FASB Emerging Issues Task Force

Issue No. 12-G

Title: Measuring the Financial Assets and Financial Liabilities of a Consolidated Collateralized Financing Entity

Document: Issue Summary No. 1, Supplement No. 3*

Date prepared: November 1, 2013

FASB Staff: Hillenmeyer (ext. 282) / McKinney (ext. 359)

EITF Liaison: Jackson Day

Dates previously discussed: September 11, 2012; March 14, 2013; June 13, 2013

Previously distributed EITF materials: Issue Summary No. 1, dated August 27, 2012; Issue Summary No. 1, Supplement No. 1, dated February 26, 2013; Issue Summary No 1. Supplement No. 2R, dated May 29, 2013

Background

1. The objective of this Issue 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 (CFE) so that a reporting entity recognizes in its consolidated statement of income (loss) only amounts related to its own beneficial interests in a CFE.

2. At its March 28, 2013 meeting, the Board ratified the consensus reached by the Task Force at the March 14, 2013 EITF meeting. During the ballot process for the proposed Update, some Board members expressed a concern that using the term "net risk exposure" to describe a reporting entity's interest in a CFE would create unnecessary complexity. The FASB staff

*** The alternative views presented in this Issue Summary Supplement are for purposes of discussion by the EITF. No individual views are to be presumed to be acceptable or unacceptable applications of Generally Accepted Accounting Principles until the Task Force makes such a determination, exposes it for public comment and it is ratified by the Board.**

revised the language in the proposed Update to respond to the concerns of the Board members; however, some Task Force members questioned whether the revised language in the proposed Update remained consistent with the decisions reached by the Task Force at its September 11, 2012 and March 14, 2013 meetings. Separately, some Task Force members also expressed concerns about the consequences of applying the guidance in the proposed Update when the fair value of the financial liabilities is the more observable measure and the reporting entity holds nonfinancial assets.

3. As a result, at the June 11, 2013 EITF meeting, the Task Force discussed the concerns expressed during the fatal flaw review of the amendments in the proposed Update. Those concerns related to (a) the use of the term net risk exposure to describe a reporting entity's interest in a CFE, (b) the measurement consequences when the fair value of the financial liabilities is more observable than the fair value of the financial assets and the reporting entity holds nonfinancial assets, and (c) how the prospective transition method should be applied. After deliberating those concerns, the Task Force decided to amend certain provisions of that draft final Update and reached a new consensus-for-exposure.

4. The Task Force reached a consensus-for-exposure that a reporting entity that has previously measured the financial assets and financial liabilities of a consolidated CFE at fair value would be required to apply the revised proposed amendments in measuring the financial liabilities of the CFE. The Task Force decided that the value of the financial liabilities would be determined on the basis of the sum of the fair value of the financial assets and the carrying value of any nonfinancial assets, less the sum of the fair value of the financial assets and the carrying value of any nonfinancial assets attributable to the beneficial interest owned by the reporting entity and the carrying value of any beneficial interests that represent compensation for services rendered by the reporting entity.

5. A reporting entity would allocate that value to the individual financial liabilities on a reasonable and consistent basis using a methodology appropriate in the circumstances. Changes in the sum of the fair value of financial assets and the carrying value of nonfinancial assets attributable to the beneficial interests (other than beneficial interests that represent compensation

for services) owned by the reporting entity would be recognized in the statement of comprehensive income of the reporting entity.

6. In reaching this consensus-for-exposure, the Task Force considered but decided against permitting the value of the financial assets to be measured on the basis of the fair value of the financial liabilities, because the valuation of the financial liabilities could include the fair value of nonfinancial assets (rather than the carrying value). In addition, the Task Force decided it could be impracticable to allocate the fair value of the financial liabilities to the individual financial assets on a reasonable and consistent basis.

7. The Task Force reached a consensus-for-exposure that beneficial interests that represent compensation for services (such as management fees) and nonfinancial assets that are being held temporarily by a CFE as a result of default by the debtor on the underlying debt instruments held as assets by the CFE or in an effort to restructure the debt instruments held as assets by the CFE would be measured in accordance with other applicable U.S. GAAP. In reaching this consensus-for-exposure, the Task Force discussed whether the amendments in the revised proposed Update should require any such nonfinancial assets held temporarily by a CFE to be measured at fair value or at carrying value in accordance with other U.S. GAAP. One Task Force member emphasized that using the carrying value rather than the fair value of nonfinancial assets to determine the value of the financial liabilities of the CFE may result in recording noneconomic losses (or gains) if and when a reporting entity buys or sells beneficial interests (other than beneficial interests that represent compensation for services) in the CFE.

8. The Task Force decided that a reporting entity would be required to apply the guidance in the revised proposed Update if it had previously elected or was required to measure the financial assets and financial liabilities of a consolidated CFE at fair value. Reporting entities that had not previously measured all eligible financial assets and financial liabilities of the consolidated CFE at fair value would be permitted to elect to apply the amendments in the revised proposed Update at the date of adoption. The Task Force also decided that a reporting entity that consolidates a CFE would not be permitted to elect to measure the financial liabilities of the CFE using the fair value option under Topic 825 on financial instruments. The Task Force decided to eliminate the

ability to elect the fair value option for the financial liabilities of a collateralized financing entity on the basis that it would promote comparability among entities that measure the assets and liabilities of the collateralized financing entity using a method other than amortized cost. In reaching its consensus-for-exposure, the Task Force clarified that the scope of the revised proposed Update would apply to (a) all reporting entities that consolidate a VIE that meets the definition of a CFE, including those that retain beneficial interests in the CFE, and (b) CFEs that hold nonfinancial assets temporarily.

