October 8, 2013

Technical Director
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File Reference No. PCC-13-02

Re: Proposed Accounting Standards Update: Consolidation (Topic 810) Applying Variable interest Entity Guidance to Common Control Leasing Arrangements

The Accounting Principles and Auditing Standards Committee of the California Society of CPAs is pleased to respond to the August 7, 2013 Proposed Accounting Standards Update Consolidation (Topic 810) Applying Variable interest Entity Guidance to Common Control Leasing Arrangements on behalf of the Society.

The Committee has two essential disagreements with the approach the Board and the PCC is using to set those alternative GAAP for private companies: one with the definition of public vs. private entities, one with how those alternatives may be implemented.

- The Committee believes any entity with a public accountability should be considered to be a public business entity. This would include entities which accept deposits from the public (e.g., banks, credit unions, and trust companies) or are the beneficiaries of government sponsored insurance programs, and insurance companies that offer insurance products to the public, as well as securities brokers/dealers, mutual funds and investment banks. We realize that the Board has to date failed to embrace the reference to public accountability. We believe this failure overlooks a significant concern of users. The fact that many of these entities have regulatory requirements to file financial statements, whether or not on a GAAP basis, is evidence that the government, as representative of the people, views public accountability as an important consideration, and it is incongruous not to hold these entities to the higher standard of non-alternative GAAP financial statements.

- The Board issuing accounting and reporting alternatives for private companies on a piecemeal basis and including them within its single set of U.S. GAAP guidance. The Committee believes that alternatives for private companies should be provided as a separate comprehensive framework. Further, those entities which adopt those standards should adopt all of them. Piecemeal adoption will tend to undermine the credibility of the standards and confuse users as to what accounting and disclosure policies are being used, no matter how much explanation is provided as to what standards are used.
Question 1: Please describe the entity or individual responding to this request. For example:

a. Please indicate whether you primarily are a preparer, user, or public accountant. If other, please specify.

b. If you are a preparer of financial statements, please indicate whether your entity is privately held or publicly held and describe your primary business and its size (in terms of annual revenue, the number of employees, or other relevant metric).

c. If you are a public accountant, please describe the size of your firm (in terms of the number of partners or other relevant metric) and indicate whether your practice focuses primarily on public entities, private entities, or both.

d. If you are a user of financial statements, please indicate in what capacity (for example, lender, investor, surety, analyst, or rating agency) and whether you primarily use financial statements of private entities or those of both private entities and public entities.

The Accounting Principles and Auditing Standards Committee ("Committee") of the California Society of Certified Public Accountants ("CalCPA") is the senior technical committee of CalCPA. CalCPA has approximately 40,000 members. The Committee includes 53 members, of whom 47 percent are from local or regional firms, 27 percent are from large multi-office firms, 12 percent are sole practitioners in public practice, 10 percent are in academia and 4 percent are in international firms. Members of the Committee are with firms which serve a large number of public and nonpublic business entities, as well as many nonbusiness entities such as NFPs, pension plans, and governmental organizations.

Question 2: Do you agree that the accounting alternative in the proposed Update should apply to all entities except public business entities, not-for-profit entities, or employee benefit plans within the scope of Topics 960 through 965 on plan accounting? If not, what type of entities should not be included in the scope of this accounting alternative?

See comment in second paragraph, above.

The Committee agrees with the substance of the proposed ASU.

The Committee believes the Board should study differentiation among NFPs with the objective of providing certain NFPs with an alternative GAAP. For example, many NFPs have regulatory filing requirements, but many do not. Some solicit support broadly; others do not, and others are private foundations. In many larger NFPs, access by supporters to management as a practical matter is not feasible. Alternative GAAP for certain NFPs needs further study, and may involve differential factors other than those between public and private companies. But, without identification of differential factors for NFPs, we do not believe the standard-by-standard approach the Board plans on using will be workable.

Question 3: Do you agree that the proposed Update does not apply to public business entities and employee benefit plans because they lack the arrangements that the accounting alternative addresses? If not, please describe the arrangements that exist for those types of entities that the Board should consider in determining whether any public business entities or employee benefit plans should be included in the scope of the proposed accounting alternative.
We agree that the proposed update should not apply to public business entities and employee benefit plans, not because those entities lack the arrangements that the accounting alternative addresses, but because they are not private companies. Those entities can have similar arrangements, particularly in cases of small or newly public entities where actual or de facto control of the lessee rests with the owners of the lessor. (We do not believe that the Board should consider the proposed accounting alternative for those entities.)

**Question 4:** Do you agree with the required criteria for applying the proposed accounting alternative? If not, please explain why.

Yes.

**Question 5:** Do you agree that paragraph 810-10-55-9, which describes the effects of guarantees and joint and several liability arrangements related to a mortgage on the lessor's assets, provides sufficient guidance to clarify what constitutes a supporting leasing activity for applying paragraph 810-10-15-17A(c)? If not, please explain why.

Yes.

**Question 6:** Do you agree that the following additional disclosures about lessor entities should be provided if a private company elects the proposed accounting alternative? If not, please explain why.

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 entity under common control (for example, amount of debt, interest rate, maturity, pledged collateral, and guarantees)
d. The key terms of any other explicit interest related to the lessor entity under common control.

Should other disclosures be required as a result of applying this alternative?

Yes. No additional disclosures beyond those proposed are necessary.

**Question 7:** Do you agree that, generally, the primary purpose of establishing a separate lessor entity in a private company setting is for tax and estate-planning purposes and not to structure off-balance-sheet debt arrangements? If not, please explain why.

We generally agree. However, the separate lessor entity may also be established to insulate the leased assets from creditor claims of the lessee.

**Question 8:** Would the proposed accounting alternative, including the required disclosures, address private company stakeholder concerns about relevance of consolidated information without causing a proliferation of the use of lessor entities to avoid reporting assets and liabilities for which the reporting entity is responsible? If not, why?

Yes.
Question 9: Do you agree that the proposed accounting alternative, when elected, is an accounting policy election that should be applied by an entity to all current and future lessor entities under common control that meet the criteria for applying this approach?

Yes, all should be treated in a consistent manner.

Question 10: Do you agree that the proposed accounting alternative should be applied using a full retrospective approach in which financial statements for each individual prior period presented and the opening balances of the earliest period presented would be adjusted to reflect the period-specific effects of applying the proposed amendments?

Yes.

Question 11: When should the proposed alternative accounting be effective? Should early application be permitted?

The proposed accounting alternative should be effective on issuance. If it is not, early application should be permitted.

Question 12: Do you agree that the example that is codified in paragraphs 810-10-55-87 through 55-89 (described in paragraphs BC19 through BC20 of this proposed Update) should be removed? Do you agree that the removal of the example would not significantly affect public business entity stakeholders? If not, please explain why.

The example is useful and, as explained in our answer to Question 3, relevant, but we agree that they should not be left as-is. We suggest that the Board consider changing them from "two owners" to a "controlling shareholder or group of shareholders."

Question 13: The PCC considered two other alternatives (as described in paragraphs BC15 through BC18 of this proposed Update) to clarify the application of VIE guidance to common control leasing arrangements.

a. Would either of those alternatives better address the concerns raised by private company stakeholders?

b. Should the PCC and the Board consider either of those alternatives in conjunction with the guidance in this proposed Update to better address the concerns raised by private company stakeholders?

No. Those alternatives should not be considered further; the accounting alternative as proposed is an appropriate solution.

We would be glad to discuss our comments further should you have any questions or require additional information.

Very truly yours,

Michael Feinstein, Chair
Accounting Principles and Auditing Standards Committee
California Society of Certified Public Accountants