

# FINANCIAL ACCOUNTING SERIES

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## EXPOSURE DRAFT

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### *Proposed Accounting Standards Update*

Issued: October 11, 2012  
Comments Due: December 10, 2012

### Consolidation (Topic 810)

#### Accounting for the Difference between the Fair Value of the Assets and the Fair Value of the Liabilities of a Consolidated Collateralized Financing Entity

a consensus of the FASB Emerging Issues Task Force

This Exposure Draft of a proposed Accounting Standards Update of Topic 810 is issued by the Board for public comment. Written comments should be addressed to:

Technical Director  
File Reference No. EITF-12G

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Financial Accounting Standards Board  
of the Financial Accounting Foundation

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### **Notice to Recipients of This Exposure Draft of a Proposed Accounting Standards Update**

The Board invites comments on all matters in this Exposure Draft and is requesting comments by December 10, 2012. Interested parties may submit comments in one of two ways:

- Emailing a written letter to [director@fasb.org](mailto:director@fasb.org), File Reference No. EITF-12G
- Sending written comments to "Technical Director, File Reference No. EITF-12G, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

Do not send responses by fax.

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# Proposed Accounting Standards Update

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# Summary and Questions for Respondents

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## Why Is the FASB Issuing This Proposed Accounting Standards Update (Update)?

Topic 810, Consolidation, requires a reporting entity to consolidate a variable interest entity (VIE) if it is determined to be the primary beneficiary of the VIE. As a result, a reporting entity may be required to consolidate a collateralized financing entity, which is a VIE that holds debt instruments and issues beneficial interests in those financial assets. The beneficial interests are financial liabilities that only have recourse to the related financial assets of the collateralized financing entity. In some instances, the reporting entity may not own any of the beneficial interests but may consolidate the collateralized financing entity for other reasons, including a subordinated fee structure. Upon initial consolidation, many reporting entities elect the fair value option to account for the financial assets and financial liabilities of the consolidated collateralized financing entities.

The objective of this proposed Update is to resolve the diversity in practice in the accounting by a reporting entity for the difference between the fair value of the financial assets and the fair value of the financial liabilities of a consolidated collateralized financing entity and to arrive at the amount a reporting entity would ultimately expect to realize.

## Who Would Be Affected by the Amendments in This Proposed Update?

The amendments in this proposed Update would apply to all entities that are required to consolidate a collateralized financing entity under the guidance of Subtopic 810-10 and are required to or have elected, under Topic 825, Financial Instruments, to measure all eligible financial assets and financial liabilities of the collateralized financing entity at fair value.

## What Are the Main Provisions?

The amendments in this proposed Update would define a collateralized financing entity as an entity that holds debt instruments, issues beneficial interests in those financial assets, and has no equity. All of the beneficial interests are financial liabilities that only have recourse to the related financial assets of the collateralized financing entity. The amendments in this proposed Update would require a reporting entity that measures the financial assets and financial liabilities of a collateralized financing entity at fair value to determine the fair value of the collateralized financing entity's financial assets and financial

liabilities consistently with how market participants would price the reporting entity's net risk exposure at the measurement date. The reporting entity would allocate the fair value of the portfolio to the individual financial assets or financial liabilities on a reasonable and consistent basis using a methodology appropriate in the circumstances in accordance with paragraph 820-10-35-18F.

## How Would the Main Provisions Differ from Current U.S. Generally Accepted Accounting Principles (GAAP) and Why Would They Be an Improvement?

The amendments in this proposed Update would require a reporting entity that consolidates a collateralized financing entity and measures the financial assets and financial liabilities of the collateralized financing entity at fair value to apply the guidance in paragraphs 820-10-35-18D and 820-10-35-18F for determining the fair value of the financial assets and financial liabilities of the collateralized financing entity, provided that the requirement in paragraph 820-10-35-18E(c) is met.

The Task Force believes that these proposed amendments will allow a reporting entity to reflect its economic position in the consolidated collateralized financing entity and will reduce the diversity in practice that exists in reflecting the results of consolidating the collateralized financing entity in the reporting entity's financial statements.

