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Ms. Susan M. Cospers  
Technical Director  
Financial Accounting Standards Board  
401 Merritt 7  
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**File Reference No. PCC-13-02**

**Re: Proposed Accounting Standards Update, *Applying Variable Interest Entity Guidance to Common Control Leasing Arrangements***

Deloitte & Touche LLP appreciates the opportunity to provide feedback on the FASB's proposed Accounting Standards Update (ASU) *Applying Variable Interest Entity Guidance to Common Control Leasing Arrangements*.

We appreciate the efforts of the FASB and Private Company Council (PCC) to address the accounting and financial reporting needs of private companies and believe that it is important to use the proposed *Private Company Decision-Making Framework — A Guide for Evaluating Financial Accounting and Reporting Guidance for Private Companies* (the "Decision Framework") in the determination of whether accounting alternatives should be available to private companies. However, because the Decision Framework has not been finalized, there is a risk that the changes in this proposed ASU will not be appropriately vetted against the final Decision Framework. Accordingly, we believe that any final decisions made regarding this proposed ASU should not precede the finalization and issuance of the Decision Framework.

Further, we are concerned that the accounting alternative in this proposed ASU allows for different recognition and measurement requirements for private companies. We want to reiterate the following beliefs we previously expressed in our comment letter on the FASB's Invitation to Comment *Private Company Decision-Making Framework*:

- There should be a rebuttable presumption that accounting standards for public and nonpublic companies should be the same except when differences are justified.
- There should be a higher threshold for differences pertaining to recognition and measurement (i.e., compared with presentation, disclosure, effective dates, etc.).
- Amendments to the Codification generally should not deviate from the conceptual framework.

We do not support finalization of the proposal as a final ASU because:

- It does not address the root causes of complexity in the variable interest entity (VIE) consolidation model when control is not clearly evident (e.g., identification, analysis, and effect of implicit variable interests and determination of the primary beneficiary among related parties). Providing an exception does not address the issues for all constituents and creates additional complexities.

- It does not contemplate the impact of, and is not coordinated with, the Board's project on accounting for leases. This may cause private companies to incur unnecessary costs.
- It creates unintended opportunities for private companies to structure off-balance-sheet debt arrangements even when control over an entity is clearly evident.

The costs and complexities associated with the determination of whether an entity is required to consolidate a VIE when control is not clearly evident (e.g., as a result of holding an implicit variable interest in the entity) are similar for both private and public companies. We believe that rather than provide private companies with a scope exception for certain arrangements, the FASB and PCC should address the broader concerns, including the identification of implicit variable interests and when certain implicit variable interests may not constitute a sufficient basis for consolidation of a VIE.

Creating a scope exception for the recognition and measurement of a company's interest in a lessor entity will result in different complexities related to application of the consolidation model. Specifically, rather than evaluating the arrangement under the current VIE guidance, private companies would be required to assess whether the arrangement qualifies for the proposed VIE scope exception. Our response to Question 4 in the appendix below discusses our concerns related to the evaluation of whether an arrangement meets the qualifying criteria for the proposed accounting alternative.

Further, the proposed ASU does not take into account the impact of the leasing guidance that the FASB is developing with the IASB. A private company may determine that it is not required to consolidate a lessor entity under the accounting alternative in the proposed ASU. However, upon adoption of the final leasing standard, the private company may be required to record the leased asset on its balance sheet again in the form of a right-of-use asset and a lease liability. We believe that the Board and PCC should consider whether it would be more costly and complex for private companies to derecognize the leased asset and related obligation under the proposed ASU only to subsequently recognize these items under the proposed leasing guidance.

In addition, the proposed ASU appears to create unintended opportunities for private companies to remove assets and liabilities from their statements of financial position, which would make it more difficult for a user to analyze an entity's resources and obligations. For example, a private company could form a VIE that is clearly under its control (i.e., under common control). The VIE could purchase all of the fixed assets required to operate the private company, finance the purchases with debt (guaranteed by the private company), and lease the assets (under operating leases) to the private company (i.e., substantially all the activities between the two entities). While the private company may clearly control the VIE (and control the related assets and be liable for the related obligations), the private company could use the exception to not consolidate the VIE (i.e., a structured off-balance-sheet arrangement).

If the Board decides to move forward with the proposed exception, we do not support the removal of the example codified in ASC 810-10-55-87 through 55-89. Because the proposed accounting alternative is optional, companies that either do not elect the accounting alternative or do not qualify for the election may apply the implementation guidance to their historical and prospective accounting. In addition, public companies often analogize to this example to determine whether they hold an implicit variable interest in a VIE.

