10 indefinitely defers the effective date of the recognition and measurement provisions in ASC 810-10, as amended by Statement 167, for a reporting entity's interest(s) in certain investment funds. A reporting entity must evaluate its interest in each investment fund separately to determine eligibility for the deferral. As a result, a reporting entity's interest in investment fund A may qualify for the deferral, while its interest in investment fund B may not.

A reporting entity that qualifies for the deferral is required to:

- Continue to apply the guidance in ASC 810-10 as it existed *before* it was amended by Statement 167 and ASU 2010-10
- Provide the disclosures required in ASC 810-10-50, as amended by Statement 167, if the entity is a VIE under the guidance in ASC 810-10 as it existed before it was amended by Statement 167 and ASU 2010-10

Applicability of deferral to a reporting entity's interest in money market funds

The deferral applies to a reporting entity's interest in an entity that is required to comply with or operate in accordance with requirements that are similar to those included in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds.

Applicability of deferral to a reporting entity's interest in other investment funds

The evaluation of whether a reporting entity's interest in other investment funds is subject to the deferral requires an evaluation of the attributes of the investment fund entity and the reporting entity's involvement with the investment fund entity. A reporting entity's interest in other investment funds is subject to the deferral if all of the following conditions are met:

- The investment fund entity meets either of the following conditions:
 - The entity has all of the attributes of an investment company in ASC 946, *Financial Services – Investment Companies*, 10-15-2(a) through (d)
 - The entity does not have all of the attributes of an investment company in ASC 946-10-15-2, but follows the practice of its industry to issue financial statements using guidance consistent with the measurement principles for investment companies in ASC 946.

- Regardless of whether an entity has the attributes of an investment company or applies investment company accounting, the amended guidance in ASU 2010-10 stipulates that the deferral does not apply to a securitization entity, an asset-backed financing entity, or an entity that was formerly considered a qualifying special purpose entity (QSPE) as defined in ASC 860, *Transfers and Servicing*.
- The reporting entity does not have an implicit or explicit obligation to fund losses of the investment fund entity that could potentially be significant to the reporting entity.

Attributes of the investment fund entity

The FASB clarifies in the basis for conclusions for ASU 2010-10 that investment fund entities with the following characteristics do not qualify for the deferral:

- Entities with multiple levels of subordinated investors, which the FASB considers to be asset-backed financing entities
- Entities with characteristics similar to those of a VIE described in Example 5 in ASC 810-10-55-93 through 55-205 (originally issued as examples in Statement 167)

However, the FASB has indicated that an investment in an entity, regardless of the size of the investment, does not, by itself, disqualify that entity for the deferral, provided that investment fund entity meets all other requirements of the deferral.

Examples of other investment fund entities that are not eligible for the deferral

The new guidance contains explicit examples of investment fund entities that are not eligible for the deferral. Those entities include structured investment vehicles (SIVs), collateralized debt obligations (CDO's), collateralized loan obligations (CLO's), commercial paper conduits, credit card securitizations, residential or commercial mortgage-backed entities, and government-sponsored mortgage entities.

Examples of other investment fund entities that may be eligible for the deferral

The new guidance also contains examples of entities that might be eligible for the deferral, which includes mutual funds, hedge funds, mortgage real estate investment funds, private equity funds, and venture capital funds. However, those entities must be evaluated to determine if all of the eligibility conditions have been met.

Evaluating the entity in which a reporting entity has an interest

In some cases a reporting entity may need to "look through" the investments of a (potential) VIE in order to determine whether it is eligible for the deferral. For example, if a reporting entity has an investment in a real estate investment trust (REIT) that has investments in securitization entities or asset-backed financing entities in which the REIT would be the primary beneficiary based on the guidance in ASC 810-10, as amended by Statement 167, we believe that the reporting entity's interest in the REIT would not be eligible for the deferral in ASU 2010-10 since the activities are related to securitization.

