



## Staff Paper

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Project	<b>Consolidation</b>
Topic	<b>Disclosures for unconsolidated structured entities</b>

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### Introduction

1. Subtopic 810-10 of the FASB's Accounting Standards Codification, as amended by Statement No. 167, requires a reporting entity that has a variable interest in a variable interest entity (VIE) but is not the primary beneficiary of that entity to provide users of the financial statements with an understanding of the nature of, and changes in, the risks associated with an enterprise's involvement with a variable interest entity. ED 10 *Consolidated Financial Statements* proposes similar, but not identical, disclosure objective.
2. The purpose of this paper is to discuss:
  - (a) whether the IASB proposals in ED 10 should be amended in the light of respondents' comments; and
  - (b) how the proposals in ED 10 and the Statement 167 amendments to Subtopic 810-10 could be aligned.
3. The following paragraphs discuss:
  - (a) potential additional disclosure requirements regarding the nature and extent of a reporting entity's involvement with structured entities that it does not control;
  - (b) disclosure requirements regarding the nature and extent of, and changes in, the market risk, credit risk and liquidity risk from the reporting entity's involvement with structured entities that it does not control;

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**Staff paper**

- (c) the scope of the proposed disclosure requirements;
- 4. This paper contains four appendices:
  - (a) Appendix A discusses application issues of a potential disclosure relating to structured entities that a reporting entity has set up or sponsored.
  - (b) Appendix B analyses whether a reporting entity could generate the information that is necessary to meet the disclosure requirement; and
  - (c) Appendix C weighs the benefits and costs of the proposals;
  - (d) Appendix D provides a summary of the staff recommendations in this agenda paper.

**Disclosure principle**

- 5. At their March meeting the boards agreed on the following general disclosure principle for unconsolidated structured entities:

A reporting entity shall disclose information that helps users of financial statements to understand the nature of, and changes in, the risks associated with the reporting entity's involvement with other entities and how those risks affect future cash flows.
- 6. The following sections of this paper discuss the scope and content of specific disclosure requirements to supplement this general disclosure principle.

**Scope**

***Requirements in Subtopic 810-10 as amended by Statement No. 167***

- 7. Paragraph 810-10-50-2AA of the ASC states that one of the principal objectives of the disclosures is to provide financial statement users with an understanding of the nature of, and changes in, the risks associated with an enterprise's **involvement** with the **variable interest entity**.

Staff paper

8. Although the term “involvement” is not defined in the Statement 167 amendments to Subtopic 810-10, the staff believe that this is generally interpreted as having a variable interest in the VIE..

***Proposals in ED 10***

9. Paragraph 48 of ED 10 proposes requiring an entity to disclose information about the nature of, and risks associated with, the reporting entity's **involvement** with a **structured entity** that the reporting entity does not control.
10. Appendix A of ED 10 defines an involvement with a structured entity as follows:

For the purposes of this [draft IFRS], involvement with a structured entity includes both contractual and non-contractual involvement that exposes the reporting entity to variability of returns of the structured entity. Involvement includes the holding of equity or debt instruments, as well as other forms of involvement such as the provision of funding, liquidity support, credit enhancement, guarantees, and asset management services.

11. Paragraph BC137 of ED 10 explains:

The Board observed that disclosure of every involvement with unconsolidated entities would not be feasible or meaningful. The disclosure requirements should help investors and other users to assess the market, liquidity and credit risks to which a reporting entity is exposed as a consequence of its involvement with structured entities. With this in mind, the Board decided to limit its disclosure requirements to involvements with structured entities that expose the reporting entity to variability of returns of the structured entities. [...] The definition of involvement is not intended to capture mere supplier or customer relationships.

***Respondents' comments to ED 10***

12. Many respondents disagreed with the proposed disclosures for a reporting entity's risk exposure from its involvement with unconsolidated structured entities. Those respondents thought that it was inconsistent with the objective of the exposure draft to develop a single comprehensive control model to require disclosures for a particular set of entities, such as structured entities. In their view, a reporting entity can be exposed to risks from its involvement with any

## Staff paper

type of entity, regardless of whether the entity is considered a structured entity. Therefore, they did not believe that a reporting entity should be required to provide specific risk disclosures for its involvement with unconsolidated structured entities.

13. Respondents noted that a requirement to provide particular disclosures for structured entities would put a lot of emphasis on the definition of a structured entity. Those respondents questioned whether ED 10 contained a sufficiently robust definition, as Appendix A of ED 10 contains only a negative definition of a structured entity. According to that definition, a structured entity is defined as an entity whose activities are not directed through voting rights or similar rights. Respondents requested that the IASB develop a more robust definition of a structured entity if the IASB were to affirm that a reporting entity must provide disclosures for its involvement with unconsolidated structured entities. The boards tentatively decided to include a positive definition of a structured entity at the March joint board meeting.
14. Many respondents also commented that the definition of involvement in Appendix A of ED 10 implies that a reporting entity must disclose its risk exposure to an overly wide set of structured entities. Respondents read the definition of an involvement to be met by literally any involvement with a structured entity, including the provision of administrative tasks or consultancy services or the issue of standardised banking products, such as interest rate swaps. Respondents did not think that disclosure of such a wide range of activities would be decision-useful to users of financial statements and asked the IASB to limit the scope to **significant** involvement with a structured entity. Some respondents asked the IASB to exempt specific types of involvement from the scope of the disclosure requirement. For example, some respondents thought that the disclosures should not apply to passive investors, such as bond holders. Other respondents believe the disclosures should apply only when a reporting entity is exposed to reputational risk from its involvement with a structured entity.
15. The following paragraphs discuss:

**Staff paper**

- (a) why a reporting entity should be required to provide particular disclosures for unconsolidated structured entities;
- (b) what constitutes an involvement with an unconsolidated structured entity; and
- (c) whether the proposed disclosure requirements should apply to material or to significant involvement with an unconsolidated structured entity.

