

# Board Meeting Handout Private Company Council Endorsement of PCC Decisions August 07, 2013

#### **Purpose of this Meeting**

 The purpose of this meeting is for the Board to consider for endorsement, the decisions reached by the Private Company Council (PCC) at its July 16, 2013 meeting on PCC Issue No. 13-02.

### PCC Issue No. 13-02, "Applying Variable Interest Entity Guidance to Common Control Leasing Arrangements"

- 2. The PCC voted to expose a proposed alternative for private companies within U.S. Generally Accepted Accounting Principles (GAAP) for applying variable interest entity (VIE) guidance to lessor entities under common control. The PCC decided that a private company lessee can elect the alternative under this proposed guidance and not apply VIE guidance for assessing whether it should consolidate the lessor entity when the arrangement between a private company lessee and a lessor entity meets all of the following conditions:
  - a. The private company and the legal entity are under common control
  - b. The private company has a lease arrangement with the legal entity
  - c. Substantially all activities between the private company and the legal entity are related to the leasing activities (including supporting leasing activities) of the legal entity.
- 3. While VIE guidance would no longer apply to the lessor entity, a private company would still have to consider other applicable Codification Topics, such as Topic 840, Leases, and Topic 460, Guarantees, for transactions or arrangements between

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the two entities. In applying this proposed alternative, a private company would have to provide all of the following additional disclosures:

- a. The key terms of the leasing arrangements
- b. The amount of debt and/or significant liabilities of the lessor entity under common control
- c. The key terms of existing debt agreements of the lessor under common control (for example, amount of debt, interest rate, maturity, pledged collateral, guarantees, and so forth)
- d. The key terms of any other explicit interest in the lessor entity.
- 4. If an entity elects to adopt this proposed accounting alternative, it would be applicable to all of its leasing arrangements that meet the requirements for applying this approach. This proposed alternative would be applied using a full retrospective approach.

#### **Question for the Board**

Question 1: Does the Board wish to endorse the decisions reached by the PCC on PCC Issue No. 13-02?

#### **Applicability to Public Business Entities**

5. The staff recommends including the following question for respondents in the proposed Update:

Do you agree that the proposed Update does not apply to public business entities because they lack the arrangements that the accounting alternative addresses? If not, please describe the arrangements that exist for public business entities that the Board should consider in determining the scope of the proposed Update.

#### Question for the Board

Question 2: Does the Board agree with the staff recommendation to (a) include the recommended question for respondents in the proposed Update and (b) conduct outreach to public business entity stakeholders through normal channels, including advisory groups and other meetings in which the FASB participates, during exposure period?

#### **Exposure Period for the Proposed Update**

6. The staff recommends that the proposed Update for PCC Issue No. 13-02 be exposed for public comment with a comment period that ends on Monday, October 14, 2013. Assuming the proposed Update is issued by August 23, 2013, this will provide approximately 50 days for stakeholders to provide feedback on the exposure draft.

#### **Question for the Board**

Question 3: Does the Board agree with the staff's recommendation that the proposed Update for PCC Issue No. 13-02 be exposed with a comment period end date of October 14, 2013

#### Removal of the FSP Example

7. The guidance in FASB Staff Position No. FIN 46(R)-5, *Implicit Variable Interest under FASB Interpretation No. 46 (revised December 2003)*, Consolidation of Variable Interest Entities, was codified in paragraphs 810-10-25-48 through 25-54, and paragraphs 810-10-55-87 through 55-89. The PCC recommended to the FASB at its July 16, 2013 meeting that the following example codified in paragraphs 810-10-55-87 through 55-89 (FSP Example) be removed from Topic 810:

#### >> Example 4: Implicit Variable Interests

**810-10-55-87** This Example illustrates the guidance in paragraphs 810-10-25-48 through 25-54.

**810-10-55-88** One of the two owners of Manufacturing Entity is also the sole owner of Leasing Entity, which is a VIE. The owner of Leasing Entity provides a guarantee of Leasing Entity's debt as required by the lender. Leasing Entity owns no assets other than the manufacturing facility being leased to Manufacturing Entity. 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 810-10-55-39. The lease meets the classification requirements for an operating lease and is the only contractual relationship between Manufacturing Entity and Leasing Entity.