9. The Task Force discussed that the guidance in the revised proposed Update should not be applied to transfers of financial assets that do not meet the conditions for a sale and, as a result, are required to be accounted for as a secured borrowing with pledge of collateral under paragraph 860-30-25-2.

Summary of Comment Letters Received and FASB Staff Analysis and Recommendations

10. The proposed Update was issued on July 19, 2013. Comment letters were due September 18, 2013. However, the deadline was extended to October 17, 2013, due to requests by certain constituents to have more time to evaluate the proposed Update. Overall, 22 comment letter responses were received on the proposed Update (one response has been excluded as it was only a request for an extension).

Constituency Group	**Number of Comment Letters**
Individuals	1
Professional organizations	5
Preparers	16
Total	22

11. The "professional organizations" category consists of organizations that represent the views in the banking, real estate financing, and asset management industries. Constituents were asked to comment on certain questions within the proposed Update. Those questions can be found in Exhibit 13-GA to this Issue Summary Supplement.

12. The FASB staff has analyzed the comment letters received and included the significant

comments, as well as the FASB staff's recommendations on how the Task Force should proceed, in the following sections:

a. Interaction with Other FASB Projects
b. Issue 1: Measurement
c. Issue 2: Scope
d. Issue 3: Disclosures
e. Issue 4: Transition, Effective Date and Early Adoption
f. Issue 5: Consideration of Reexposure

Interaction with Other FASB Projects

13. In addition to responding to the questions in proposed Update, nine respondents (CLs #1, #2, #11, #13, #14, #15, #19, #21, and #23) highlighted the interaction of the proposed amendments in this Issue with the proposed Accounting Standards Update, *Consolidation (Topic 810): Principal versus Agent Analysis* (the proposed Consolidation Update) which could result in the deconsolidation of many CFEs. Six of those respondents noted that this EITF Issue should be delayed until the completion of the Consolidation Update, while the remaining three asked the Task Force to be cognizant of the interaction between the two projects.

14. Currently, a reporting entity that is an investment manager of a CFE often consolidates the CFE even when it holds a small beneficial interest (or holds no beneficial interest) in the CFE. That is because the reporting entity often is considered to have the power to direct the activities of the CFE that most significantly affect the CFE's economic performance and has the right to receive benefits from the CFE (through both management fees and any beneficial interests directly owned) that could be significant to the CFE. Under today's variable interest entity guidance in Topic 810, that fact pattern would generally indicate that the reporting entity is the primary beneficiary and should consolidate the CFE. However, if the proposed Consolidation Update is finalized, a reporting entity would determine whether its role as an investment manager is in a principal or agent capacity. Reporting entities within the scope of this Issue would deconsolidate their CFEs if their role as an investment manager is in an agent capacity under the proposed guidance. Thus, amendments resulting from this Issue would introduce new

measurement guidance for some consolidated CFEs that could potentially be deconsolidated under the proposed consolidations guidance once finalized.

15. All respondents acknowledged that measuring the assets and liabilities of a CFE is an area that results in diversity in practice and should be addressed. However, some of the respondents noted that the delay in the finalization of this Issue has reduced the urgency of addressing that diversity. When this Issue was first discussed, the proposed Consolidation Update was not yet in redeliberations. Now, more than a year after this Issue was added to the EITF agenda, redeliberations for the consolidation project are active and, based on the plan presented to the Board in September 2013, final amendments for consolidation are expected by the second half of 2014. Thus, if amendments from this Issue are finalized and effective for calendar-year companies in 2015, it is possible that the new measurement guidance would be applied for only a year before many entities within the scope of this Issue would deconsolidate their CFEs. At this time, it is unclear how many or what types of CFE structures would be deconsolidated as a result of the proposed Consolidation Update. Based on recent outreach, some entities do not expect to deconsolidate their CFEs upon finalization of the proposed Consolidations Update because they would still be considered the primary beneficiary on the basis of their role, for example, as a guarantor or a special server, rather than as an investment manager.

16. Several respondents also emphasized the interaction of this Issue with the proposed Accounting Standards Update, *Financial Instruments—Overall (Subtopic 825): Recognition and Measurement of Financial Assets and Financial Liabilities* (the proposed C&M Update). However, there was less emphasis on this interaction because of the expectation of some respondents that many of the reporting entities within the scope of this Issue would no longer consolidate many CFEs by the time the C&M Update becomes effective. The proposed C&M Update would require nonrecourse financial liabilities that are settled with only the cash flows from the related financial assets to be measured on the same basis as those assets. While that is directionally consistent, it is not fully consistent with the consensus-for-exposure reached by the Task Force on this Issue because the proposed C&M Update does not apply to structures in which the financial liabilities can be settled in part by nonfinancial assets. That is, under the C&M Update, a reporting entity would continue to measure certain nonrecourse financial

liabilities that are in the scope of this Issue at amortized cost, creating a potential conflict between the two projects.

