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Technical Director
FASB
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Via Email to director@fasb.org

Grant Thornton LLP
175 W Jackson Boulevard, 20th Floor
Chicago, IL 60604-2687

T 312.856.0200
F 312.565.4719
www.GrantThornton.com

Re: File Reference No. PCC-13-02

Dear Ms. Cosper:

Grant Thornton LLP appreciates the opportunity to comment on proposed Accounting Standards Update (ASU), *Consolidation (Topic 810): Applying Variable Interest Entity Guidance to Common Control Leasing Arrangements*. We support the efforts of the Private Company Council (PCC) and FASB to provide an elective accounting alternative for private companies in applying the variable interest entity (VIE) guidance to lessor entities under common control. However, as more fully discussed in our responses to the Questions for Respondents included in Appendix A, we believe that further work is required on the scope of the accounting alternative to both meet the objectives of the PCC and avoid unintended consequences, including, but not limited to, structuring opportunities. We believe that the scope may be too broad in certain respects and too limited in other respects. Our response to the Questions for Respondents includes recommendations to address certain concerns we have with the proposed scope of the accounting alternative. In Appendix B we have included example fact patterns for the Board's consideration in evaluating whether the scope is appropriate.

While we support the efforts of the PCC and FASB in providing relief for private companies in applying the variable interest entity guidance to lessor entities under common control, it is also our observation that constituents believe that this is not the only situation in which consolidation under the variable interest model does not present meaningful financial information for the users of their financial statements. Consistent with our recommendation in our response to the proposed ASU, *Consolidation (Topic 810): Principal versus Agent Analysis*, we recommend that a post-implementation review of Statement 167 be completed with the objectives of obtaining a better understanding of constituent concerns about the model and determining whether the model could be improved for both public entities and private companies. We would be pleased to discuss our experiences with the application of Statement 167 with the Board and staff.

Other comments

Common control

Eligibility for the accounting alternative hinges, in part, on interpretation of the term “common control,” a term not currently defined in the *FASB Accounting Standards Codification*® (ASC) Glossary. It is presently unclear whether “control” as used in “common control” means a controlling financial interest under the voting interest and/or variable interest consolidation models. Additionally, we note that SEC registrants apply the definition of common control in EITF Issue 02-5, “Definition of ‘Common Control’ in Relation to FASB Statement No. 141,” even though a consensus was never reached based on the SEC observer who stated that “SEC registrants should continue to follow the guidance in paragraph 3 ... when determining whether common control of separate entities exists.” We note that such definition includes only immediate family members and would not encompass grandchildren. We observe that certain legal entities may be established with ownership by trusts to benefit grandchildren or that the grandchildren may be owners of the legal entity.

We would prefer other wording that is less ambiguous. If the Board elects to retain common control as a criterion for eligibility, we suggest that the final Update include a definition of common control for purposes of applying the proposed guidance and applying the guidance in ASC 460.

Application of other GAAP

We believe that the Board should clarify whether a private company that does not consolidate a lessor entity under common control would be excluded from the scope of the guarantee literature under ASC 460-10-15-7(i), which states that Topic 460 does not apply to a guarantee of an entity’s own future performance. An explicit or indirect (as contemplated in ASC 460-10-15-4(d)) guarantee by the private company would, in our view, generally result in the private company guaranteeing its own performance under the lease. However, the Board’s expectation that an entity would continue to apply ASC 460 causes us to question our interpretation of the literature.

If our understanding above is incorrect, we also note that guarantees issued between corporations under common control are excluded from the recognition provisions in ASC 460 (ASC 460-10-25-1(f)). We are unclear if such scope exception would apply to the lessor entity under common control with the private company as often the lessor entity is not a corporation.

The Summary and Questions for Respondents sections of the proposed ASU indicated that “In addition, entities that elect this alternative should continue to apply other applicable Codification guidance, including Topic 840, *Leases* and Topic 460, *Guarantees*.” We note that if the private company previously consolidated the legal entity, it would not have been applying Topic 460 or Topic 840 in the consolidated financial statements and that it would not therefore continue to apply such guidance. Application of Topic 840 and Topic 460 should be viewed as an alternative to consolidation.