**810-10-55-89** Manufacturing Entity should consider whether it holds an implicit variable interest in Leasing Entity. Although the lease agreement itself does not contain a contractual guarantee, Manufacturing Entity should consider whether it holds an implicit variable interest in Leasing Entity as a result of the leasing

arrangement and the relationship between it and the owner of Leasing Entity. For example, Manufacturing Entity would be considered to hold an implicit variable interest in Leasing Entity if Manufacturing Entity effectively guaranteed the owner's investment in Leasing Entity. The guidance in paragraphs 810-10-25-48 through 25-54 shall be used only to evaluate whether a variable interest exists under the Variable Interest Entities Subsections and shall not be used in the evaluation of lease classification in accordance with Topic 840. Paragraph 840-10-25-26 addresses leases between related parties. Manufacturing Entity may be expected to make funds available to Leasing Entity to prevent the owner's guarantee of Leasing Entity's debt from being called on, or Manufacturing Entity may be expected to make funds available to the owner to fund all or a portion of the call on Leasing Entity's debt guarantee. The determination as to whether Manufacturing Entity is effectively guaranteeing all or a portion of the owner's investment or would be expected to make funds available and, therefore, an implicit variable interest exists, shall take into consideration all the relevant facts and circumstances. Those facts and circumstances include, but are not limited to, whether there is an economic incentive for Manufacturing Entity to act as a guarantor or to make funds available, whether such actions have happened in similar situations in the past, and whether Manufacturing Entity acting as a guarantor or making funds available would be considered a conflict of interest or illegal.

8. The PCC believes that the FSP Example contradicts the accounting alternative provided in the proposed Update because the accounting alternative would exempt private companies with a fact pattern very similar to the FSP Example from applying VIE guidance. While the removal of the FSP example would affect public companies in a literal sense, based on limited outreach thus far, the staff believes that the FSP Example primarily relates to private companies and does not significantly affect public companies. If the proposed Update is finalized, the staff believes that the FSP would no longer provide any incremental value because it is ambiguous and is rarely analogized to by public companies.

#### **Question for the Board**

Question 4: Does the Board agree with the PCC's recommendation to remove the FSP Example from Topic 810? If so, does the Board agree with the staff's recommendation to (a) expose that removal in the proposed Update for PCC Issue No. 13-02, and (b) conduct further outreach with public company stakeholders through normal channels including advisory groups and other meetings in which the FASB participates?



## Board Meeting Handout Disclosure Framework—Board's Decision Process August 7, 2013

#### **Purpose of This Meeting**

1. The purpose of this meeting is to discuss how the Board's decision process can apply to not-for-profit entities and to discuss the comments received on the decision questions in Chapter 2 of the Invitation to Comment, *Disclosure Framework*, that are specifically related to information about line items in financial statements (see questions L1–L16 in the Invitation to Comment).

#### **Not-for-Profit Entities**

- 2. In the Invitation to Comment, the Board's decision process is discussed on the basis of disclosures that would be relevant to a business enterprise. The general focus is on providing information that is useful in the assessment of cash flows to the resource provider. The decision questions and the commentary that follow each question were written with a business enterprise in mind.
- 3. Question 1 of the Invitation to Comment states the following:

The details of this Invitation to Comment do not focus on the informational needs of donors to not-for-profit organizations. How, if at all, should the Board's decision process (see Chapter 2) be supplemented to consider the needs of donors? How, if at all, should not-for-profit reporting entities modify their decision-making process (see Chapter 4) for the needs of donors when deciding which disclosures to include in notes to financial statements?