***Staff analysis: Why should a reporting entity be required to provide particular disclosures for unconsolidated structured entities?***

16. A reporting entity is exposed to many different types of risks from its involvement with structured entities. Although Topic 275, *Risks and Uncertainties* and IFRS 7 *Financial Instruments: Disclosures* provide general risk disclosures, the staff believe that additional risk disclosures are required for structured entities. The proposed disclosures in ED10, which are similar to the requirements in the Statement 167 amendments to Subtopic 810-10, were a direct response to concerns related to investment and securitisation activities and the lack of disclosures in the wake of the credit crisis and reflect the observation that the risks *associated with some activities* are more systemic than others.

***Staff analysis: What constitutes an involvement with an unconsolidated structured entity?***

17. The staff have developed two views as to what would constitute involvement with an unconsolidated structured entity. The two views are as follows:

*View 1: Exposure is Limited to the Reporting Entity's Investment*

18. Some staff support providing additional disclosures about a reporting entity's involvement with an unconsolidated structured entity only when that involvement exposes the reporting entity to losses beyond the carrying amounts of the reporting entity's assets and liabilities that relate to its involvement with the structured entity. Therefore, for example, involvement might refer to particular guarantees, the provision of liquidity or credit support, or implicit obligations to provide support to a structured entity. Involvement would not

## Staff paper

refer to, for example, an investment in a structured entity for which the reporting entity's maximum exposure to loss is the carrying amount of the investment.

19. Staff supporting this view would argue that, if a reporting entity's exposure to losses is limited to the carrying amount of its assets and liabilities, the risk disclosures already within IFRS 7 or IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and Topic 450, *Contingencies* are sufficient to meet the needs of users in this respect.
20. The advantage of this approach is that it addresses issues raised by respondents to ED10 regarding duplication of risk disclosures between the proposals in ED10 and the requirements of IFRS 7. It also addresses the concerns that the disclosures proposed by ED10 are excessive and might require disclosure of involvement such as the provision of administration services.
21. The disadvantages are that it will be more difficult to define 'involvement', and may not address requests from users to have risk disclosures relating to a reporting entity's involvement with structured entities, *as well as* risk disclosures relating to financial instruments held by a reporting entity (which are addressed by IFRS 7).

*View 2: Exposure to any Variability*

22. Other staff support the approach taken in Subtopic 810-10 and in ED10, ie a reporting entity has an involvement with an unconsolidated entity when that involvement exposes it to variability of returns of the unconsolidated structured entity.
23. Subtopic 810-10 requires disclosures for a reporting entity that is the primary beneficiary of a variable interest entity as well as a reporting entity that holds variable interests in a variable interest entity, but is not the entity's primary beneficiary. Therefore, a reporting entity that holds variable interests in a variable interest entity has an "involvement" with that entity.
24. The staff believe that the IASB intended the scope of the proposed disclosure requirements in ED 10 to be similar to the scope of Statement No.167 because this is how 'involvement' was defined in ED10. In other words, a reporting

## Staff paper

entity has an involvement with an unconsolidated entity whenever it is exposed to variability of returns of the unconsolidated structured entity.

25. The staff opposed to this view are concerned that it does not, necessarily, address the concerns of respondents regarding the scope of the disclosure requirements. The requirements might be interpreted widely and could require, for example, providers of administrative services to prepare disclosures about their involvement with an unconsolidated entity. The staff supporting this view believe that the definition of a variable interest has been in place in the United States since the issuance of Interpretation 46, *Consolidation of Variable Interest Entities*, in January 2003, and although the definition was clarified with the issuance of FSP FIN 46(R)-6 in April 2006, constituents have not voiced concerns with regards to the scope of the disclosure requirements.

***Staff analysis: Should the proposed disclosure requirements apply to material or significant involvement with an unconsolidated structured entity?***

26. Paragraph 30 of the IASB's conceptual framework states that information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. FASB Concept Statement No. 2 contains a similar definition. In addition, the concept of materiality applies to disclosures requirements. Accordingly, a reporting entity does not need to provide the proposed disclosure requirements related to its risk exposure from its involvement with unconsolidated structured entities if the item is immaterial.
27. However, many respondents to ED 10 believe the proposed requirements were either unclear as to whether the materiality threshold would apply or thought that the materiality threshold was too low.
28. One way to address this concern would be to require that the proposed disclosure requirements only apply to a reporting entity's involvement with an unconsolidated structured entity that exposes it to **significant** variability of the returns of the structured entity.
29. A number of respondents to ED 10 asked the IASB to state explicitly that it intends the proposed disclosure requirements to apply to significant risk

## Staff paper

exposures with unconsolidated structured entities only. Those respondents stated that a significance threshold would reduce uncertainty for preparers about the scope of the proposed disclosure requirements. In addition, it would allow preparers to focus on information about those risk exposures that, in their view, would be of most interest to users.

30. The difficulty with that approach is that significance is neither defined in IFRSs nor in US GAAP. Therefore, the term is open to interpretation and there is a risk that diversity in practice might arise. Because of this problem, we have come to different conclusions as to whether adding the word “significant” would assist preparers in applying the proposed disclosure requirements.
31. Some staff agree that the boards should require a reporting entity only to provide the proposed disclosures if it is exposed to significant variability of returns of an unconsolidated structured entity. However, other staff emphasise that the concept of materiality is a long-standing concept in IFRSs and US GAAP. These staff are also concerned that allowing users to determine which disclosures would be significant for investors could potentially result in items not being disclosed. Those staff also note that the FASB decided to delete the term “significant” from the Interpretation 46(R) requirements with the issuance of Statement No. 167 as this threshold is consistent with the requirements in other standards.

**Questions 1 and 2 for the boards**

(1) Do the boards think that a reporting entity has an involvement with an unconsolidated entity that is relevant for disclosure purposes when it is exposed to variability of returns of that entity? If not, would you support an approach that defines involvement more narrowly as involvement that exposes the reporting entity to losses beyond the carrying amounts of the reporting entity's assets and liabilities that relate to its involvement with the structured entity?

(2) Do the boards believe that the final disclosure requirements should state that the disclosure requirements for unconsolidated structured entities should apply only to a reporting entity's involvement with entities that exposes the reporting entity to **significant** variability of returns?



