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CAQ Alert #2010-21 – April 19, 2010

CALL FOR PAPERS!

In collaboration with the CAQ, the *International Journal of Disclosure and Governance* will publish a special issue on *The State and Future of Auditing*. The CAQ encourages members with an interest in authoring a journal article on an audit-related topic to respond to this call for papers. The deadline is May 1.

DEAR CENTER MEMBERS

New Standard on Accounting for Variable Interest Entities – Section 404 Considerations

Note: ***Subsequent to the issuance of CAQ Alert #2010-20 (Issued on April 9, 2010), the SEC staff shared with the CAQ SEC Regulations Committee (Committee) its views regarding the internal control over financial reporting (ICFR) reporting requirements for an entity newly consolidated pursuant to FASB Statement No. 167 (Statement 167), now codified within Accounting Standards Codification (ASC) Topic 810-10, Consolidation.***

The SEC staff's FAQ #1 on Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports (see also Section 4310.11 of the Division of Corporation Finance Financial Reporting Manual) addresses how a registrant should apply the requirements of Section 404 of the Sarbanes-Oxley Act of 2002 to an entity consolidated pursuant to FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities — An Interpretation of ARB No. 51* (FIN 46(R)), now codified within ASC Topic 810. The question in FAQ #1 was raised amidst concerns that in instances where a registrant lacks the ability to dictate or modify the internal controls of a variable interest entity (VIE), the registrant may not have legal or contractual rights or authority to assess the internal controls of the newly consolidated entity even though that entity's financial information is included in the registrant's consolidated financial statements. The SEC staff concluded that a VIE in existence prior to December 15, 2003 that is consolidated may be scoped out of the internal control reporting requirements if the registrant does not have the right or authority to assess the internal controls of the FIN 46(R) consolidated entity and also lacks the ability, in practice, to make that assessment. A similar exception also is available for an entity accounted for via proportionate consolidation in accordance with ASC 810-10-45-14 (EITF 00-1) if management does not have the ability to assess ICFR. The SEC staff also provided for a short deferral of the requirement to review internal controls for a newly acquired business (see SEC staff FAQ #3/Section 4310.11(c) in the Division of Corporation Finance Financial Reporting Manual). Questions have arisen regarding the ICFR reporting requirements for an entity newly consolidated pursuant to Statement 167/ASC 810-10.

The SEC staff stated that VIEs consolidated upon adoption of Statement 167/ASC 810-10 should be included in management's reports on ICFR. Because the criteria for consolidation of a VIE are based upon control, the SEC staff stated that a registrant will no longer be able to justify excluding consolidated VIEs from the scope of their internal controls assessment. Registrants likely will have the right or authority to assess the internal controls of those VIEs. Furthermore, because the consolidation of VIEs under Statement 167/ASC

810-10 will occur as of the first day of the registrant's fiscal year, the SEC staff believes the registrant will have sufficient time to perform that assessment and would be unable to rely on the temporary relief provided under FAQ #3.

The SEC staff stated the guidance included in FAQ #1 continues to apply only in the rare circumstance in which the VIE was in existence prior to December 15, 2003 AND the registrant, despite having control, does not possess the right or authority to assess the VIE's internal controls and lacks the ability, in practice, to make that assessment. Registrants may continue to follow the guidance in FAQ #1 in this rare circumstance.

FAQ #3 addresses a situation where a registrant acquires a business during a year but it is not possible to conduct an assessment of an acquired business' internal controls during the period between the consummation date and year end. A registrant may exclude an acquired business from the scope of its internal control assessment in this situation. **The SEC staff stated that after adoption of Statement 167/ASC 810-10, an SEC registrant may apply the guidance in FAQ #3 when considering whether it would be appropriate to exclude a VIE that is newly consolidated due to events or changes in circumstances from the scope of its internal control assessment in the fiscal year consolidation first occurs if an assessment is not possible.**

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