Accounting Issues and Alternatives

Issue 1: Measurement

17. The proposed amendments would permit a reporting entity that becomes the primary beneficiary of a variable interest entity that is a CFE to measure the financial liabilities of a CFE using the following calculation (included in paragraphs 810-10-30-2A and 810-10-35-6 of the revised proposed Update):

a. The sum of the following two amounts:
   i. The fair value of the financial assets held by the collateralized financing entity
   ii. The carrying value of any nonfinancial assets held by the collateralized financing entity
b. Less the sum of the following two amounts:
   i. The sum of the fair value of financial assets and the carrying value of nonfinancial assets attributable to the beneficial interest owned by the reporting entity
   ii. The carrying value of any beneficial interests that represent compensation for services rendered by the reporting entity.

18. Seventeen of 22 respondents expressed concerns over the requirement to derive the value of the financial liabilities on the basis of the fair value of the financial assets and the carrying value of the non-financial assets. Many respondents noted that the fair value of the financial liabilities is sometimes more observable than the fair value of the financial assets. The American Bankers Association (CL#1A) noted:

> As the assets and the liabilities of a CFE are inextricably linked, the reporting entity should begin with the instruments that have the most observable inputs to the fair value estimate. In certain cases, the fair value of the assets may be based on observable inputs while the liabilities are thinly traded, if at all. Many CLOs

> fall into this category. Conversely, the assets may be estimated purely on Level 3 (modeled) inputs, though the liabilities (the securities) have a relatively active market. This is typical of a mortgage-backed security market.

19. Twelve respondents also questioned whether the proposed formula was too prescriptive and could be interpreted in a way that would distort the net income of the reporting entity. Those respondents were concerned that the reference to the value of the beneficial interests owned by the reporting entity (other than beneficial interests that represent compensation) could be interpreted to be something other than fair value of the reporting entity's beneficial interest and thus could result in the net income of the reporting entity including amounts that are not attributable to the reporting entity's beneficial interests in the CFE. Others expressed concerns about how the formula could misrepresent the economics of hybrid financial liabilities (such as interest-only strips) or beneficial interests with guaranteed returns.

20. Based on that feedback, the staff has explored the advantages and disadvantages of retaining the approach in the proposed Update relative to an approach that would allow the use of the more observable of the financial assets or financial liabilities.

View A: No changes should be made to the proposed Update.

21. The proposed measurement approach was intended to eliminate the difference between the fair values of financial assets and financial liabilities related to beneficial interests held by others, thereby resulting in a reporting entity only recognizing as income or loss the changes in the financial assets and financial liabilities of the CFE that are attributable to the reporting entity (that is, the changes in the value of the reporting entity's own beneficial interests). Four respondents generally did not object to that approach, although some of those respondents requested clarification to ensure that the formula would result in an income statement effect that includes the changes in the fair value of the reporting entity's own economic interests in the CFE. Also, two of the four respondents who did not object to the approach suggested putting this Issue on hold until the proposed Consolidation Update is final.

22. Proponents of View A note that the proposed measurement approach for the financial

liabilities of a CFE directionally aligns with the guidance in the proposed C&M Update, which provides that an entity shall measure the nonrecourse financial liability on the same measurement basis as the related financial assets if the contractual terms of the financial liability require the entity to settle the entire liability with only the cash flows from the related financial assets.

23. Proponents of View A believe that the fair value of a CFE's assets should drive the valuation of both assets and liabilities since the liabilities can only be settled with the assets. Premiums or discounts that result from changes in the market supply and demand of a CFE's liabilities (which would affect the exchange price of a CFE's beneficial interests) should not be factored into the valuation of the assets.

24. Proponents of View A also believe that it would be inappropriate to use the fair value of the financial liabilities to derive the value of the assets of the CFE because a CFE could temporarily hold nonfinancial assets (for example, real estate upon a mortgage loan foreclosure), which generally would be carried at the lower of cost or fair value less cost to sell.

25. Opponents of View A emphasize that in some circumstances, the fair value of the financial liabilities of the CFE are more observable and thus could result in a fair value measurement that is higher in the fair value hierarchy than the fair value of the financial assets. Opponents believe that in those circumstances, a requirement to use the fair value of the assets to derive the liabilities would be inappropriate.

26. Furthermore, some comment letter respondents who opposed the proposed measurement principle highlighted that the valuation of the financial assets generally is more burdensome because there generally are numerous financial assets compared to relatively few financial liabilities that primarily consist of different classes of beneficial interests (in an example provided by one preparer, there were approximately 200 assets to value versus approximately 20 liabilities).

27. If the proposed approach is retained, several respondents raised concerns that the words used to describe the measurement of a reporting entity's owned beneficial interest (other than

those that represent compensation for services) might result in a net income effect that does not represent fairly changes in the entity's own economic risk. Many respondents believe that the net income effect of the entity's owned beneficial interests (other than those that represent compensation for services) should be the change in their fair value.

28. Some respondents specifically explained that the language in paragraphs 810-10-30-2(a) of the proposed calculation could be interpreted such that the value allocated to the beneficial interests owned by a reporting entity should be a pro rata allocation of the financial and nonfinancial assets of the CFE, rather than the fair value of the portion of the beneficial interests owned by the reporting entity (excluding those that represent compensation for services). A fair-value-based allocation often would be different from a pro rata allocation due to the structured tranches of a CFE; that is, the "waterfall" calculations required to value the different classes of beneficial interests issued would result in a fair value of a specific beneficial interest not corresponding with its percentage of overall ownership. As a result, if View A (or View B) is selected, the FASB staff believes that the Task Force should clarify that the changes in the fair value of the beneficial interests owned by reporting entity would be recognized in a reporting entity's income statement. That would require a reporting entity to measure the fair value of its owned beneficial interests (excluding those that represent compensation for services). The staff understands that most reporting entities already measure the fair value of their beneficial interests today.