## Staff paper

**Nature and extent of involvement**

32. At the March 2010 board meeting, the boards tentatively decided that a reporting entity should disclose qualitative and quantitative information about its involvement with unconsolidated structured entities, including summary information about the nature, purpose, size and activities of those structured entities, including how the structured entities are financed. This decision incorporates the requirements of paragraph 810-10-50-5A(d) of the Accounting Standards Codification and the proposals included in paragraph B40 of ED10 within the final standard.
33. The staff did not ask the boards for a decision regarding the proposals in paragraphs B41 and B42 of ED10, according to which a reporting entity would disclose information about its income from, and the value of assets transferred to, structured entities that it has set up or sponsored. The following paragraphs discuss those proposals.

***Proposals in ED 10***

34. Paragraphs B41 proposed that, for unconsolidated structured entities that the reporting entity has set up or sponsored, the reporting entity disclose a summary of:
  - (a) income from the reporting entity's involvement with structured entities, including a description of the types of income presented in the summary; and
  - (b) the value of assets transferred to those structured entities, at the date the transfers were made.

The requirements in paragraph B41 would be required for all structured entities, including those structured entities whose assets were acquired from a third party.

35. Paragraphs B41 and B42 contain further application guidance on how a reporting entity should provide the disclosure. According to that guidance a reporting entity would present the information for the current reporting period

## Staff paper

and the two preceding reporting periods in a tabular format, unless another format is more appropriate.

**Respondents' comments to ED 10**

36. Most respondents accepted that, in response to the financial crisis, a reporting entity should provide disclosures about the nature and extent of its involvement with an unconsolidated structured entity. However, many respondents disagreed with the proposal to require disclosures for unconsolidated structured entities that the reporting entity has set up or sponsored, regardless of whether there is any ongoing involvement.
37. Respondents argued that the reporting entity would not be exposed to risks from the structured entity in the absence of any ongoing involvement. However, if the proposed disclosure requirements were intended to provide information about a reporting entity's fee income from transactions with structured entities, they argued that IFRS 8 *Operating Segments* and IAS 18 *Revenue* require a reporting entity to provide information about the composition of its revenues.
38. Many respondents noted also that the proposed disclosure seemed to focus on securitisation vehicles only. Those respondents asked the IASB how it intended the proposed disclosure requirements to apply to other structured entities, such as investment funds or mutual funds.
39. Most respondents recommended that the IASB should remove the proposed disclosure requirement. However, if the IASB should affirm the proposed disclosure requirements, respondents asked the IASB to provide application guidance as to the following:
  - (a) When has a reporting entity sponsored or set up a structured entity and is there a difference between those terms? For example, do the disclosure requirements apply when the reporting entity has provided technical services as an agent of other parties only? Respondents generally acknowledged that the terms "sponsor" and "set up" are used in the disclosures of many reporting entities. However, in their view,

## Staff paper

those terms are used with more than one meaning. Therefore, they were concerned that, if the IASB should not define those terms, divergence in practice might arise.

- (b) What represents income from a reporting entity's involvement with a structured entity? Did the IASB mean fee income only or did it intend a reporting entity to disclose all cash flows generated by its involvement with an unconsolidated structured entity? Some respondents also thought that the IASB should require a reporting entity to disclose cash flow information, rather than income information.
  - (c) To which transfers should the disclosure requirement apply? Would transfers at fair value be included in the disclosure? Also, does the disclosure requirement apply to transfers of the current period only or is it intended to be cumulative? In addition, some respondents questioned whether a reporting entity should also disclose transfers from the structured entity to the reporting entity.
  - (d) How should the "value" of assets transferred to a structured entity be measured? How should a reporting entity aggregate the required information if it has transferred assets at different dates and for different values? Some respondents thought that a more practical disclosure was to require a reporting entity to disclose the carrying amounts of assets transferred to a structured entity at the reporting date, rather than at the date of the transfer.
40. The vast majority of respondents disagreed with the application guidance on how a reporting entity should present the disclosure. ED 10 proposes that the information must be provided in a tabular format, unless another format is more appropriate. ED 10 would also require a reporting entity to provide the information as a minimum for the current period and the two preceding periods. Respondents read both requirements as rules, from which the reporting entity could depart only in extraordinary circumstances. Respondents generally did not think that the IASB should require a particular disclosure format. Rather

**Staff paper**

they thought that the IASB should leave it to the judgement of preparers as to how they would best present the proposed disclosures.

**Staff analysis**

41. When a reporting entity has no continuing involvement with a structured entity there is no financial instrument or existing relationship as an anchor for assessing risk. Yet, setting up or sponsoring a structured entity can create residual risks for the sponsoring entity, particularly when the sponsoring entity selected the assets or marketed the vehicle to prospective investors to invest in the vehicle. If the structured entity encounters difficulties it is possible that the sponsor could be challenged on their advice or actions (ie were they negligent, did they provide adequate advice to investors etc) or may choose to act to protect its reputation.
42. The proposed disclosures were designed to give users of the financial statements a sense of the scale of the operations the reporting entity had managed with these types of transactions. The proposals were not intended to help assess the actual risk of failure or recourse (including as a result of negligence) to the reporting entity but they would give a sense of the scale involved and the extent of the reporting entity's reliance on such entities to facilitate its business. For example, as the credit crisis developed investors became concerned about the extent that banks had been involved in SIVs (structured investment vehicles). Yet, few banks reported information about the extent of their involvement with establishing SIVs. It was, therefore, difficult to assess the potential exposure a particular entity might have to such vehicles.
43. ED 10 required that revenue is used as the disclosure anchor because, in many cases, when there is no continuing involvement, there would be no asset or liability associated with sponsored vehicles on the reporting entity's balance sheet. The revenue disclosures were therefore not intended to convey

## Staff paper

information in their own right, but the intention is that they would be the anchor on which the asset disclosures would be based.<sup>1</sup>