## When Would the Amendments Be Effective?

The amendments in this proposed Update would be applied using a modified retrospective approach to only those consolidated collateralized financing entities that exist as of the date of adoption. Adjustments to the financial assets and financial liabilities of those consolidated collateralized financing entities would be made to all relevant prior periods presented upon the date of adoption, beginning from the fiscal year in which FASB Statement No. 167, *Amendments to FASB Interpretation No. 46(R)* (codified by Accounting Standards Update No. 2009-17, *Consolidations (Topic 810): Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities*), was initially adopted. Reporting entities would also be permitted to apply the proposed amendments retrospectively to all consolidated collateralized financing entities by adjusting the financial assets and financial liabilities of all relevant prior periods presented upon the date of adoption, beginning from the fiscal year in which Statement 167 was initially adopted. Early adoption would be permitted. The effective date will be determined after the Task Force considers stakeholder feedback on the proposed Update.

## How Do the Proposed Provisions Compare with International Financial Reporting Standards (IFRS)?

IFRS does not contain any guidance specific to collateralized financing entities.

IFRS 10, *Consolidated Financial Statements*, includes guidance for a reporting entity's accounting for entities required to be consolidated. Additionally, IFRS 9, *Financial Instruments*, contains similar measurement guidance to the fair value option guidance provided in Topic 825. However, IFRS 9 requires certain criteria to be met in order to exercise the option to designate a financial asset or liability at fair value through profit or loss.

IFRS 13, *Fair Value Measurement*, contains similar guidance as in Topic 820, Fair Value Measurement, for (a) permitting a reporting entity to measure the fair value of a group of financial assets and financial liabilities consistently with the way in which market participants would price the net risk exposure at the measurement date, and for (b) allocating any resulting adjustments to the individual financial assets or financial liabilities. IFRS 13 also contains the same requirements as those contained in paragraph 820-10-35-18E that a reporting entity must meet in order to apply the measurement guidance discussed above. IFRS 13, however, does not contain the exception proposed in this Update that would allow a reporting entity to apply this guidance if it meets only the requirement for measuring the financial assets and financial liabilities of a collateralized financing entity at fair value in the statement of financial position at the end of each reporting period.

### Questions for Respondents

The Board invites individuals and organizations to comment on all matters in this proposed Update, particularly on the issues and questions below. Comments are requested from those who agree with the proposed guidance as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed guidance are asked to describe their suggested alternatives, supported by specific reasoning.

**Question 1:** Do you agree that a reporting entity should measure the fair value of a collateralized financing entity's financial assets and financial liabilities consistently with how market participants would price the reporting entity's net risk exposure (that is, how a market participant measures the retained beneficial interest held by the reporting entity) at the measurement date?

**Question 2:** Do you agree that the scope of the amendments in this proposed Update should apply to all entities that are required to consolidate a collateralized financing entity, as defined, and are required to or have elected, under Topic

825, to measure all eligible financial assets and financial liabilities of the collateralized financing entity at fair value?

**Question 3:** Do you believe that current U.S. GAAP provides guidance for reporting entities about how to account for any differences between the carrying amount of the financial assets and the carrying amount of the financial liabilities of a consolidated collateralized financing entity that is not within the scope of this proposed Update? If not, please explain why.

**Question 4:** Do you agree that the proposed amendments should be applied using a modified retrospective approach, with the option to apply the proposed amendments retrospectively? If not, please explain why.

**Question 5:** Do you agree that early adoption of the proposed amendments should be permitted? If not, please explain why.

**Question 6:** Is the guidance in paragraphs 820-10-35-18D and 820-10-35-18F difficult to apply to collateralized financing entities, as defined? If so, what additional information would be useful in applying the guidance in this proposed Update?

**Question 7:** The proposed amendments would apply to public and nonpublic entities. Should the proposed amendments be different for nonpublic entities? If so, please describe how and why you think they should be different.

**Question 8:** For preparers, how much time would be needed to implement the proposed amendments?

**Question 9:** For preparers, what costs do you expect to incur as a result of implementing the proposed amendments?

# Amendments to the *FASB Accounting Standards Codification*<sup>®</sup>

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## Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–4. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is underlined, and deleted text is ~~struck out~~.

## Amendments to Master Glossary

2. Add the following new term to the Master Glossary, with a link to transition paragraph 810-10-65-4, as follows:

### **Collateralized Financing Entity**

A variable interest entity that holds debt instruments, issues beneficial interests in those financial assets, and has no equity. All the beneficial interests are financial liabilities that only have recourse to the related financial assets of the collateralized financing entity.

