

**PROPOSED FASB STAFF POSITION**

**No. FIN 46(R)-b**

**Title:** Implicit Variable Interests Resulting from Related Party Relationships under FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*

**Comment Deadline:** January 20, 2005

1. The Board directed the FASB staff to issue this FASB Staff Position (FSP) to address whether a reporting enterprise should consider whether it has an implicit variable interest in a variable interest entity (VIE) when specific conditions exist.

2. Paragraph 16 of FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*, states:

For purposes of determining whether it is the primary beneficiary of a variable interest entity, an enterprise with a variable interest shall treat variable interests in that same entity held by its related parties as its own interests.

3. Paragraph 17 states:

If two or more related parties . . . hold variable interests in the same variable interest entity, and the aggregate variable interest held by those parties would, if held by a single party, identify that party as the primary beneficiary, then the party, within the related party group, that is most closely associated with the variable interest entity is the primary beneficiary.

4. The FASB staff is aware of transactions where a reporting enterprise has an interest in, or other involvement<sup>1</sup> with, a VIE that is not considered a variable interest and the reporting enterprise's related party<sup>2</sup> (a non-VIE) has a variable interest in the same VIE. For these types of transactions, the FASB staff understands that there is diversity in practice as to whether the reporting enterprise considers whether an implicit variable interest has been created

---

<sup>1</sup> A reporting enterprise's interest in, or other involvement with, a VIE may take many different forms such as a lessee under a leasing arrangement or a party to a supply contract, service contract or derivative contract. The determination as to whether an interest in, or other involvement with, a VIE constitutes a variable interest absent the related party relationship should be based on the specific facts and circumstances of the transaction.

<sup>2</sup> For purposes of this FSP, refer to paragraph 16 of Interpretation 46(R) for the definition of the term *related party*.

between it and the VIE. Paragraph B10 of Interpretation 46(R) provides one example of an implicit variable interest, that is, an implicit agreement to replace impaired assets held by a variable interest entity that protects holders of other interests in the entity from suffering losses. However, Appendix B to Interpretation 46(R) is not intended to provide a complete list of all possible variable interests.

5. Q—Should a reporting enterprise consider whether it has an implicit variable interest in a variable interest entity for purposes of applying paragraphs 16 and 17 of Interpretation 46(R) when both of the following conditions exist?

- a. The reporting enterprise has an interest in, or other involvement with, a VIE but the explicit terms of any interest held or involvement by the reporting enterprise directly in a VIE would not identify that interest or involvement as a variable interest in that entity. Therefore, the reporting enterprise has no explicit variable interest in the entity. In addition, without considering related party relationships, this reporting enterprise would have no implicit variable interest in the entity.
- b. A party related to the reporting enterprise has a variable interest or potential variable interest in the same VIE.

6. A—Yes. The reporting enterprise should consider whether it has an implicit variable interest in the variable interest entity when both of the conditions described above exist. The determination as to whether an implicit variable interest exists should be based on whether, in substance, the reporting enterprise through its relationship with its related party will absorb the variability of the VIE.<sup>3</sup> A reporting enterprise that holds an implicit variable interest in a VIE should apply the guidance in paragraph 17 of Interpretation 46(R) to determine whether it is the primary beneficiary of the VIE.

---

<sup>3</sup> The identification of variable interests involves determining which assets, liabilities, or contracts absorb or receive the variability of the VIE. Regardless of whether a related party relationship exists, the determination as to whether an implicit variable interest exists should always be based on whether, in substance, the reporting enterprise will absorb the variability of a VIE.

**Effective Date and Transition**

7. For entities to which Interpretation 46(R) has been applied, the guidance in this FSP shall be applied in the first reporting period beginning after [the date the FSP is finalized]. Restatement to the date of the initial application of Interpretation 46(R) is permitted but not required. Early application is permitted for periods for which financial statements have not yet been issued. For entities to which Interpretation 46(R) has not been applied, the guidance in this FSP shall be applied in accordance with the effective date and transition provisions of Interpretation 46(R).

**Example**

The owner of Manufacturing Company is also the owner of Leasing Company, which is a VIE. Leasing Company owns no assets other than the manufacturing facility being leased to Manufacturing Company. The lease, with market terms, contains no explicit guarantees of the residual value of the real estate or purchase options and is therefore not considered a variable interest under paragraph B24 of Interpretation 46(R). The lease meets the classification for an operating lease and is the only contractual relationship between Manufacturing Company and Leasing Company.

Based on the guidance in this FSP, Manufacturing Company should consider whether it has an implicit variable interest in Leasing Company.

Although the lease agreement itself does not contain a contractual guarantee, Manufacturing Company should consider whether the relationship between it and the owner creates an implicit variable interest in Leasing Company.<sup>4</sup> For example, an implicit variable interest may be created through an implicit guarantee by Manufacturing Company of the owner's equity investment in

---

<sup>4</sup> The guidance in this FSP applies to related parties as defined in paragraph 16 of Interpretation 46(R) and does not only apply to situations in which entities are under common control. For example, the guidance in this FSP applies to situations in which (1) a reporting enterprise has an interest in, or other involvement with, a VIE and an officer of the reporting enterprise has a variable interest in the same VIE, or (2) a reporting enterprise enters into a contractual arrangement with an unrelated third party that has a variable interest in a VIE and that arrangement creates a principal-agency relationship.

Leasing Company.<sup>5</sup> The determination as to whether an implicit variable interest exists should be based on whether, in substance, Manufacturing Company, through its relationship with the owner, will absorb the variability of Leasing Company.

---

<sup>5</sup> The guidance in this FSP should be used only to evaluate whether a variable interest exists under Interpretation 46(R) and should not be used in the evaluation of lease classification in accordance with FASB Statement No. 13, *Accounting for Leases*. Paragraph 29 of Statement 13 addresses leases between related parties and states "...the classification and accounting shall be the same as for similar leases between unrelated parties, except in cases where it is clear that the terms of the transaction have been significantly affected by the fact that the lessee and lessor are related. In such cases the classification and/or accounting shall be modified as necessary to recognize economic substance rather than legal form. The nature and extent of leasing transactions with related parties shall be disclosed."