Obligation to fund potentially significant losses of the investment fund entity

The determination of whether the reporting entity's interest in an investment fund entity obligates the reporting entity to fund losses of that entity that could potentially be significant to that entity requires consideration of

- The legal structure of the reporting entity's interest
- The purpose and design of the investment fund entity
- Implicit and explicit guarantees provided by the reporting entity and the reporting entity's related parties

The Basis for Conclusions for ASU 2010-10 indicates how certain interests, structures, and agreements described below should be considered in such an assessment.

Consideration of the legal structure of the reporting entity's interest

According to the Basis for Conclusions, "if a reporting entity's exposure to the obligations of an investment fund, such as a partnership is limited based on the legal structure of its interest, the entity may qualify for the deferral." For instance, the Basis for Conclusions states that if a general partner has unlimited liability with respect to its interest in a limited partnership which has general recourse debt obligations, the general partner would not be deemed to have exposure to losses of the partnership that could potentially be significant to the partnership, as long as both of the following conditions exist:

- The general partner has no assets other than its interest in the limited partnership.
- The partnership's creditors have no recourse to assets of the financial reporting entity (general partner's investor).

Consideration of the purpose and design of the investment fund entity

The Basis for Conclusions indicates that a "claw back arrangement," where an investment manager may be required to refund prior fee payments made by the reporting entity up to the amount of fees previously received, does not violate the deferral criteria.

In addition, the Basis for Conclusions indicates that an investor's (reporting entity's) agreement to make future capital contributions to the investment fund entity should be analyzed based on facts and circumstances. For example, a capital commitment requirement to fund the entity over time, as the investment manager finds suitable investments, would not violate the deferral criteria for that entity. However, if such a commitment could relate to funding losses, it would be considered an obligation to fund the entity's losses even if all of the investors must contribute on a pro rata basis.

Subsequent reevaluation of deferral status

For each interest in an investment fund entity that initially qualifies for the deferral, a reporting entity must continuously reevaluate whether such interest continues to meet the deferral conditions. The reporting entity may cease to qualify for the deferral because of a change in facts and circumstances. As of the date the reporting entity ceases to qualify for the deferral, the reporting entity must

- Apply the previously deferred guidance to determine whether the entity is a VIE and, if so, whether the reporting entity has a variable interest in the VIE, is the primary beneficiary of the VIE, or both
- Initially measure the assets, liabilities, and noncontrolling interests of the VIE in accordance with ASC 810-10-30-1 through 30-6 if the reporting entity must consolidate the VIE because it is the primary beneficiary

C. Fees paid to decision makers / service providers

ASC 810-10-55-37, as amended by Statement 167, provides guidance as to when fees paid to a legal entity's decision maker(s) or service provider(s) represent variable interests. ASU 2010-10 clarifies that interests in a legal entity held by a decision maker's or service provider's related parties are considered to be the decision maker's or service provider's own interests for the purpose of evaluating all of the conditions in ASC 810-10-55-37. However, related parties for that evaluation should not include either an employee or an employee benefit plan of the decision maker or service provider (and its other related parties) unless the employee or employee benefit plan is used in an effort to circumvent the provisions of the VIE subsections in ASC 810-10.

In addition, ASU 2010-10 clarifies that a quantitative calculation of expected losses, expected residual returns, and expected variability is not required and must not be the only approach used to evaluate whether a decision maker's or service provider's fee represents a variable interest under ASC 810-10-55-37.

D. Disclosures

The deferral under ASU 2010-10 does not apply to the disclosure requirements in ASC 810-10-50. Accordingly, all public and nonpublic reporting entities must provide the disclosures required by ASC 810-10-50, as amended by Statement 167.

A reporting entity with an interest in a legal entity that qualifies for the deferral must use the guidance on VIEs that existed *before* Statement 167 and ASU 2010-10 were issued to determine whether that legal entity is a VIE and therefore subject to the disclosure requirements in ASC 810-10, as amended by Statement 167.

E. Effective date

The amended guidance in ASU 2010-10 is effective for fiscal years beginning after November 15, 2009 and for interim periods within those years. This coincides with the effective date of Statement 167.

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