Finally, we are concerned that the proposed ASU's comment period may be too short (it is one of the shortest of any FASB proposal) to obtain sufficient feedback. As the Decision Framework points out, private companies have "fewer and less specialized accounting personnel" than public

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companies; thus, private companies may need more time to comment on exposure drafts. We therefore recommend that future PCC-related proposals have longer comment periods.

The appendix below contains our detailed responses to the proposed ASU's questions for respondents.

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Deloitte & Touche LLP appreciates the opportunity to comment on the proposed ASU. If you have any questions regarding our comments, please contact Trevor Farber at 203-563-2547.

Yours truly,  
Deloitte & Touche LLP

Cc: Robert Uhl

**Appendix**  
**Deloitte & Touche LLP**  
**Responses to the Proposed ASU's Questions for Respondents**

***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 do not support this proposed accounting alternative for private companies because we do not believe that the PCC and Board have sufficiently justified why recognition and measurement for private companies should be different from that for public companies. It appears that the PCC intended to address constituents' concerns regarding consolidation in situations in which control is not clearly evident, such as the example derived from FSP FIN 46(R)-5.<sup>1</sup> If the Board is concerned about the identification and analysis of implicit variable interests or that certain implicit variable interests do not constitute a sufficient reason to consolidate an entity, the Board should address this issue directly for both public and private companies.

***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.*

Arrangements addressed by the proposed accounting alternative may affect private companies more frequently. However, arrangements involving implicit variable interests currently exist for public entities as well.

Therefore, we recommend that the FASB and PCC pursue an approach that addresses the root causes of complexity for both private and public companies rather than merely providing a scope exception for a limited subset of entities.

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

We acknowledge that a number of private companies have indicated that they encounter difficulties in applying the current VIE consolidation requirements related to implicit variable interests when analyzing whether they are required to consolidate related-party leasing entities. This appears to be the primary reason for issuing the proposal. However, the criteria for the exception do not limit its application to these specific situations (e.g., the private company could clearly control the lessor entity through an explicit interest). In addition, we believe that the different evaluation required by the proposal may not resolve these issues and may actually create additional complexities.

For instance, to qualify for the accounting alternative, a private company would be required to evaluate whether it and the lessor entity are under common control. Although the term "common control" is not defined in the Codification, the EITF previously discussed the definition in EITF

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<sup>1</sup> FASB Staff Position No. FIN 46(R)-5, "Implicit Variable Interests Under FASB Interpretation No. 46(R), Consolidation of Variable Interest Entities."

Issue 02-5.<sup>2</sup> While the Task Force did not reach a consensus on this Issue, the SEC observer noted a number of situations in which the SEC staff believes a common-control arrangement exists. It is unclear whether the proposal would require a private company to apply the SEC staff's view or the current consolidation guidance (including the VIE subsections) in determining whether the private company and the lessor entity are under common control.

In addition, there may be situations in which either the private company or the lessor entity is jointly controlled by a number of investors. For example, the lessor entity may be jointly controlled by two investors: (1) one that is related to the private company and (2) an institutional investor. Currently, the guidance in ASC 810-10 and the implementation guidance in ASC 810-10-55-88 illustrate how the private company should account for its relationship with the lessor entity in these situations. However, the proposed ASU would eliminate this guidance and therefore could create diversity in the accounting for these relationships.

**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 generally agree that the activities identified in proposed paragraph ASC 810-10-55-9 would constitute supporting leasing activities. However, the lessor entity often may not have any direct employees. Rather, the activities typically performed by the owner of a property may be performed by the private company on behalf of the lessor entity. Such activities may include paying property and income taxes, negotiating the financing for the property, and maintaining the property. We recommend that the Board and PCC address whether such activities would be considered leasing activities, as that term is used in proposed paragraph ASC 810-10-15-17A(c).

**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?*

It appears that many of the items that an entity is required to disclose in the footnotes would have been reflected on the balance sheet (and in the footnotes) if the entity did not elect to apply this proposed accounting alternative. While we agree that these items should be disclosed, this disclosure requirement calls into question whether the proposed accounting alternative for private companies is justified.

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<sup>2</sup> EITF Issue No. 02-5, "Definition of 'Common Control' in Relation to FASB Statement No. 141."