44. The staff has discussed respondents' comments to ED10 with users of financial statements. Those users encouraged the boards to finalise the proposed disclosure requirements without modifications. In their view, the proposals assist users when analysing financial statements as follows:
- (a) In the financial crisis some reporting entities decided to support structured entities that they had sponsored or set up, even though those reporting entities had previously stated that they did not have any ongoing involvement with those structured entities. The proposed disclosures would assist users in assessing a reporting entity's risk exposure from structured entities for which the reporting entity has *no ongoing contractual involvement*.
  - (b) The proposals would also provide users with a better understanding of how much income a reporting entity generates from its involvement with unconsolidated structured entities. This assists users in understanding the reporting entity's business model and the risks associated with that model.
45. We note that some of the reasons why users welcome the proposal are addressed by other (proposed) disclosure requirements. For example:
- (a) The boards tentatively decided to require specific disclosures about a reporting entity's implicit obligations to provide support to entities at the March 2010 board meeting.
  - (b) IAS 18 *Revenue* and IFRS 8 *Operating Segments* require a reporting entity to disclose information about particular revenue categories. In particular, IFRS 8 requires disclosure of revenue for each operating segment, disaggregation of total reported revenue by (group of similar)

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<sup>1</sup> The revenue earned relative to the assets managed or sponsored might convey information about the relative involvement the reporting entity had with the vehicle (ie the larger the percentage fee or commission the greater the involvement), but that was an ancillary benefit.

## Staff paper

products/services and by geography, and disclosures about the reporting entity's types of products and services and its major customers.

- (c) The IASB has issued in June 2009 ED/2009/6 *Management Commentary*, which would provide users with a basis for understanding management's objectives and its strategies for achieving those objectives.
46. Nonetheless, none of those disclosure requirements would fully replace the proposals in paragraphs B41-B42 of ED 10. IAS 18, IFRS 8 and ED/2009/6 do not contain specific disclosure requirements for unconsolidated structured entities. Therefore, information about a reporting entity's transactions with those entities would not be reported separately from other, more general, disclosures.
47. However, our discussions with users have confirmed that they believe that it would be very useful to have information about the scale of a reporting entity's operations that is derived from transactions with unconsolidated structured entities, ie to have more information about a reporting entity's business model and the risks associated with that business model. This would be particularly useful if a reporting entity were no longer able to generate fee income from its involvement with structured entities because of particular events that might cause a significant decrease in the use of such entities for investing or financing purposes. Those users also confirmed that their requests for such information precedes the financial crisis, and is not simply a reaction to it.
48. The staff are of the view that reporting entities face many risks from their past activities and such business risks should not be addressed more generally, perhaps in Management Commentary. Some staff would argue that such disclosures, if considered necessary, should *not* be part of a disclosure package that addresses a reporting entity's exposure to risk from its involvement with unconsolidated structured entities. In addition, those staff believe that the disclosures about the nature and extent of a reporting entity's involvement with unconsolidated structured entities already agreed to by the boards are sufficient (ie, to require a reporting entity to disclose qualitative and quantitative

**Staff paper**

information about its involvement with unconsolidated structured entities, including information about the nature, purpose, and activities of structured entities, including how those activities are financed). They believe that if a reporting entity does not have any further involvement with a structured entity (considering its implicit variable interests) then including this requirement contradict the conclusion on how to define involvement discussed in question 1 above.

49. Other staff acknowledge that the consolidation project is the only IASB or FASB project on the current agenda that specifically deals with disclosures relating to a reporting entity's involvement with structured entities. The structured entity disclosures that the boards confirmed at the March meeting were a direct response to concerns related to investment and securitisation activities in the wake of the financial crisis and reflected the observation that the risks associated with some activities are more systemic than others. Therefore, in order to address the requests for such information from users, those staff recommend that the disclosures proposed in paragraph B41 are retained in the final standard. The appendix to this agenda paper addresses further application issues associated with this proposal.

## Staff paper

**Question 3 for the boards**

- (3) Do the boards believe that a reporting entity should be required to disclose:
- (a) income from its involvement with structured entities that it has set up or sponsored; and
  - (b) the fair value of assets recognised by those structured entities at the time that the structured entities are established?

Both disclosures would be required regardless of whether the assets of the structured entity were acquired from a third party.

**Nature of risks*****Requirements in Subtopic 810-10***

50. Paragraph 810-10-50-4 requires an enterprise that holds a variable interest in a variable interest entity, but is not the variable interest entity's primary beneficiary, to disclose:
- (a) the carrying amounts and classification of the assets and liabilities in the enterprise's statement of financial position that relate to the enterprise's variable interest in the VIE;
  - (b) the enterprise's maximum exposure to loss as a result of its involvement with the variable interest entity, including how the maximum exposure is determined and the significant sources of the enterprise's exposure to the variable interest entity. If the enterprise's maximum exposure to loss as a result of its involvement with the variable interest entity cannot be quantified that fact shall be disclosed.
  - (c) A tabular comparison of the carrying amounts of the assets and liabilities, as required by (a) above, and the enterprise's maximum exposure to loss as required by (b) above. An enterprise shall provide qualitative and quantitative information to allow financial statement users to understand the differences between the two amounts. That discussion shall include, but is not limited to, the terms of



**Staff paper**

arrangements, giving consideration to both explicit arrangements and implicit variable interests that could require the enterprise to provide financial support to the variable interest entity, including events or circumstances that could expose the enterprise to a loss.

51. Paragraph 810-10-50-4 contains two more disclosure requirements that will apply to some variable interest entities only:
- (a) Information about any liquidity arrangements, guarantees, and/or other commitments that may affect the fair value or risk of the enterprise's variable interest in the variable interest entity is encouraged.
  - (b) If applicable, significant factors considered and judgments made in determining that the power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance is shared in accordance with the guidance in paragraph 810-10-25-38D.

***Proposals in ED 10***

52. Paragraph B43 of ED 10 requires a reporting entity to disclose information about its exposure to risks from its involvement with unconsolidated structured entities. According to paragraph B44, a reporting entity must present in tabular format, unless another format is more appropriate, a summary of:
- (a) the carrying amount of the assets and liabilities recognised in the reporting entity's consolidated financial statements relating to the reporting entity's involvement with structured entities.
  - (b) the line items in the consolidated statement of financial position in which those assets and liabilities are recognised.
  - (c) the reported amount of assets held by structured entities with which the reporting entity has involvement, measured at the date of the reporting entity's consolidated financial statements. The reporting entity must disclose the measurement basis of the assets presented in the summary, distinguishing between assets originated by the reporting entity and those originated by other entities.