View B: Allow entities to use the more observable of the fair value of the financial assets or the financial liabilities to measure the financial assets and the financial liabilities of a collateralized financing entity.

29. In View B, a reporting entity that consolidates a collateralized financing entity would recognize and measure the CFE's assets and liabilities based on the fair value of the financial assets or the financial liabilities of a collateralized financing entity, whichever is more observable. The more observable value of the financial assets and the financial liabilities would be allocated to the one with the less observable value. The following amendments would be made to Topic 810 (replacing the amendments in the revised proposed Update) under the View B

measurement approach for the initial and subsequent measurement of a consolidated CFE. In addition, the staff has included an illustrative example in Exhibit 12-GB.

> **810-10-35-6** A reporting entity that consolidates a VIE that is a **collateralized financing entity** and elects to apply the guidance in paragraphs 810-10-30-2A through 30-2E shall subsequently measure both the financial assets and the financial liabilities of the collateralized financing entity in consolidation using the more observable of the fair value of the financial assets or the fair value of the financial liabilities.
>
> **810-10-35-7** If the fair value of the financial assets of the collateralized financing entity is more observable, the financial liabilities should be measured in consolidation as the sum of the fair value of the financial assets and the carrying value of any nonfinancial assets temporarily held, less the sum of the fair value of the beneficial interests owned by the reporting entity and the carrying value of the beneficial interests that represent compensation for services. The resulting amount should be allocated to the individual financial liabilities using a reasonable and consistent methodology.
>
> **810-10-35-8** If the fair value of the financial liabilities of the collateralized financing entity is more observable, the financial assets should be measured in consolidation as the sum of the fair value of the financial liabilities, the fair value of the beneficial interests owned by the reporting entity, and the carrying value of the beneficial interests that represent compensation for services, less the carrying value of any nonfinancial assets temporarily held. The resulting amount should be allocated to the individual financial assets using a reasonable and consistent methodology.
>
> **810-10-35-9** The carrying value of the beneficial interests that represent compensation for services (for example, rights to receive management fees or premiums from the collateralized financing entity), and the carrying value of any nonfinancial assets temporarily held by the collateralized financing entity shall be accounted for in accordance with other applicable Topics.
>
> **810-10-35-10** Changes in the fair value of the beneficial interests owned by the reporting entity shall be recognized in the consolidated statement of comprehensive income of the reporting entity.

30. Different types of CFEs have different structures, asset types, and liabilities. For some CFEs, the fair value of the financial assets is more observable than the fair value of the financial liabilities. For others, the fair value of the financial liabilities is more observable. Thirteen of the 23 comment letter respondents requested that a reporting entity be allowed to use the fair value of the financial assets or the financial liabilities, whichever is more observable, to derive the value of the other, or requested that the reporting entities that consolidate CFEs still be permitted to utilize the fair value option for financial liabilities. As currently drafted, the proposed Update

would preclude the use of fair value option for financial liabilities.

31. Four additional respondents recommended that the proposed amendments be changed back to the original proposal. That is, a reporting entity should measure the fair value of its net economic risk exposure resulting from its involvement in a CFE in a manner that is consistent with Topic 820 and allocate that fair value of the gross assets and liabilities in a consistent and reasonable manner. Those respondents, however, generally shared the same concerns about the revised proposed Update as those who support View B: financial assets should not be used to derive the value of the liabilities when the fair value of the financial assets is less observable than the fair value of the financial liabilities. They also noted that the proposed formula could result in an amount in the reporting entity's income statement that does not represent the changes in the fair value of the entity's own economic risks. The FASB staff believes that the concerns raised by those who suggested that the amendments be changed back to the original proposal could be addressed by View B. For example, one respondent (CL#11) supported the use of net risk exposure and noted:

> We do not support disregarding more reliable data available to measure the fair value of the financial liabilities of the CFE directly. When the fair value of the CFE's financial liabilities has greater observability than the fair value of its financial assets, preparers should have the flexibility to use the fair value of the CFE's financial liabilities to derive the fair value of its financial assets. For example, consider a residential mortgage securitization where a reporting entity may have market observations for all the securities issue by the CFE, but have no reliable observations for the numerous mortgage loans owned by the CFE. The ASU would require that the financial liabilities be measured using the less reliable inputs for the assets and supersede the more reliable market observations for those financial liabilities that may be available. This is inconsistent with the notion of the fair value hierarchy which emphasizes the use of the most observable/reliable inputs in fair value measurements.

32. Opponents of View B believe that the fair value of a CFE's assets should drive the valuation of both assets and liabilities since the liabilities can only be settled with the assets. Premiums or discounts that result from changes in the market value of a CFE's liabilities (beneficial interests) should not be factored into the valuation of the assets. Additionally, the fair value of financial liabilities should not drive the value assigned to nonfinancial assets (such as real estate owned

through foreclosure) because the proposed Update was not intended to change existing U.S. GAAP guidance relating to the measurement of nonfinancial assets.