## Amendments to Subtopic 810-10

3. Add paragraph 810-10-30-2A and paragraph 810-10-35-6 and their related headings, with a link to transition paragraph 810-10-65-4, as follows: **[Text from paragraphs 820-10-35-18D through 35-18F is included below for reference.]**

### **Consolidation—Overall**

#### **Initial Measurement**

##### **Variable Interest Entities**

##### **> > Collateralized Financing Entities**

**810-10-30-2A** When a reporting entity becomes the primary beneficiary of a VIE that is a **collateralized financing entity**, the reporting entity shall initially measure the financial assets and financial liabilities of the collateralized financing entity using the measurement guidance in paragraphs 820-10-35-18D and 820-10-35-18F, provided that the requirement in paragraph 820-10-35-18E(c) is met. To use the measurement guidance in paragraph 820-10-35-18D, the reporting

entity shall not consider the requirements in paragraphs 820-10-35-18J through 35-18K, which require a reporting entity to ensure that the market risk (or risks) to which the reporting entity is exposed within a group of financial assets and liabilities is substantially the same and that the duration of the reporting entity's exposure to a particular market risk (or risks) is substantially the same.

## Subsequent Measurement

### Variable Interest Entities

#### > Collateralized Financing Entities

**810-10-35-6** A reporting entity that consolidates a VIE that is a **collateralized financing entity** shall subsequently measure the financial assets and financial liabilities of the collateralized financing entity using the measurement guidance in paragraphs 820-10-35-18D and 820-10-35-18F, provided that the requirement in paragraph 820-10-35-18E(c) is met. To use the measurement guidance in paragraph 820-10-35-18D, the reporting entity shall not consider the requirements in paragraphs 820-10-35-18J through 35-18K, which require a reporting entity to ensure that the market risk (or risks) to which the reporting entity is exposed within a group of financial assets and liabilities is substantially the same and that the duration of the reporting entity's exposure to a particular market risk (or risks) is substantially the same.

## Fair Value Measurement—Overall

### Subsequent Measurement

#### **> > Application to Financial Assets and Financial Liabilities with Offsetting Positions in Market Risks or Counterparty Credit Risk**

**820-10-35-18D** A reporting entity that holds a group of **financial assets** and **financial liabilities** is exposed to market risks (that is, **interest rate risk**, **currency risk**, or **other price risk**) and to the credit risk of each of the counterparties. If the reporting entity manages that group of financial assets and financial liabilities on the basis of its net exposure to either market risks or credit risk, the reporting entity is permitted to apply an exception to this Topic for measuring fair value. That exception permits a reporting entity to measure the fair value of a group of financial assets and financial liabilities on the basis of the price that would be received to sell a net long position (that is, an asset) for a particular risk exposure or paid to transfer a net short position (that is, a liability) for a particular risk exposure in an orderly transaction between market participants at the measurement date under current market conditions. Accordingly, a reporting entity shall measure the fair value of the group of financial assets and financial liabilities consistently with how market participants would price the net risk exposure at the measurement date.

**820-10-35-18E** A reporting entity is permitted to use the exception in the preceding paragraph only if the reporting entity does all of the following:

- a. Manages the group of financial assets and financial liabilities on the basis of the reporting entity's net exposure to a particular market risk (or risks) or to the credit risk of a particular counterparty in accordance with the reporting entity's documented risk management or investment strategy
- b. Provides information on that basis about the group of financial assets and financial liabilities to the reporting entity's **management**
- c. Is required or has elected to measure those financial assets and financial liabilities at fair value in the statement of financial position at the end of each reporting period.

**820-10-35-18F** The exception in paragraph 820-10-35-18D does not pertain to financial statement presentation. In some cases, the basis for the presentation of financial instruments in the statement of financial position differs from the basis for the measurement of financial instruments, for example, if a Topic does not require or permit financial instruments to be presented on a net basis. In such cases, a reporting entity may need to allocate the portfolio-level adjustments (see paragraphs 820-10-35-18I through 35-18L) to the individual assets or liabilities that make up the group of financial assets and financial liabilities managed on the basis of the reporting entity's net risk exposure. A reporting entity shall perform such allocations on a reasonable and consistent basis using a methodology appropriate in the circumstances.

4. Add paragraph 810-10-65-4 and its related heading as follows:

**> Transition Related to Accounting Standards Update No. 2012-XX,  
Consolidation (Topic 810): Accounting for the Difference between the Fair Value of the Assets and the Fair Value of the Liabilities of a Consolidated Collateralized Financing Entity**

**810-10-65-4** The following represents the transition and effective date information related to Accounting Standards Update No. 2012-XX, *Consolidation (Topic 810): Accounting for the Difference between the Fair Value of the Assets and the Fair Value of the Liabilities of a Consolidated Collateralized Financing Entity*:

- a. An entity shall apply the pending content that links to this paragraph in either of the following ways:
  1. Using a modified retrospective approach applicable to only those consolidated collateralized financing entities that exist as of the date of adoption. Adjustments to the financial assets and financial liabilities of those consolidated collateralized financing entities shall be made to all relevant prior periods presented upon the date of adoption, beginning from the fiscal year in which FASB Statement No. 167, *Amendments to FASB Interpretation No. 46(R)*, was initially adopted.