**Staff paper**

- (d) the amount that best represents the reporting entity's maximum exposure to loss from its involvement with structured entities, including how the maximum exposure to loss is determined.
53. In addition, paragraph B46 introduces a list of examples that the reporting entity is only required to disclose if it considers the information to be relevant to an assessment of the risks to which the reporting entity is exposed. The list of examples includes (a) the credit rating and average life of the structured entity's assets; (b) information about the structured entity's funding and loss exposure; and (c) the types of returns the reporting entity received during the reporting period.

***Respondents' comments to ED 10***

54. Some respondents thought that the proposed disclosure requirements were too prescriptive. In their view, a reporting entity should be allowed to disclose its risk exposure on the basis of the information generated by its internal risk reporting system rather than on the basis of the information required in ED 10.
55. Respondents had the following comments on the application of the proposed disclosures in paragraph B44 of ED 10:
- (a) The proposals require a reporting entity to disclose the assets held by structured entities, but it would only disclose information about the related liabilities of a structured entity when it deems that information to be relevant to the risk assessment. Respondents did not think that disclosure of the assets of a structured entity could ever be useful, without information on the funding of the structured entity.
  - (b) How should the assets held by a structured entity be measured when (a) that entity does not prepare consolidated financial statements in accordance with IFRSs or (b) has a reporting date that is different from that of the reporting entity?

## Staff paper

- (c) Respondent also did not think that aggregated information about the assets held by different structured entities would provide useful information.
  - (d) Respondents asked the IASB to define the term “loss” and to provide application guidance on how that loss should be measured.
  - (e) How should the maximum exposure to loss proposal be applied to derivatives, such as interest rate swaps, that expose a reporting entity to theoretically unlimited losses?
  - (f) Some respondents thought that a reporting entity should disclose its expected losses, rather than its maximum loss exposure. However, other respondents did not think that the maximum loss disclosure should be replaced by an expected loss disclosure. Those respondents argued that the term “maximum loss” was well understood, while an “estimated loss” notion would require the provision of additional application guidance on how the loss should be estimated.
  - (g) Most respondents disagreed with the proposal to prescribe a tabular format for the disclosures, unless another format is more appropriate.
56. Paragraph B46 requires a reporting entity to provide additional disclosures, when this information is relevant to the risk assessment. Respondents believed that without further explanations as to what the IASB considers to be relevant when assessing risks, a reporting entity would be required to provide all of the disclosures mentioned in paragraph B46. Respondents disagreed with such a “check list” approach and asked the Board to clarify that paragraph B46 does not contain a list of mandatory disclosures, but that a reporting entity must exercise judgement about the extent of the risk disclosures it will provide.
57. Finally, some respondents argued that the proposed disclosure requirements in paragraph B46 are overly focused on structured entities that hold financial instruments within the scope of IAS 39 / IFRS 9. Those respondents noted that not all structured entities hold such instruments and asked the IASB to clarify how the proposed disclosure requirements would apply to those entities.

## Staff paper

**Staff analysis**

58. Agenda paper 4C explains that, although a reporting entity should generally be allowed to tailor its disclosures so to meet the specific informational needs of its users, the final disclosure requirements should contain a minimum set of disclosures that should apply to all reporting entities. We are concerned that the lack of specific requirements might impair the comparability of the disclosures of different entities or of the same entity in different periods. We are also concerned that it could mean that a reporting entity does not provide disclosures that users deem to be important.
59. Users of financial statements confirmed that information about a reporting entity's loss exposure from its involvement with unconsolidated entities and supplemental information of both the reporting entity's and the structured entity's financial position is relevant to their analysis of financial statements and that a reporting entity should always provide this information. Therefore, we do not recommend that the risk disclosures should be based entirely on a reporting entity's risk reporting system, but recommend that the final disclosure requirement contain some minimum risk disclosures.

*Assets held by the structured entity*

60. We agree with respondents that disclosure of the assets that are held by a structured entity without information about the funding of the structured entity is of limited use only. We also acknowledge that application of the proposal might be difficult because a structured entity would not necessarily prepare financial statements in accordance with IFRSs and a structured entity's reporting date might be different from that of the reporting entity.
61. We recommend that the boards do not specifically require a reporting entity to disclose the assets held by a structured entity, as part of the disclosures about a reporting entity's *risk exposure* from its involvement with unconsolidated structured entities. The disclosures about the *nature* of the reporting entity's involvement with an unconsolidated structured entity require a reporting entity to disclose information about the nature, purpose, size and activities of a

## Staff paper

structured entity and how the structured entity is financed. We believe that this requirement would normally include information about the assets held by the structured entity and the funding of those assets.

62. Therefore, we do not believe that a separate requirement to disclose the assets held by a structured entity is necessary. In our view, the more general disclosure requirement would give preparers the flexibility to deal with situations where disclosure of the assets held by a structured entity is difficult to provide.
63. At their last meeting, the boards agreed to include a general aggregation principle into the final disclosure requirements. We believe that this principle would provide sufficient guidance on when and how a reporting entity could aggregate information in the disclosures.

*Maximum loss exposure*

64. We believe that information about the maximum loss exposure of a reporting entity would provide relevant information to users of financial statements. We acknowledge that, sometimes, information about a reporting entity's expected losses might be more relevant than information about the reporting entity's maximum losses and that the disclosure of either value would require a reporting entity to apply judgement. However, we are concerned that the reporting entity would often identify a positive expected value of the returns from its involvement with an unconsolidated structured entity and would therefore not disclose any loss exposure if a reporting entity were to disclose its expected loss exposure.
65. We recommend that the boards do not provide a definition of what represents a loss to a reporting entity, but leave it to a reporting entity to identify what constitutes a loss in the particular context of that reporting entity. The reporting entity should then disclose how it has determined its maximum loss exposure. This is the approach adopted in Subtopic 810-10 as amended by Statement No. 167 and proposed in ED 10. The FASB staff is not aware of significant implementation issues associated with that approach.