We would be pleased to discuss our comments with you. If you have any questions, please contact Mark K. Scoles, Partner, Accounting Principles Consulting Group, at 312.602.8780 or Mark.Scoles@us.gt.com; or Jamie Mayer, Managing Director, Accounting Principles Consulting Group, at 312.602.8766 or Jamie.Mayer@us.gt.com.

Sincerely,

/s/ Grant Thornton LLP

Appendix A – Responses to questions for Respondents

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.**

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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?

We agree with the overall principle of addressing the needs of private companies in application of the variable interest entity literature to related-party leasing arrangements. However, we observe that the standard could result in increased complexity for financial statement users who are comparing/analyzing financial statements of companies that are (1) public, (2) nonpublic and do not elect the accounting alternative, or (3) nonpublic and elect the accounting alternative. While this could be a concern, we believe that the potential difference between public and non-public companies exists regardless of the accounting alternative and that appropriate disclosures will provide users with appropriate information to analyze the differences. Refer to our response to Question 6 for our recommended changes to the proposed disclosures.

We agree with the proposed scope out for employee benefit plans.

We do not believe it is necessary for the proposed Update to scope out not-for-profit entities since such entities are already excluded from the scope of the variable interest entity literature and specifically excluding them in proposed ASC 810-10-15-17A will cause confusion. This could also cause confusion for a for-profit entity that is consolidated by a not-for-profit entity.

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.

See our response to question 2. We also believe that the Board should consider transactions that may exist in the future in determining the scope of the accounting alternative. While we generally agree that public business entities lack the arrangements that the accounting alternative addresses, such arrangements may exist. For example, consider the following:

- A private company is acquired by a public company and the owner(s) of the private company and legal entity receives shares in the public company and/or a seat on the board of the public company, and the lease arrangement continues to exist.
- Only 20% of the public company's stock is held by outsiders and the remaining stock is held by a holding company that has a separate subsidiary whose sole asset is leased back to the public company.

However, should the Board decide to expand the scope to include public entities, we believe that this could give rise for structuring opportunities.

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

We believe that further work is required on the scope of the accounting alternative to both meet the objectives of the PCC and avoid unintended consequences in that the scope may be too broad in certain respects and too limited in other respects.

Scope considerations

We believe that the Board should explore more explicit guidance that directly relates to the objective of providing relief to related entities where the arrangements have been entered into for demonstrable estate planning or tax purposes and have not been structured to achieve a particular financial reporting result including compliance with debt covenants.

We also suggest that the Board consider restricting eligibility for the accounting alternative to those entities that do not have an explicit variable interest in the legal entity. Alternatively the Board could consider a scope condition that indicates in order to qualify for the scope exception, the creditors of the legal entity cannot have any explicit recourse against the private

company. Financial involvement due to common explicit variable interests, such as guarantees of debt or residual values, or loans provided by the private company to the lessor legal entity would, in our view, indicate that the alternative accounting should not be applied.

We note that often the reporting entity may provide services to the legal entity related to other investments that the legal entity has that do not relate to the private company. We believe that such other services should not violate proposed ASC 810-10-15-17A(c), provided such services are consistent with the purpose and design of establishing the legal entity for estate and tax-planning purposes. We also believe that the Board should specifically describe the types of lease arrangements that would and would not be eligible for the scope exception. Refer to our examples in Appendix B.

Application of the accounting alternative

The criteria in proposed ASC 810-10-15-17A is unclear as to whether such entities that meet the criteria would be scoped out of the VIE literature entirely or whether they are only scoped out of the primary beneficiary determination. As currently written, the guidance could be interpreted as exempting a private company from the requirement to consolidate a VIE under common control (recognition) but possibly not from the disclosure requirements if the entity has an implicit or explicit variable interest in the legal entity that is a VIE. We do not believe this is the Board's intent because there are separate disclosure requirements in proposed ASC 810-10-50-2AD for entities that elect the accounting alternative.