33. Many comment letter respondents who are proponents of View B emphasized that nonfinancial assets are immaterial to the overall assets of most CFEs (some respondents indicated that nonfinancial assets generally are less than 5 percent of the total assets of the CFE). Further, because the nonfinancial assets held generally are the result of foreclosed real estate, the carrying value of the related loan would be marked down to the fair value (less cost to sell) of the underlying real estate until the real estate is sold. Since nonfinancial assets must be held only temporarily to qualify for the scope of the amendments, there generally would not be a significant change in the market value from the time a nonfinancial asset is reclassified from a financial asset to a nonfinancial asset to the time the nonfinancial asset is sold. Thus, many of the comment letter respondents noted that the accounting for the nonfinancial assets should not drive the measurement approach for all of the assets and liabilities of a CFE. In addition, under View B, the staff notes that the measurement of nonfinancial assets does not need to be changed even if the fair value of the financial liabilities is more observable; that is, nonfinancial assets would continue to be measured in accordance with other applicable Topics under View B similar to View A.

34. Other opponents highlight that View B would not be consistent with the Board's tentative decisions in the proposed C&M Update. In the proposed C&M Update, nonrecourse liabilities are measured on the same basis as the underlying assets because the only cash flows that a holder of those liabilities would receive are cash flows from those assets. Otherwise, if the financial asset and nonrecourse liability were not measured on the same basis, there would be an economic mismatch. However, the Board did not explore whether the economic mismatch could also be resolved by using the fair value of financial liabilities to measure the financial assets.

Staff Recommendation

35. Overall, there was strong opposition in the comment letter responses to the proposed Update, with only 2 of the 23 comment letters supporting the finalization of the amendments as proposed or prior to the completion of the consolidations project. The concerns raised by the

respondents primarily related to the use of the fair value of the financial assets of the CFE versus the financial liabilities. The FASB staff discussed specific examples with valuation professionals and comment letter respondents that highlight when and why financial liabilities might be more observable (for example, in mortgage-backed structures, the underlying assets are often restricted from sale and thus have no observable transactions to be used in a fair value measurement, while the beneficial interests, at least of certain tranches, are more frequently exchanged). Some respondents also indicated that it is often less complex to value the financial liabilities because there generally are relatively few beneficial interest holders as compared to the number of financial assets owned by a CFE. Based on the feedback received, and under the premise that a CFE's measurement of its assets and liabilities should generally match, the FASB staff believes that measurement of a CFE's financial assets and liabilities should be based on the more observable measure, which may not always be the fair value of the financial assets. Therefore, the FASB staff does not recommend moving forward with the amendments as proposed and as presented in View A.

36. The staff recommends View B. The staff believes that View B addresses the concerns raised by most of the respondents about fair value measurements and the income statement effect of owned beneficial interests. When the fair value of financial liabilities is more observable, that should be basis for measuring the CFE's assets. If the assets contain temporarily held nonfinancial assets (such as real estate), those assets should continue to be measured based on other applicable U.S. GAAP (fair value less cost to sell in the case of real estate held for sale). The difference between the fair value of the financial liabilities and the carrying value of nonfinancial assets should then represent the derived value of the financial assets of the CFE. A reporting entity also should continue to measure the fair value of its owned beneficial interests in the CFE (and changes therein) to calculate the income statement and net equity impact of consolidating the CFE. That method would ensure that a reporting entity's income statement reflects changes in the fair value of the reporting entity's owned beneficial interests. The staff understands that fair value of a reporting entity's owned beneficial interests (other than those that represent compensation for services) is tracked by most reporting entities today, and is used in determining the income statement effect attributable to the reporting entity.

37. The staff acknowledges the concerns raised in several comment letters about the interaction of this Issue with the proposed Consolidation Update and the proposed C&M Update. However, the final timing and the related effect on reporting entities that consolidate CFEs is uncertain. The staff has heard from a number of preparers that their CFEs may not be deconsolidated as a result of the Consolidation Update. Ultimately, while several comment letter respondents suggested delaying the finalization of this Issue, many comment letter respondents also supported immediate attention to this Issue. The staff believes that the Issue should be addressed by the Task Force as proposed under View B by the staff.

Question 1: Does the Task Force agree with the staff's recommended amendments to the revised proposed Update such that a consolidated CFE's financial assets and liabilities would be measured on the basis of the fair value of the CFE's financial assets or financial liabilities, whichever is more observable?

Question 2: Does the Task Force agree that the income statement impact of consolidating a CFE should be clarified to reflect the changes in the fair value of the reporting entity's owned beneficial interests in the CFE (excluding those related to compensation for services provided by the reporting entity to the CFE)?

Issue 2: Scope

38. Two respondents (CLs #6 and #22) requested that the scope clarification that is currently in the basis for conclusion (paragraph BC13) be included in the codification amendments of the revised proposed Update. The scope clarification noted that "this proposed update should not be applied to transfers of financial assets that do not meet the conditions for a sale and, thus, are required to be accounted for as a secured borrowing with pledge of collateral under paragraph 860-30-25-2."

39. When asked whether the decision to apply the proposed amendments should be an accounting policy decision made for all CFEs or applied to each individual CFE, eight of the nine respondents who commented on this question said that it should be a decision applied to each individual CFE. Those respondents noted that each CFE is structured differently and a

reporting entity should be able to take into account the facts and circumstances surrounding each individual CFE when making the decision as to whether to apply the proposed amendments. The proposal currently does not specify that the application of the proposed amendments is an accounting policy election to be applied to all CFEs. One respondent said that to fully reduce the diversity in practice, the proposed amendments should apply to all consolidated CFEs, even if a reporting entity had not previously elected the fair value option for both the financial assets and financial liabilities.