## Staff paper

66. We acknowledge that some financial instruments expose a reporting entity to, theoretically, unlimited losses. Accordingly, paragraph 810-10-50-4(b) states that if a reporting entity's maximum exposure to loss cannot be quantified that fact must be disclosed. We recommend that the boards incorporate this statement into the final disclosure requirements. Furthermore, we believe that, if a reporting entity is exposed to theoretically unlimited losses, disclosure of the reporting entity's expected loss exposure will assist users in their analysis. We intend to emphasise this observation in drafting.
67. Furthermore, we believe that a comparison of the carrying amounts of the assets in the reporting entity's statement of financial position and the reporting entity's maximum exposure to loss will provide users with a better understanding of the differences between the reporting entity's maximum loss exposure and the reporting entity's expectation as to whether it is likely that it will bear all or only some of those losses. Therefore, we recommend that the boards require a disclosure similar to that in paragraph 810-10-50-4 according to which a reporting entity would be required to disclose a comparison of the assets and liabilities of the reporting entity that relate to the reporting entity's involvement with unconsolidated structured entities and the reporting entity's maximum exposure to loss.

*Supplemental disclosures*

68. When the IASB issued ED 10, it did not intend each item of the list of proposed supplemental disclosures in paragraph B46 to apply in all circumstances. Rather, the IASB thought that all of the proposed disclosures have the potential to provide important information for the analysis of a reporting entity's financial statements. However, depending on a particular set of facts and circumstances, some of the proposed disclosures would be more relevant than others. Therefore, a reporting entity might be expected to provide some, but not all, of the disclosures proposed in paragraph B46.
69. We acknowledge that this is not how respondents to the ED read the proposals. Most respondents understood paragraph B46 as a checklist with which the reporting entity must comply fully. We would be concerned if, as a result of the

## Staff paper

new disclosure requirements, a reporting entity would be required to provide disclosures that preparers and users consider to be irrelevant. Therefore, we recommend that the final disclosure requirements should incorporate the list of supplemental disclosures as examples only of those that might provide useful information depending on the circumstances. However, the standard should clarify that the boards would expect a reporting entity to provide qualitative and quantitative risk disclosures beyond the minimum disclosures required in paragraph 810-10-50-4 of the Accounting Standards Codification and paragraph B44 of ED 10 in order to meet the overall disclosure objectives. When drafting the final disclosure requirements, we will explore further whether additional examples should be added to that list, which do not relate to financial instruments.

70. Paragraph 810-10-50-4 contains two disclosures that are not included in ED 10:
- (a) Paragraph 810-10-50-4(d) encourages the reporting entity to provide information about liquidity arrangements, guarantees and/or other commitments that might affect the fair value or risk of a reporting entity's returns from its involvement with an unconsolidated structured entity. We believe that this scenario should be added to the list of examples in paragraph B46 of ED 10.
  - (b) Paragraph 810-10-50-4(e) requires a reporting entity to disclose significant factors considered and judgements made in determining that the power over a structured entity is shared among multiple unrelated parties, such that no party controls the structured entity. In our view, this disclosure forms already part of the disclosure that a reporting entity's should disclose all significant judgements and assumptions in determining whether it controls another entity. Therefore, we do not believe that the disclosure requirement in paragraph 810-10-50-4(e) is specifically required, as it would be required based on the disclosure requirements discussed in paper 4C.

## Staff paper

*Disclosure format*

71. We acknowledge that users of financial statements generally preferred a tabular format of the risk disclosures. However, most of the staff agree with the majority of respondents who argued that the final disclosure requirements should not require a particular disclosure format. Rather, the boards should leave it to the judgement of preparers how they best present information about the nature and extent of, and changes in, a reporting entity's risk exposure from its involvement with unconsolidated structured entities. Some staff believe that the reference to a tabular format should remain in the final standard. Those staff note that the IASB took this approach in its revisions to IFRS 7 in March 2009 (for annual periods ending on or after 31 December 2009). It would seem to be inconsistent to reverse that approach. That change was made as a result of preparer and user outreach.

**Questions 4 and 5 for the boards**

- (4) Do the boards agree that a reporting entity should disclose:
- (a) the carrying amount of the assets and liabilities recognised in the reporting entity's consolidated financial statements relating to the reporting entity's involvement with structured entities;
  - (b) the line items in the consolidated statement of financial position in which those assets and liabilities are recognised;
  - (c) the amount that best represents the reporting entity's maximum exposure to loss from its involvement with structured entities, including how the maximum exposure to loss is determined. If a reporting entity cannot quantify its maximum exposure to loss from its involvement with structured entities it must disclose that fact; and
  - (d) a comparison of the carrying amount of the assets and liabilities of the reporting entity that relate to the reporting entity's involvement with unconsolidated structured entities and the reporting entity's maximum exposure to loss? If not, why?
- (5) Do the boards believe that the final disclosure requirements should require a particular disclosure format?

The disclosure standard would include a list of supplemental disclosures as examples of those that might provide useful information depending on the circumstances.



## Staff paper

**Appendix A: Further application issues relating to the disclosure proposed in paragraph B41 of ED 10**

1. In response to respondents requests for clarification of the disclosure proposals in paragraph B41 (as noted in paragraph 39 of this paper), the staff supporting the inclusion of the disclosure proposals in B41 recommend the following.

*Set up or sponsored*

2. The disclosure should continue to be required for unconsolidated structured entities that the reporting entity has set up or sponsored. There are two potential issues that arise in retaining the wording ‘set up or sponsored’:
  - (a) The first is that, without being defined, the terms could be interpreted differently. Although we acknowledge that this could be the case, the terms are already widely used in practice. The staff believe that the best way to deal with this concern is to require a reporting entity to explain how it has interpreted ‘set up’ or ‘sponsored’ when providing the required disclosures.
  - (b) The second is that the wording might require a reporting entity that simply facilitates the set up of an entity to provide extensive disclosures—for example, a law firm. Although there is the potential that this could be the case, the input from users would suggest that it would still provide useful information for such entities to provide information about income that they generate from transactions with structured entities. In addition, we believe that it would be difficult to ‘scope’ such entities out of the disclosure requirements other than by creating a list of entities that would not be required to apply the requirements. This would create rules that might encourage structuring to avoid the requirements. Therefore, we do not recommend that the boards exempt a particular set of entities from the proposed disclosure.