2. Retrospectively, to all consolidated collateralized financing entities. Adjustments to the financial assets and financial liabilities of consolidated collateralized financing entities shall be made to all relevant prior periods presented upon the date of adoption, beginning from the fiscal year in which Statement 167 was initially adopted.
- b. Earlier adoption of the pending content that links to this paragraph is permitted.
- c. An entity shall provide the disclosures in paragraphs 250-10-50-1 through 50-3 in the period the entity adopts the pending content that links to this paragraph.

*The amendments in this proposed Update were approved for publication by the unanimous vote of the seven members of the Financial Accounting Standards Board:*

Leslie F. Seidman, *Chairman*  
Daryl E. Buck  
Russell G. Golden  
Thomas J. Linsmeier  
R. Harold Schroeder  
Marc A. Siegel  
Lawrence W. Smith

# Background Information and Basis for Conclusions

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## Introduction

BC1. The following summarizes the Task Force's considerations in reaching the conclusions in this proposed Update. It includes the Board's basis for ratifying the Task Force conclusions when needed to supplement the Task Force's considerations. It also includes reasons for accepting certain approaches and rejecting others. Individual Task Force and Board members gave greater weight to some factors than to others.

## Background Information

BC2. Under Subtopic 810-10, if a reporting entity holds a controlling financial interest in a VIE, that entity is determined to be the primary beneficiary of the VIE and is required to consolidate the VIE. Characteristics of a controlling financial interest in a VIE are (a) the power to direct the activities of the VIE that most significantly affect the VIE's economic performance (the power criterion) and (b) the obligation to absorb losses of the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE (the losses-benefits criterion).

BC3. Collateralized financing entities include VIEs that hold debt instruments, issue beneficial interests in those financial assets, and have no equity. All the beneficial interests are financial liabilities that only have recourse to the related financial assets of the collateralized financing entity. Reporting entities that do not hold any of the beneficial interests may be required to consolidate collateralized financing entities in accordance with Subtopic 810-10 because of other reasons, such as the subordinated fee structure.

BC4. Upon initial consolidation of a collateralized financing entity, many reporting entities elect the fair value option to account for all eligible financial assets and financial liabilities of the collateralized financing entity under Subtopic 825-10. Subtopic 825-10 provides guidance on circumstances in which a reporting entity may choose, at specified election dates, to measure eligible items at fair value (the fair value option). Diversity in practice has developed in the accounting for the difference between the fair value of assets and the fair value of the liabilities of a collateralized financing entity upon initial consolidation. For example, some reporting entities initially record the difference in the consolidated statement of comprehensive income as a gain or loss and allocate the amount to the noncontrolling beneficial interest holders in arriving at net income (loss) available to common shareholders. Those amounts are then reclassified to

appropriated retained earnings in the statement of changes in equity. Other reporting entities initially record the difference as a direct adjustment to appropriated retained earnings in the statement of changes in equity.

BC5. Paragraph 825-10-35-4 requires that subsequent gains and losses as a result of a change in fair value of the assets and liabilities of a collateralized financing entity be recorded within the reporting entity's consolidated net income (loss). Practice has developed regarding the presentation of that subsequent change in fair value of the assets and liabilities of a consolidated collateralized financing entity whereby the portion of that change that is not attributable to the reporting entity is allocated to the noncontrolling interest holders to arrive at the net income (loss) attributable to common shareholders. The net income (loss) allocated to the noncontrolling interest holders is then reclassified to appropriated retained earnings in the statement of changes in equity. Accordingly, under that approach, the change in fair value of the consolidated assets and liabilities after initial consolidation is attributed to the beneficial interest holders of the collateralized financing entity and excluded from the reporting entity's net income attributable to common shareholders and earnings-per-share calculation.