4. Comment letter respondents generally stated that the focus on potential cash flows to the resource provider would not capture the types of information that would be most useful to donors. Some respondents said that it would be appropriate for disclosures to aid in donors' donation decisions. Other respondents added that

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disclosures of not-for-profit entities should provide information that helps users assess the following:

- a. How resources have been used to further evaluate:
  - 1. Adherence to mission
  - 2. Compliance with restrictions
  - 3. Effectiveness and efficiency
- b. Financial stability and liquidity
- 5. In additional outreach performed with not-for-profit entities, constituents said that the decision questions could be supplemented with examples of disclosures specifically targeted toward donors. Similarly, a number of comment letters suggested examples of disclosures that should be included in the Board's decision process. Those comments were consistent with information received from the FASB's Not-for-Profit Advisory Committee.
- 6. Donors are interested in how a not-for-profit entity uses its resources (cash) to accomplish its mission. Therefore, the staff notes that the basis for deciding on disclosure requirements for not-for-profit entities can be supplemented to address the needs of donors by including the following language in an Exposure Draft:

In addition to providing information that is useful in the assessment of cash flows to resource providers, disclosures of not-for-profit entities should provide information that will assist donors in the assessment of how resources of the entity have been and can be used in pursuit of its mission (or, said differently, provide information that can be used in assessing a not-for-profit entity's services and ability to provide services).

7. This additional purpose for the notes should result in information that would enable donors to assess the stewardship of the entity over its resources as well as, to some degree, the efforts and outputs of the entity.

- 8. Some of the existing decision questions are so specific to particular issues or elements that there is no need (or more specifically, no opportunity) to include additional considerations relative to not-for-profit entities. For example, if a change in an amount from period to period is hard to understand (Question L7 of the Invitation to Comment), understanding that change would be useful for all users. However, some questions appear specifically directed to resource providers of business enterprises.
- 9. To explicitly contemplate not-for-profit entities in the Board's decision process, the decision questions in the proposed Exposure Draft could incorporate wording that links the Board's decision process to the needs of donors.

#### Staff Recommendation

10. The staff recommends that the Board's decision process include the additional language recommended in paragraph 6 of this handout.

#### **Questions for the Board**

- 1. Does the Board agree that the Board's decision process should address providing information that will assist donors in the assessment of how resources of the entity have been and can be used in pursuit of its mission (or, said differently, provide information that can be used in assessing a not-for-profit entity's services and ability to provide services) as described in paragraph 6 of this handout?
- 2. Does the Board think that the existing decision questions address the needs of donors (if reworded as described in question 1) or are there additional questions that should be added?

#### **Decision Questions—Line Items**

- 11. The following is a summary of the primary issues raised regarding the line item decision questions in Chapter 2 of the Invitation to Comment and the staff's analysis and recommendations on the issues:
  - a. **Forward-looking concerns**—Some constituents remarked that questions L2 and L3 of the Invitation to Comment could result in forward-looking

disclosures. Since the issuance of the Invitation to Comment, the Board has addressed disclosure of information that is oriented toward the future. Because the Board has tentatively decided which types of disclosures oriented toward the future are and are not appropriate for the notes, the staff is not seeking any decisions on this topic at this meeting.

- b. **Not-for-profit considerations**—Respondents suggested that questions could incorporate examples that were specific to not-for-profit entities. Those comments will be addressed based on the Board's decisions made regarding questions 1 and 2 of this handout.
- c. Disclosure of an alternate accounting policy—Respondents objected to the suggestion in question L10 of the Invitation to Comment to disclose the results of alternative accounting when a choice between methods is provided under U.S. generally accepted accounting principles (GAAP). The staff notes that the disclosure of the magnitude of the effect from applying the alternative is indicated when the accounting method is "unusual, if results produced are counter to what a reader might otherwise expect...or if the method otherwise dramatically affects the financial statements...." A normal routine choice of an acceptable method would not indicate a disclosure of the magnitude of the alternate method. The staff does not recommend a change to this question.
- d. **Transition disclosures**—Respondents said that disclosing the pro forma effect of an accounting pronouncement before it is effective, as suggested by question L13, was inappropriate. While a discussion about a new accounting standard is appropriate, requiring a quantification of that effect in all circumstances may be contrary to the reason for allowing a transition period. The staff thinks that the following two options are modifications that would address respondent concerns:
  - 1. Option A—Remove the following indicated disclosure:

The pro forma effect on current-year financial statements

2. Option B—Modify the indicated disclosure as follows:

The pro forma effect on current-year financial statements, if known by the entity in advance of the transition date

Option B leaves the Board the option to require the disclosure while highlighting that it would be contingent on the pro forma data being available.

- e. **Overlapping disclosures**—Respondents commented that some indicated disclosures would overlap with Security and Exchange Commission (SEC) disclosures. The Board has addressed overlap with SEC-required disclosures and decided that the Board could require disclosure in the notes, even if that information is required elsewhere in the report or outside of the report by a securities regulator or other regulator if including the information in the notes represents an improvement in financial reporting and the benefits of providing the information outweigh the costs.
- f. Combination of questions—Respondents suggested that some disclosures could be combined. The staff thinks that the disclosures that result from each question are different in content. The reasons for each disclosure are different and, therefore, a particular set of circumstances could result in a 'yes' answer for some questions and a 'no' answer for other questions. Furthermore, the staff thinks that structuring the Board's decision process to be more specific will result in easier navigation through the process and more consistent disclosure requirements. For those reasons, the staff thinks it is beneficial to keep the questions separate from one another.
- g. Alternative measures—Some respondents stated that the alternative measure disclosures suggested by question L16 would decrease the clarity of information presented and disclosed. Although the Board may not require that a particular measurement be reflected in the financial results or position of the company, the information may still be relevant to users. If the Board were to require that type of disclosure, increased costs to preparers may result. The staff recognizes those concerns but does not think that the Board should be precluded from ever requiring that type of disclosure given the potential

usefulness and relevance of the information to users. Rather, the Board should weigh the costs within the context of the benefits of a particular disclosure.

h. Linkage between line items—Two respondents noted that there is no decision question currently directed toward how a line item from one financial statement relates to line items in other financial statements. The staff thinks that this question should be included in the Board's decision process as follows:

#### **Decision Question**

Question L17—Does a line item have a direct relationship to another line item(s) in another statement about which a user is not expected to be aware of the relationship or the potential effects of that relationship?

#### **Information to Be Considered for Disclosure**

The Board should consider requiring disclosure of the following:

- a. A description of the relationship(s) between line items if users are not expected to be aware of the relationship(s)
- b. The effects a change in a particular item has on another item
- c. A reconciliation of the relationship between line items on various statements.

#### Why the Information Could Be Important

At times, financial statement presentation makes relationships between line items clear. For example, accounts receivable and sales are related, and that relationship is clear. However, if financial instruments are not disaggregated by measurement bases on the statement of financial position, it might be useful to understand how changes in the value of the aggregated amount affect various line items on the statement of comprehensive income.

#### Staff Recommendation

- 12. In summary, the staff recommends the following:
  - a. The indicated disclosure in question L13 of the Invitation to Comment should be modified as follows:

The pro forma effect on current-year financial statements if known by the entity in advance of the transition date.

b. A decision question should be added related to the relationships between line items as described in paragraph 11(h) of this handout.

#### **Questions for the Board**

- 3. Does the Board agree that the indicated disclosure in question L13 should be modified as shown in paragraph 12(a) of this handout?
- 4. Does the Board agree that a decision question should be added related to the relationships between line items as described in paragraph 11(h) of this handout?
- 5. Does the Board think any of the other issues raised in this handout should be considered further?