## Staff paper

*Income from a reporting entity's involvement with unconsolidated structured entities*

3. The staff recommend that the term 'income' should be defined to include not only fee income from setting up or sponsoring the structured entity, but also fee income from continuing to provide services, gains or losses if the reporting entity sold assets to the structured entity, and interest income or fair value gains or losses from any equity or debt securities that the reporting entity might hold in the structured entity.

*The value of assets transferred to the structured entities at the date the transfers were made*

4. We recommend that the final standard ask for the fair value of assets recognised by the structured entities at the time that the structured entities are established for the following reasons:
  - (a) The objective of the disclosure of assets is to provide a sense of the scale of the structured entities' operations that the reporting entity has been involved with. This might imply that the disclosures should require the cumulative amount of assets recognised by those structured entities, or possibly, for the value of the assets of the structured entities at the end of the reporting period. However the staff do not believe that asking for the cumulative amount of assets recognised by the structured entities would provide useful information—often, asset purchases of structured entities are simply to replace assets that have been paid by the counterparties to those assets (eg revolving short-term receivable securitisations such as credit card or trade receivable securitisations), or to replace assets that have been sold (eg investment vehicles
  - (b) The staff propose that a reporting entity should disclose the fair value of the assets recognised by the structured entities at the time that the structured entities are established. We believe that the reporting entity should have information about the fair value of the assets recognised by the structured entity at that time assuming that it was involved in setting up or sponsoring the structured entity. In addition, if the structured entity is not required to report using IFRS or US GAAP, simply asking

**Staff paper**

for the value of assets recognised by the structured entity may lead to inconsistent disclosures being made.

- (c) Within the derecognition project, the board has tentatively decided *not* to define a *transfer* of financial assets. Rather, the project will refer to transactions that result in derecognition or do not result in derecognition. Therefore, we believe that we should not refer to transfers of assets but rather to assets recognised by the structured entities.
5. The staff do not recommend retaining the requirement in paragraph B42 to provide the information for the current reporting period and the preceding two reporting periods. We agree with those respondents that questioned why this disclosure would be required for a specified minimum period that is different from the general requirements for comparatives, which apply to all of the other disclosure requirements relating to a reporting entity's involvement with structured entities.

## Staff paper

**Appendix B: Data availability**

6. Respondents to ED 10 held different views as to whether preparers would be able to obtain the information to meet the proposed disclosure requirements. Some respondents believed that, generally, the reporting entity would already have the information available for risk management purposes.
7. However, a majority of respondents argued that a reporting entity might not be able to provide the required information because the reporting entity does not control the structured entity and, therefore, cannot force the structured entity to provide the necessary information. Those respondents acknowledged that if, in the future, they are involved in the design of a structured entity they could contractually require the entity to provide the information required in ED10. However, they did not think that it would be feasible to modify contractual arrangements that are already in place or where the reporting entity was not involved in the design of the structured entity.
8. Many respondents compared the proposal to the current accounting requirements for associates. Those respondents argued that preparers often struggle to obtain information from associates that is required to apply the equity method and meet the disclosure requirements in IAS 28 *Investments in Associates*. For the same reasons, respondents stated that it is difficult for the auditors of a reporting entity to verify the accounting and information provided in the disclosures with respect to those entities. Therefore, they asked the IASB not to exacerbate the problem by requiring preparers to obtain information from another class of entities that they do not control.
9. Respondents acknowledged that paragraph B39 exempts a reporting entity from providing disclosures about its involvement with unconsolidated structured entities if obtaining the information that is necessary to comply with the requirements is impracticable. In that case, the reporting entity must disclose why it is impracticable to obtain the information and how it manages its risk exposure. Paragraph 7 of IAS 1 *Presentation of Financial Statements* explains that applying a requirement is impracticable when the entity cannot apply it after

**Staff paper**

making every reasonable effort to do so. Respondents argued that a reporting entity would generally not be able to meet this threshold and asked the IASB to require that a reporting entity must make its “best” efforts to obtain the information.

10. Many respondents asked the IASB to conduct field tests to better understand the practical implications of the proposed disclosures.

**Staff analysis**

11. We acknowledge that respondents to ED 10 came to different conclusions as to whether preparers could obtain the information that is necessary to comply with the proposed disclosure requirements. However, we note that Subtopic 810-10 as amended by Statement No. 167 already requires U.S. preparers to provide disclosures that are similar to those proposed in ED 10.
12. We suspect that many respondents believe that preparers might not be able to obtain the information required in the proposals because they read the proposed disclosure requirements in ED 10 as rules that would apply to the same extent to all involvements with structured entities. However, agenda paper 4C clarifies that the reporting entity must decide, in the light of its circumstances, how much detail it must provide to meet the proposed disclosure requirements.
13. We would expect that the more a reporting entity is exposed to risks from its involvement with a structured entity, the more it would have access to information about the structured entity. Therefore, we believe that where the proposals would require a reporting entity to provide detailed information about its involvement with a structured entity, that information should be available.
14. Paragraph B39 proposes that a preparer should be exempt from the proposed disclosures if it is impracticable to obtain the information required in the disclosures. If so, ED 10 proposes that a reporting entity should disclose why it is impracticable to obtain the information, and how it manages its exposure to risks from its involvement with those unconsolidated structured entities.

**Staff paper**

15. In light of the proposed changes to the disclosure requirements, we do no longer think that an impracticability exemption is needed and recommend that it be removed. In particular, we believe that removing the requirement to disclose the assets held by a structured entity and clarifying that the disclosures in paragraph B46 of ED 10 are not always required will simplify the application of the disclosure requirements.
16. We do not believe that additional field testing of the proposed disclosure requirements is necessary because Subtopic 810-10 (before the amendments in Statement No. 167) already required preparers to provide comparable disclosures.

## Staff paper

**Appendix C: Benefits and costs*****Respondents' comments to ED 10***

17. Most respondents expressed concerns about the extent of the proposed disclosure requirements for a reporting entity's risk exposure from its involvement with unconsolidated entities and argued that the IASB had not provided a thorough cost-benefit analysis for those proposals. Those respondents argued that the proposed disclosures were not cost-beneficial because they would burden users of financial statements with unnecessary detail, which would obscure rather than highlight information about a reporting entity's risk exposure.
18. At the same time, they argued that the proposals would require preparers to introduce significant changes to their reporting systems and thus impose high costs on preparers. Some respondents believed that, as a general principle, the disclosures for unconsolidated entities should not be more onerous than those for consolidated entities. Similarly, some respondents thought that the IASB should not require a reporting entity to disclose information that the unconsolidated structured entity would not need to provide in its own financial statements.
19. Some preparers argued that, in response to the proposals in ED 10, they would prefer to consolidate a structured entity rather than provide the proposed disclosures.