Staff Recommendation

40. The FASB staff does not recommend any further changes to the scope of the Issue. While the staff acknowledges the concerns raised by the respondents mentioned above, the FASB staff believes that the scope of the guidance is clear such that it applies to reporting entities that consolidate a CFE. If the sale of a financial asset is accounted for as a secured borrowing (instead of a sale), the financial asset would not be included in the CFE because it would still be reported by the parent entity.

41. The staff believes that the adoption of this guidance should be an accounting policy election applied consistently by a reporting entity to all of its consolidated CFEs. Reporting entities that do not elect this guidance should apply other relevant Topics in U.S. GAAP in accounting for the assets and liabilities of their consolidated CFEs, except the fair value option guidance of Topic 825 on financial instruments. The staff believes that consistent application of the guidance within a reporting entity is critical to the understandability of that entity's financial statements by users. While structures vary by CFE, the staff does not believe that there is any basis for reporting entities to elect this guidance on a CFE-by-CFE basis. That type of unconditional option could make the analysis of an entity's financial statements very difficult for users because they may not understand the financial statement effect of the mixed use of this guidance for some CFEs and other U.S. GAAP for other CFEs. The staff believes that the staff's recommended approach in View B provides ample flexibility in the measurement of the financial assets and financial liabilities of a CFE by allowing the use of the more observable measure. The staff believes that this flexibility under View B would provide entities with the ability to select the appropriate fair value measure for each of their CFEs based on their specific structures. Further, a reporting

entity would have the option to not adopt the guidance and apply other Topics in U.S. GAAP (except for the fair value option) if fair value is not observable for either the assets or the liabilities of the CFE, or otherwise the entity does not prefer measuring its CFEs in accordance with this guidance.

Question 3: Does the Task Force wish to reaffirm the scope of the proposed amendments?

Issue 3: Disclosures

42. The revised proposed Update includes the following disclosure provision as an amendment:

> **810-10-50-20** A reporting entity that consolidates a collateralized financing entity and measures financial liabilities in accordance with paragraphs 810-10-30-2A through 30-2C and 810-10-35-6 through 35-9 shall disclose the information required by Topic 820 on fair value measurements and Topic 825 on financial instruments for measuring the fair values of the financial assets. For the financial liabilities, a reporting entity shall only disclose that the amounts of the financial liabilities are determined on the basis of the fair value of the financial assets and the carrying value of any nonfinancial assets. The disclosure requirements in Topics 820 and 825 relating to the fair value measurement of financial instruments are not applicable to financial liabilities of a consolidated collateralized financing entity that are measured in accordance with paragraphs 810-10-30-2A through 30-2C and 810-10-35-6 through 35-9.

43. One respondent (CL#2) noted that any fair value disclosures should focus on the fair value of the beneficial interests owned by the reporting entity. Another respondent (CL#21) asked for clarification about what disclosures in Topics 820 and 825 should be made. No other respondents specifically commented on the proposed disclosures.

44. Question 5 asked users whether disclosures about the method used to allocate the fair value of the financial assets to the individual liabilities and the value of the beneficial interest retained by the reporting entity provide decision-useful information. No responses were received specifically from users. Comment letters and discussions with preparers have indicated that users would not be interested in the allocation of those amounts (and often asked to see financial statements that exclude the balances related to consolidated CFEs altogether to understand a reporting entity's net economic risk). The staff reviewed several examples of financial

statements in which disclosures are provided that show a consolidating balance sheet or other disclosures that clearly indicates which assets creditors have recourse to and which debt obligations are the debt obligations of the company (that is, those schedules showed the financial position of the reporting entity excluding any consolidated CFEs).

Staff Recommendation

45. If the Task Force revises the measurement attribute to the approach outlined in View B, the disclosure requirements should be revised accordingly. The Task Force decided that the disclosure requirements in Topics 820 and 825 related to the fair value of financial instruments would not be applicable to financial liabilities measured under the revised proposed Update. The FASB staff recommends that the above paragraph be amended to reflect those disclosures that also would not be applicable to financial assets that are measured based on the fair value of financial liabilities.

Question 4: If changes are made to the measurement as outlined in View B, does the Task Force wish to revise the disclosure requirements as recommended by the staff above?

Issue 4: Transition, Effective Date and Early Adoption

46. As currently drafted, the revised proposed Update is mandatory for all reporting entities that prior to the effective date measured the financial assets and financial liabilities of a CFE at fair value. Those reporting entities are required to apply the revised proposed Update using either a modified retrospective or a full retrospective transition method. Other reporting entities that did not previously measure the financial assets and financial liabilities of a CFE at fair value (that is, entities that previously used other Topics in U.S. GAAP) are not required to adopt the proposed amendments, but if they elect to apply the proposed amendments, those reporting entities are required to use the modified retrospective transition method, and are precluded from using the full retrospective transition method. In Question 6, respondents were asked whether they agreed with the proposed transition methods. Question 7 asked whether early adoption of the amendments should be permitted.