Assuming that the intent of the accounting alternative is to provide relief from the recognition, measurement, and disclosure provisions, we believe that the scope alternative should indicate that "If the reporting entity makes an accounting policy election to not apply the VIE subsections, the disclosure in paragraph 810-10-50-2AD shall apply."

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.

We believe the guidance in proposed ASC 810-10-55-9 should be expanded to specifically address when the private company provides "back office" services or other management services to the legal entity unrelated to leasing and to indicate whether this would be problematic.

We also suggest that the implementation guidance should point out that a guarantee by a lessee of debt that has recourse only to the leased asset would constitute a guarantee of the residual value of the asset by the lessee that should be considered when classifying the lease under ASC 840.

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?

We do not agree with the proposed disclosures that a private company would be required to make if it elects the accounting alternative.

We observe that if the entity elects the accounting alternative, the lease would be subject to the lease disclosure requirements in ASC 840, which already requires an entity to provide a “general description of its leasing arrangements.” As such, we are unclear whether the disclosure in proposed ASC 810-10-50-2AD(a) is meant to capture something the Board does not believe is currently captured under ASC 840.

We also believe that the disclosures in proposed in proposed ASC 810-10-50-2AD(b) through ASC 810-10-50-2AD(d) above should be reconsidered and made consistent with the existing variable interest entity disclosures. We believe that having a similar disclosure requirement for similar arrangements would address concerns financial statement users may have about the decreased comparability that would result when an entity elects the accounting alternative. We are concerned that the disclosures in b and c may result in disclosures that are not relevant to the financial statement user (for example, it is possible that a private company may have a leasing arrangement with an entity under common control, but that the private company does not have an explicit or implicit variable interest with the legal entity).

As illustrated below, we believe the disclosures can be modified to avoid the need for an entity to assess whether it has a variable interest in a variable interest entity. In particular, we believe that the following disclosures are important:

- Whether the reporting entity has elected the accounting alternative and whether all common control leasing arrangements qualify for the accounting alternative. (We note that it is possible, depending on the scope, that not all leasing arrangements will qualify for the accounting alternative.)
- If the accounting policy election has not been made, whether the reporting entity plans to make an election in the future.

- If facts and circumstances change such that the ability to apply the accounting policy election has changed in the most recent financial statements, the primary factors that caused the change and the effect on the enterprise's financial statements.
- Whether creditors of a legal entity have recourse to the general credit of the private company.
- Terms of arrangements that could require the private company to provide financial support (for example, guarantees, liquidity arrangements, and obligations to purchase assets) to the legal entity, including events or circumstances that could expose the private company to a loss.
- Whether, during the periods presented, the private company has provided financial or other support (including deferral of lease payments or changes in lease payments) to the legal entity that it was not previously contractually required to provide or whether the reporting entity intends to provide that support, including both of the following:
 1. The type and amount of support, including situations in which the reporting entity assisted the legal entity in obtaining another type of support.
 2. The primary reasons for providing the support.
- Qualitative and quantitative information about the private company's involvement with the legal entity, including, but not limited to, agreements and arrangements between the private company and the legal entity, the nature, purpose, size, and activities of the legal entity, and how the legal entity is financed.

If the Board does not agree, we believe the Board should clarify whether the disclosure in ASC 810-10-50-2AD (d) would require the reporting entity to disclose explicit variable interests or something else.

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 do not believe that it is advisable to assume that 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. Accordingly, we believe that a demonstrable tax or estate-planning purpose should be one of the conditions that a private company must meet in order to apply the proposed accounting alternative. Refer to our response to question 4 and example fact patterns we have provided in Appendix B.

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?

In its current form, we believe that there would still be concerns about the relevance of the information. We also suggest enhancements to the eligibility criteria to discourage structuring opportunities. Refer to our response to question 4 and example fact patterns we have provided in Appendix B.