***Staff analysis***

20. The staff note that the objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions. The benefits derived from information should exceed the cost of providing it. The evaluation of benefits and costs is a matter of judgement. Furthermore, the costs are not necessarily borne by those who enjoy the benefits. For these reasons, it

## Staff paper

is difficult to apply a cost-benefit test in any particular case. In making its judgement, the boards must consider:

- (a) the costs incurred by preparers of financial statements;
  - (b) the costs incurred by users of financial statements when information is not available;
  - (c) the advantage that preparers have in developing information, when compared with the costs that users would incur to develop surrogate information; and
  - (d) the benefit of better economic decision-making as a result of improved financial reporting.
21. We have discussed the proposed disclosures with many users and asked them whether the proposals would assist their analysis of financial statements. All users confirmed that the new disclosures provided them with information that was not previously available to them, but which they considered to be important for a thorough understanding of a reporting entity's risk exposure.
22. Many users referred to the recent financial crisis and emphasised that a better understanding of a reporting entity's involvement with unconsolidated structured entities might have helped to identify earlier the extent of risks taken by reporting entities. Therefore, all users agreed that the new disclosures would significantly improve the quality of financial reporting and asked the boards to include the proposed disclosures about a reporting entity's risk exposure from its involvement with unconsolidated entities in the final disclosure requirements.
23. At the same time, the proposed disclosure requirements impose additional costs for preparers of financial statements. The proposed disclosures would require preparers to disclose detailed information about a reporting entity's involvement with, and risk exposure from, unconsolidated entities. This would be a change for IFRS preparers, as neither *IAS 27 Consolidated and Separate Financial Statements* nor *SIC-12 Consolidation – Special Purpose Entities* contain comparable disclosure requirements. Most preparers confirmed that the proposals would require significant changes to their management information



## Staff paper

systems. Subtopic 810-10 as amended by Statement No. 167 requires U.S. preparers to provide disclosures similar to those proposed in the current project.

24. Agenda papers 8G-8J seek to mitigate respondents' concerns about the costs borne by preparers as follows:
- (a) *Scope*: This paper proposes that a reporting entity should not be required to provide the proposed disclosure requirements for all risk exposures from unconsolidated entities. Rather, a reporting entity should only provide those disclosures if it has a material/significant involvement with an unconsolidated structured entity.
  - (b) *Judgement about the extent of disclosures*: According to agenda paper 4C, a reporting entity must decide in the light of circumstances, how much detail it provides in its disclosures. This paper applies this principle to the disclosures for unconsolidated entities by requiring a core set of mandatory disclosures, and allowing preparers' discretion in deciding to what extent additional disclosures are necessary to meet the disclosure objectives.
  - (c) *Transition guidance*: The transition guidance proposed in agenda paper 4F would not require a reporting entity to restate comparatives.
25. While we believe that those proposals will reduce compliance costs for preparers, they will not reduce those costs to zero. Therefore, the boards will need to decide as part of their overall cost-benefit assessment, whether the benefits for users of financial statements offset the costs of preparers.

## Staff paper

**Appendix D: Summary of the disclosure requirements for unconsolidated structured entities**

1. This agenda paper discusses the scope of the proposed disclosure requirements for a reporting entities involvement with unconsolidated structured entities. We seek the boards' input as to whether involvement with an unconsolidated structured entity means exposure to variability of returns of that entity. Or, whether the meaning of involvement is narrower and relates to loss exposure beyond the carrying amounts of the reporting entity's assets and liabilities that relate to the reporting entity's involvement with the structured entity, only. In addition, this agenda paper discusses whether the disclosure requirements should apply only to a reporting entity's involvement with structured entities that expose the reporting entity to significant variability of returns.
2. At their March meeting the boards agreed on the following general disclosure principle for a reporting entity's involvement with unconsolidated structured entities:

A reporting entity shall disclose information that helps users of financial statements to understand the nature of, and changes in, the risks associated with the reporting entity's involvement with other entities and how those risks affect future cash flows.
3. At that meeting, the boards tentatively decided also that a reporting entity should disclose qualitative and quantitative information about its involvement with unconsolidated structured entities, including summary information about the nature, purpose, size and activities of those structured entities, including how the structured entities are financed. Some staff recommend in this agenda paper to expand this disclosure requirement to require a reporting entity to disclose (a) income from its involvement with structured entities that it has set up or sponsored and (b) the fair value of assets recognised by those structured entities at the time that the structured entities are established.
4. In addition, we recommend in this agenda paper that a reporting entity should disclose:

**Staff paper**

- (a) the carrying amount of the assets and liabilities recognised in the reporting entity's consolidated financial statements relating to the reporting entity's involvement with structured entities;
  - (b) the line items in the consolidated statement of financial position in which those assets and liabilities are recognised;
  - (c) the amount that best represents the reporting entity's maximum exposure to loss from its involvement with structured entities, including how the maximum exposure to loss is determined. If a reporting entity cannot quantify its maximum exposure to loss from its involvement with structured entities it must disclose that fact; and
  - (d) a comparison of the carrying amount of the assets and liabilities of the reporting entity that relate to the reporting entity's involvement with unconsolidated structured entities and the reporting entity's maximum exposure to loss.
5. In March, the boards tentatively decided that a reporting entity could provide the disclosures on an aggregated basis, unless separate disclosure would provide more decision-useful information. The final disclosure requirements will contain application guidance on how the information could be aggregated.
6. We will also clarify in drafting that the specific disclosure requirements described above are minimum disclosures only and that, depending on individual facts and circumstances, additional disclosures might be needed to meet the general disclosure principle. Therefore, the final disclosure requirements will contain a list of supplemental disclosures as examples of those that might provide useful information depending on the circumstances.