47. While many respondents did not comment on transition, seven respondents specifically concurred with the modified retrospective approach with an option to apply a full retrospective approach to those reporting entities that previously elected the fair value option for both the financial assets and the financial liabilities of the CFE. Furthermore, in the original exposure draft, several respondents were supportive of a modified retrospective approach and early adoption. Two respondents noted that a full retrospective approach also should be available to those that did not previously elect the fair value option for the financial assets and financial liabilities of a CFE. The Task Force did not permit full retrospective adoption for those entities that had not previously elected the fair value option because it did not want those entities to measure the fair value of assets and liabilities retrospectively using hindsight.

48. As proposed, the amendments would be effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. Nonpublic entities could adopt a year later. Question 9 asked preparers how much time would be needed to implement the proposed amendments. Several respondents indicated that it would take six months to a year to implement the proposed amendments and thus raised concerns that as currently proposed, there may not be sufficient time for transition.

Staff Recommendation

49. As noted earlier in the Scope section, the staff believes that the adoption of this guidance should be an accounting policy election applied consistently to all consolidated CFEs. Therefore, if the Task Force agrees with the staff's recommendation on scope, the staff recommends that all reporting entities be given an accounting policy election at the time of transition (effective date or the date on which an entity consolidates a CFE for the first time) such that the reporting entity can either adopt this guidance or apply other Topics in U.S. GAAP (except fair value option) to account for the CFE's assets and liabilities. This way, the discrepancies that exist today as a result of the diverse application of the fair value option would be eliminated, but entities would also be given an option at transition to apply other U.S. GAAP (except fair value option) if they find that to be more suitable and relevant for the accounting of the assets and liabilities of their consolidated CFEs. The staff believes that all reporting entities should adopt the guidance using either the modified retrospective transition method as consistent with the revised proposed

Update or using the full retrospective transition method.

50. The staff believes that the effective date should be delayed, such that the amendments are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2014, for all entities. The staff believes that requiring application of these amendments within a few months after issuance would be too burdensome for the reporting entities within the scope of this Issue. However, those that wish to apply the amendments sooner should have the ability to do so through early adoption.

Question 5: Does the Task Force agree with reaffirming the transition requirements in the revised proposed Update and agree with the revised effective date described above, with early adoption permitted?

Reexposure

51. The Task Force should consider whether to reexpose this Issue based on the changes to the revised proposed Update since the issuance of the second exposure draft. Reexposure generally is required when there has been a substantive change to the scope or to the primary recognition, measurement, or disclosure principles. Reexposure is intended to allow constituents to have an opportunity to raise issues or concerns not previously considered by the Task Force. A substantive change usually does not result from a change based on input provided by respondents in comment letters, including input on alternative approaches to resolve an issue.

52. The FASB staff believes that if View B is selected, it is a change that would not necessitate reexposure because it is based on direct feedback from constituents on the two previous exposure drafts and additional outreach performed by the FASB staff. Furthermore, View B provides more flexibility than the previous approach by allowing the use of the measurement that is more observable. As discussed earlier, the majority of respondents opposed the revised proposed Update and asked that entities have the option to use the more observable of the fair value of the financial assets or the financial liabilities. Furthermore, the staff has proposed other changes as clarifications based on comment letter feedback (as confirmed through outreach) to ensure that

the net income of the reporting entity appropriately reflects the changes in the fair value of the reporting entity's owned beneficial interests in the CFE.

53. In determining whether a revised Exposure Draft should be issued, other factors to consider include whether constituents have had sufficient opportunity to fully consider the implications of the change and communicate their views on the change (for example, through comment letters, roundtable meetings, and constituent outreach activities during redeliberations) and whether the Task Force would benefit in its decision making by additional input on the changes, considering the extent to which such input would provide new information not previously considered by the Task Force.

54. The FASB staff believes that it has received sufficient input both through the comment letters and through subsequent outreach on all key decisions. The FASB staff also believes that constituents had sufficient opportunity to consider the implications of the decisions.

Question 6: Does the Task Force believe that the revised proposed Update should be reexposed again?

Exhibit 12GA

Constituents were asked to comment on the following questions in the revised proposed Update:

> **Question 1:** Do you agree with the measurement of the financial liabilities of a consolidated collateralized financing entity as described in paragraph 810-10-30-2A? Do you also agree that a reporting entity that consolidates a collateralized financing entity should no longer be permitted to measure the financial liabilities of the collateralized financing entity using the fair value option of Topic 825 (whether or not the reporting entity elects to apply the measurement guidance under the proposed Update)?
>
> **Question 2:** Do you agree that a reporting entity that previously elected or was required to measure all eligible financial assets and financial liabilities of the consolidated collateralized financing entity at fair value should be required to apply the amendments in this proposed Update to those collateralized financing entities that exist at the date of adoption? Do you also agree that a reporting entity that had not previously measured all eligible financial assets and financial liabilities of the consolidated collateralized financing entity at fair value should be permitted to elect to apply the amendments in this proposed Update to those collateralized financing entities that exist at the date of adoption? Do you agree that a reporting entity that consolidates for the first time a collateralized financing entity should have an option to not apply the amendments in this proposed Update?
>
> **Question 3:** Should the decision to apply the proposed amendments be an accounting policy decision or a decision to be applied to individual collateralized financing entities? Please explain.
>
> **Question 4:** The proposed amendments require that a reporting entity allocate the calculated value to the individual financial liabilities on a reasonable and consistent basis using a methodology appropriate in the circumstances. For preparers, is additional allocation guidance necessary? If yes, what methods should be used to allocate the calculated value of the financial liabilities to the individual financial liabilities?
>
> **Question 5:** For users, would disclosures about the method used to allocate the fair value of the financial assets to the individual liabilities and the value of the beneficial interests retained by the reporting entity provide decision-useful information?
>
> **Question 6:** Do you agree that the proposed amendments should be applied using a modified retrospective approach, with the option to apply the proposed amendments retrospectively for reporting entities that have previously measured the financial assets and financial liabilities of the collateralized financing entity at fair value? If not, please explain why.