## Scope and Other Considerations

BC6. The Task Force reached a consensus-for-exposure that the fair value of a collateralized financing entity's financial assets and financial liabilities should be measured consistently with the guidance on financial assets and financial liabilities with offsetting positions in market risks or counterparty credit risk in Topic 820. The Task Force noted that the objective of measuring the financial assets and financial liabilities consistently would result in a net amount that represents the amount that the reporting entity would expect to realize. The Task Force considered that, by contract, the assets and liabilities of a collateralized financing entity are managed together and, thus, a reporting entity, by analogy, would use the guidance in paragraph 820-10-35-18D to measure the fair value of the group of financial assets and financial liabilities consistently with how market participants would price the net risk exposure at the measurement date. The Task Force observes that when the reporting entity owns none of the collateralized financing entity's beneficial interests, the transaction price would most often be zero and the financial assets and financial liabilities would be presented on a gross basis with the portfolio-level fair value adjustments allocated to the individual financial assets or financial liabilities based on the more determinable fair value of either the financial assets or the financial liabilities. If the reporting entity owns some of the beneficial interests of the collateralized financing entity, the fair value of the beneficial interests held by the reporting entity should be determined based on the perspective of market participants, consistent with the objective of measuring the net amount that the reporting entity would expect to realize if it has (or believes it can readily obtain) the means to terminate the collateralized financing entity, that is, to sell the

collateralized financing entity's assets, settle the collateralized financing entity's obligations, and realize the net amount. Several Task Force members commented on the practical difficulties associated with actually realizing any implied arbitrage profits.

BC7. In arriving at its consensus-for-exposure, the Task Force clarified that although this measurement guidance currently exists in Topic 820, not all reporting entities that consolidate collateralized financing entities meet all three criteria in paragraph 820-10-35-18E and the criteria in paragraphs 820-10-35-18J through 35-18K. As a result, certain reporting entities are not able to measure the fair value of the financial liabilities of a consolidated collateralized financing entity in the same way they measure the related financial assets of the consolidated collateralized financing entity. The amendments in this proposed Update will allow such entities to use the measurement guidance in paragraph 820-10-35-18D.

BC8. The Task Force decided to limit the scope of the guidance in this proposed Update to apply to reporting entities that consolidate a collateralized financing entity and are required to or have elected a fair value option under Topic 825 to subsequently account for all eligible financial assets and financial liabilities of the collateralized financing entity at fair value. The Task Force also clarified that this proposed Update would apply to collateralized financing entities that only hold financial assets and issue beneficial interests that only have recourse to the financial assets held by the collateralized financing entity and defined a collateralized financing entity as an entity that holds debt instruments, issues beneficial interests in those financial assets, and has no equity. The beneficial interests are financial liabilities that only have recourse to the related financial assets of the collateralized financing entity.

BC9. The Task Force discussed whether the scope of this proposed Update should be broadened to apply to all reporting entities that are required to consolidate VIEs upon applying Subtopic 810-10. The Task Force determined that the diversity in practice primarily relates to a reporting entity's accounting for the difference between the fair value of financial assets and the fair value of financial liabilities of collateralized financing entities, as defined. Therefore, the Task Force determined that the scope should not be broadened.

## Transition and Early Adoption

BC10. The Task Force reached a consensus-for-exposure that the amendments in this proposed Update should be applied using a modified retrospective approach to only collateralized financing entities that exist as of the date of adoption. Adjustments to the financial assets and financial liabilities of those consolidated collateralized financing entities would be made to all relevant prior periods presented upon the date of adoption, beginning from the fiscal year in which Statement 167 was initially adopted. The Task Force also agreed that

reporting entities should be given an option to apply the guidance in this proposed Update retrospectively beginning from the fiscal year in which Statement 167 was initially adopted.

BC11. The Task Force decided to permit early adoption of the proposed amendments to eliminate existing diversity in practice as soon as is practicable.

## Benefits and Costs

BC12. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Task Force's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC13. The Task Force does not anticipate that entities will incur significant costs as a result of the amendments in this proposed Update. The proposed amendments would provide the benefit of improving consistent application of U.S. GAAP by eliminating diversity in practice.

## Amendments to the XBRL Taxonomy

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The following proposed changes to the U.S. GAAP Financial Reporting Taxonomy (UGT) would be required if the provisions of this Exposure Draft are finalized as proposed. The proposed changes to the UGT are available for public comment in the development UGT throughout the year at [www.fasb.org](http://www.fasb.org). Changes to the UGT for final Accounting Standard Updates will be formally exposed for public comment as part of the annual release process starting in September of each year.

<b>Element Name</b>	<b>Standard Label</b>	<b>Documentation</b>
AccountingStandardUpdate2012XXMember	Accounting Standards Update 2012-XX [Member]	Accounting Standards Update 2012-XX, Consolidation (Topic 810): Accounting for the Difference between the Fair Value of the Assets and the Fair Value of the Liabilities of a Consolidated Collateralized Financing Entity