We believe that, in addition to the disclosures required by the proposal, private companies should disclose any arrangements entered into by the lessor entity that may increase the risk exposure of the private company (such as the existence of a hedge or a swap entered into by the lessor entity). Such disclosures about the company's potential risk exposure would constitute decision-useful information for private-company stakeholders.

***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.*

A separate lessor entity may primarily be established for tax, legal, or estate-planning purposes. However, as previously noted, we are concerned that if this proposed accounting alternative is finalized, private companies will be able to establish separate lessor entities whose primary purpose is to circumvent the current recognition guidance, effectively keeping certain assets (potentially those subject to impairment) and leverage off their balance sheets.

In addition, under the FASB's proposed leasing guidance, an entity would only be required to account for a related-party lease that is legally enforceable. Accordingly, a private company could establish a special-purpose leasing entity that leases assets from third parties and then subleases the assets to the private company. Because the proposed leasing guidance would require an entity to account for the sublease on the basis of its legal form rather than its substance, the entity could circumvent the proposed leasing guidance under this proposed ASU.

***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?*

As noted above, we are concerned that if the proposed accounting alternative is implemented, entities could establish separate lessor entities for structuring purposes.

***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 believe that if the Board and PCC ultimately decide to permit entities to elect the proposed accounting alternative, the adoption of the accounting alternative represents an accounting policy election that should be applied to all interests that meet the criteria for applying the approach.

***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 agree that if the Board and PCC ultimately decide to permit entities to elect the proposed accounting alternative, a full retrospective approach should be used to apply the proposed ASU.

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

We believe that if the Board and PCC ultimately decide to finalize the proposal, the guidance should be effective no sooner than for reporting periods beginning on or after December 15,

2014. In this case, public companies that currently rely on the implementation example in ASC 810-10-55-88 (if it is removed as proposed) would have sufficient time to update their analysis for identifying whether they hold an implicit variable interest in an entity. However, the Board and PCC should also consider the feedback received from both public and nonpublic entities on timing.

**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.*

Currently, there is limited guidance on evaluating whether an entity holds an implicit variable interest in another entity. The proposed removal of the example in ASC 810-10-55-87 through 55-89 may create further confusion regarding the evaluation of the existence of an implicit variable interest. Accordingly, entities that do not elect the proposed accounting alternative or do not qualify for the election would have less guidance to support their historical and prospective accounting conclusions.

We further note that the Basis for Conclusions indicates that (1) the Board is proposing removal of the example because it contradicts the accounting alternative in the proposal and (2) the example primarily applies to private companies. We disagree with the Board's reason for removing the example since we believe that the implementation guidance in the example is accurate and continues to apply to public entities that analogize to it. Therefore, rather than remove the example, the Board should provide additional implementation guidance to help all entities identify variable interests.

**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?*

Rather than finalizing the proposal's approach, the Board and PCC should consider alternatives for clarifying the application of VIE guidance to all arrangements. However, we do not support the clarifications described in the first alternative considered (and rejected) by the PCC. The basis for this alternative is that the implied guarantee should not be considered a variable interest because it only absorbs the risk created by the lessee entity. That is, the only variability being transferred to the lessee is its own credit risk. We disagree with this conclusion because it does not take into account the lessee entity's potential exposure to the variability of the lessor entity's assets (the residual value of the leased assets).

We do support the second alternative considered by the PCC, since we believe that additional guidance on evaluating whether one party has the power to direct the activities of a VIE would be beneficial for evaluating all arrangements. An entity needs to use significant judgment in performing this evaluation, especially when determining whether a related-party lease arrangement provides the lessee with such power. However, providing additional guidance on

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determining the primary beneficiary, without addressing the issues related to identifying implicit variable interests, would not address the concerns raised to the PCC.

### **Other Comments**

Because the disclosure requirements in proposed paragraph ASC 810-10-50-2AD are included in the Variable Interest Entities subsection, it is unclear whether these disclosures would only apply to legal entities that meet the criteria in proposed paragraph ASC 810-10-15-17A **and** meet the definition of a VIE. If this is the Board's and PCC's intent, they should consider that identifying whether an explicit or implicit guarantee exists is an important part of the analysis of a potential VIE, because a guarantee may cause the lessor entity to be a VIE under ASC 810-10-15-14(b)(2) if the guarantee protects the equity holders from the expected losses of the entity. That is, the equity investors (as a group) would lack the obligation to absorb the expected losses of the legal entity if they are directly or indirectly protected from the expected losses by other parties involved with the legal entity.