Question 7: Do you agree that early adoption of the proposed amendments should be permitted? If not, please explain why.

Question 8: 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 the requirements should be different.

Question 9: For preparers, how much time would be needed to implement the proposed amendments?

Question 10: For preparers, what costs do you expect to incur as a result of implementing the proposed amendments?

Exhibit 12-GB

Example 1: Measurement of the Financial Liabilities When the Fair Value of Financial Assets Is More Observable

A reporting entity earns compensation for its services to a collateralized financing entity and also owns other beneficial interests. The reporting entity has determined that it must consolidate the collateralized financing entity under Topic 810. The collateralized financing entity's only assets are corporate debt obligations, and the beneficial interests issued in the entity are thinly traded. The reporting entity determines that the fair value of the financial assets is more observable than the fair value of the financial liabilities. Because the fair value of the financial assets is more readily observable, the reporting entity determines the amount to be allocated to the financial liabilities of the collateralized financing entity as follows:

	June 20, 20X2 (Measurement upon initial consolidation)	Dec 31, 20X2
Fair value of the financial assets	$ 100	$ 105
Plus: Carrying value of the nonfinancial assets (1)	5	5
Total value of the assets of the collateralized financing entity	105	110
Less: Fair value of the reporting entity's owned beneficial interests (other than those that represent compensation) (2)	10	12
Less: Carrying value of beneficial interests related to compensation (3)	6	8
Amount to be allocated to the financial liabilities of the collateralized financing entity in consolidation	$ 89	$ 90
Net assets of the collateralized financing entity (4)	$ 16	$ 20
Change in the net assets of the collateralized financing entity (5)		$ 4
Changes in the beneficial interests attributable to the reporting entity (5)		$ 4

(1) The nonfinancial assets that are carried by the collateralized financing entity are measured based on other Topics. To determine the total value to be allocated to the financial liabilities, the reporting entity uses the sum of the fair value of the financial assets and the carrying value of the nonfinancial assets.

(2) The fair value of the beneficial interests owned by the reporting entity (other than compensation) is calculated by the reporting entity and recorded on its standalone books. In consolidation, this amount is subtracted from the financial liabilities of the collateralized financing entity because it does not represent an amount due to third-party beneficial interest holder.
(3) The reporting entity has rights to a portion of the beneficial interests through its compensation arrangement. This amount is measured in accordance with other Topics. This also reduces the financial liability of the collateralized financing entity in the consolidated financial statements because it does not represent an amount due to third-party beneficial interest holders.
(4) The net assets are equal to the fair value of the reporting entity's beneficial interest. The change in the fair value of the reporting entity's beneficial interest, hence the change in net assets, are recognized in the reporting entity's net income.
(5) The change in the net assets of the collateralized financing entity is equal to the change in the value of the beneficial interests owned by the reporting entity including compensation.

Example 2: Measurement of the Financial Assets When the Fair Value of Financial Liabilities Is More Observable

A reporting entity earns compensation for its services to a collateralized financing entity and also owns other beneficial interests. The reporting entity has determined that it must consolidate the collateralized financing entity under Topic 810. The collateralized financing entity's only assets are mortgage-backed securities with primarily unobservable inputs. The beneficial interests of the collateralized financing entity are frequently traded, albeit not in an active market. Because the fair value of the financial liabilities is more readily observable, the reporting entity determines the amount to be allocated to the financial assets of the collateralized financing entity as follows:

	June 20, 20X2 (Measurement upon initial consolidation)	Dec 31, 20X2
Fair value of the financial liabilities	$ 90	$ 95
Plus: Fair value of the reporting entity's beneficial interests (other than those that represent compensation) (1)	10	12
Plus: Carrying value of beneficial interests related to compensation (2)	6	8
Total value of the financial liabilities of the collateralized financing entity (3)	106	115
Less: Carrying value of the nonfinancial assets (2)	5	5
Amount to be allocated to the remaining financial assets of the collateralized financing entity	$ 101	$ 110
Net assets of the collateralized financing entity (4)	$ 16	$ 20

Change in the assets of the collateralized financing entity (5)	$	4
Changes in the beneficial interests attributable to the reporting entity (5)	$	4

(1) This value represents the fair value of the reporting entity's beneficial interest owned (other than those that represent compensation) in the collateralized financing entity.

(2) The beneficial interests that represent compensation for services and nonfinancial assets held by the collateralized financing entity are measured in accordance with other Topics.

(3) The total liabilities to be allocated to the financial assets of the collateralized financial entity include the reporting entity's owned beneficial interests and any beneficial interests related to compensation. A reporting entity's retained beneficial interests are financial liabilities of the collateralized financing entity that are eliminated in consolidation.

(4) The net assets are equal to the reporting entity's beneficial interest. The change in these net assets will flow through to the reporting entity's net income.

(5) The change in the net assets of the collateralized financing entity is equal to the change in the value of the beneficial interests attributable to the reporting entity including compensation.