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?

We agree. However, we believe that clarification is needed as to when the accounting alternative could be elected—that is, only at issuance of the final standard, the first time the reporting entity enters into a leasing arrangement with a related-party legal entity, or a one-time irrevocable election at any time. For example, a reporting entity may decide not to elect the accounting alternative on adoption for cost/benefit reasons. However, in the future it may expand operations and its use of lessor legal entities may expand, or it may prefer to make the election the next time it refinances its debt, since adopting the alternative may require a change in debt covenants (and simply incurring a cost to modify the debt arrangements for only debt covenants may not be cost beneficial).

We also believe that the final standard should include guidance as to how an entity would account for situations in which circumstances change and the conditions for the accounting alternative either are no longer met or are now met.

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?

We disagree with the full retrospective approach because we believe that revising the opening retained earnings for differences may not be cost beneficial for some reporting entities and may actually preclude those entities from electing the accounting alternative. Instead, we believe that the Board should consider a modified retrospective approach similar to the transition guidance provided in ASU 2009-17 while allowing entities to elect full retrospective application.

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

We believe that the proposed alternative should not contain an effective date, but rather should allow for an entity to make a one-time irrevocable accounting policy election to apply the

accounting alternative prior to the issuance of financial statements (including, for example, if the company has a September 30, 2013 calendar year-end and has not issued its September 30, 2013 financial statements before issuance of the final ASU). Some entities may have gotten comfortable with the consolidation of lessor entities and would not experience significant cost savings by transitioning to the proposed guidance for existing arrangements. However, the entity may have reasons to elect not to apply the VIE guidance in the future—if, for example, the business expands and enters into arrangements with additional lessor entities (which would be no different than an entity that previously did not have a lease with a lessor legal entity) or as part of debt renegotiations.

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.

We do not agree with the removal of paragraphs 810-10-55-87 through 55-89 as they such guidance would continue to be relevant to entities that do not elect the accounting policy election or are not eligible for the accounting policy election. We also note that the examples in paragraphs 810-10-55-87 through 55-89 include important principles that are applicable in evaluating whether an implicit variable interest exists more generally (beyond related-party leasing). More specifically, we believe the following guidance in ASC 810-10-55-87 is applicable to all evaluations of implicit variable interests:

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.

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?**

As it relates to the first alternative, we believe that if the private company has an explicit variable interest, the private company should not be scoped out of the VIE guidance, as discussed in our response to question 4.

As it relates to the second alternative, we note that for certain VIE structures, the second alternative would also impact the VIE determination under ASC 810-10-15-14(b)(1). However, we agree that while the second alternative has potential, we believe it would be better addressed as part of the FASB's *Consolidations: Principal versus Agent Analysis* project. Specifically, we believe that guidance should be enhanced in the overall VIE model in defining what are the "most significant activities" and how such activities are controlled.

Appendix B – Example fact patterns

Below are example fact patterns for the Board's consideration in evaluating whether the proposed scope of the accounting alternative meets the objective of the FASB and PCC and does not result in any unintended consequences/anomalies. The examples below all assume legal entity and private company are under common control unless otherwise noted:

- Private company and legal entity are both wholly owned by a single common owner. Private company leases its manufacturing facility from the legal entity. Private company has guaranteed the debt of the legal entity. Under the proposal, the private company would appear to be eligible for the accounting alternative.
- Private company and legal entity are both wholly owned by a single common owner. Private company leases its manufacturing facility from the legal entity. Owner has pledged 100% of his/her stock ownership in private company as collateral for debt of legal entity. Under the proposal, the private company would appear to be eligible for the accounting alternative.
- Private company is wholly owned by a married couple. Legal entity is owned by the married couple and trusts established for the married couple's grandchildren. The trusts for the grandchildren represent greater than 50% ownership in legal entity. Private company leases its manufacturing facility from the legal entity. Private company has guaranteed the debt of the legal entity. Under the proposal, it is not clear whether the entities would be under common control as the current definition applied in practice by SEC registrants (EITF 02-5) indicates that only immediate family members (not grandchildren of the married couple) would be considered in evaluating common control.
- Private company and legal entity are majority owned by multiple common owners. Private company leases its manufacturing facility from the legal entity. Private company has guaranteed the debt of the legal entity. Under the proposal, it is not clear whether the private company would be eligible for the accounting alternative as it is not clear whether the entities are under common control.
- Private company leases a building from legal entity and guarantees the debt. Legal entity is owned 50% by the controlling shareholder of the private company and 50% by the chief financial officer of the private company. Under the proposal, the private company would not appear to be eligible for the accounting alternative because the private company and legal entity are not under common control.
- Private company leases its manufacturing facility from the legal entity. The legal entity also makes other investments unrelated to leasing. In addition to providing accounting and tax support to the legal entity related to leasing, the private company provides similar services related to other investments of the legal entity. Under the proposal, the private company would not appear to be eligible for the accounting alternative if the other activities are significant.

- Consider the previous fact pattern, but also assume that the chief financial officer of private company manages the other investments of the legal entity for the owners. Under the proposal, the private company would not appear to be eligible for the accounting alternative if the investment management activities are significant.
- Private company forms a holding company that 100% owns both private company and legal entity, and has guaranteed the debt of the legal entity. Private company leases from legal entity all of its manufacturing facilities. The holding company has not made any equity investment in the legal entity. Under the proposal, it is unclear whether the private company would be eligible for the accounting alternative. Some believe it would, but others point out that ASC 810-10-15-13A specifies that only substantive terms, transactions, and arrangements shall be considered in a VIE analysis.
- Private company and legal entity are limited partnerships and have the same managing member. Private company's wholly owned subsidiary serves as the management company of the legal entity. Legal entity owns an office building. Private company and legal entity have entered into a lease for the private company to use in providing on-site management services to the legal entity. Legal entity's primary business is to lease the office space to third parties and provide a return for the limited partners in the legal entity. Under the proposal, the private company would appear to be eligible for the accounting alternative.
- The owner of the private company establishes a separate legal entity that will be owned by his children. The owner transfers land and a warehouse from the private company to the legal entity. The legal entity obtains a mortgage on the land and warehouse that is guaranteed by the private company. Under the proposal, the private company would appear to be eligible for the accounting alternative. However, the transaction likely would not qualify for sale-leaseback accounting and the private company would account for such transaction either under the deposit method or as a financing (whichever is more appropriate under ASC 360-20).
- Private company enters into a "sale-leaseback" arrangement with a legal entity in which sales-leaseback accounting does not apply. For example, this could be the case when the private company transfers land and related pipeline capacity to a legal entity if the private company was significantly involved in the design/redesign of the legal entity. The legal entity would lease a significant portion of the capacity to the private company and the private company would provide management services to the legal entity. Under the proposal, the private company would appear to be eligible for the accounting alternative.
- Private company enters into a lease with legal entity that gives legal entity access to a private jet. Private company has agreed to cover all non-variable repair costs, and has guaranteed the debt. The owner of the private company also uses the private jet for personal use. Under the proposal, the private company would appear to be eligible for the accounting alternative. However, assume that private company was in the airline business and leased its fleet from legal entity. Private company also guarantees the debt and covers all repairs and maintenance

on the jets. Under the proposal, the private company would also appear to be eligible for the accounting alternative.

- Private company and legal entity are wholly owned subsidiaries of holding company. Private company is the operating company and has no employees. Private company has entered into an arrangement to lease the employees from legal entity. Under the proposal, the private company would appear to be eligible for the accounting alternative.
- Private company and legal entity are wholly owned subsidiaries of holding company. Private company has no assets and leases from the legal entity all of its tangible and intangible assets. Under the proposal, the private company would appear to be eligible for the accounting alternative.