Project **Consolidation**

Topic **Separate Presentation**

Purpose

1. The purpose of this memorandum is to discuss whether any or all of the elements of a consolidated entity should be permitted or required to be classified separately from other elements in a reporting entities' consolidated financial statements.

Background and Basis for Conclusions in Statement 167

2. The Statement 167 amendments to Subtopic 810-10 require that a reporting entity separately classify on the face of its balance sheet those assets of a consolidated Variable Interest Entity (VIE) that can only be used to settle obligations of the consolidated VIE, and those liabilities of a consolidated VIE for which creditors (or beneficial interest holders) do not have recourse to the general credit of the reporting entity. In its initial deliberations, the FASB considered a linked presentation model in which certain assets would be classified separately on a reporting entity's statement of financial position. Any liabilities that are funded solely from the cash flows from those assets would be reflected as a deduction from the related assets on the statement of financial position with a subtotal for a net amount.

3. The linked presentation model was initially discussed as part of the FASB's short-term project to amend FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. When the FASB added the related project to amend Interpretation 46(R), it considered

whether the scope of linked presentation should be included in the project to amend Interpretation 46(R) or expanded to other guidance about the presentation of financial and nonfinancial assets with related liabilities. The FASB decided that extending the scope of linked presentation to a much broader population of assets and liabilities, including those that are nonfinancial, would be a significant change that would be more appropriate to develop as part of the joint projects with the IASB on derecognition and financial statement presentation. In addition, the FASB decided that it would need to address significant implementation issues that could not be completed in the short term. This includes issues related to the measurement of the linked assets and liabilities and determining which assets and liabilities would be shown as linked. Consequently, the FASB decided not to pursue a linked presentation model at the time because of the short-term nature of the Statement 167 project.

4. In the Exposure Draft of Statement 167, the FASB requested that constituents comment as to whether elements of consolidated VIEs should be required to be classified separately from other elements in the reporting entity's financial statements. A number of respondents requested that separate classification of elements of consolidated VIEs be permitted but not required. Other respondents requested that separate classification of consolidated elements of a VIE be required in situations in which (a) the assets of the consolidated VIE could be used only to settle obligations of the consolidated entity and (b) the obligations of the VIE could be settled only by the assets of the consolidated entity. These respondents stated that separate presentation, combined with enhanced disclosures, would provide transparent and useful information about an reporting entity's involvement and associated risks in a VIE.

5. The FASB concluded that separate presentation should be required by a reporting entity consolidating a VIE for (a) assets of a consolidated VIE that could be used only to settle obligations of the consolidated VIE and (b) liabilities of a consolidated VIE for which creditors (or beneficial interest holders) do not have recourse to the general credit of the primary beneficiary. The FASB considered, but rejected, a single line-item display of those assets and liabilities. The FASB decided that requiring separate presentation of elements of

consolidated VIEs should be limited to the situations described in (a) and (b) above to avoid potential inconsistency and comparability issues.

Alternatives for Board Consideration

Alternative A - Require separate classification on the face of the reporting entity's balance sheet for assets of all consolidated entities that can only be used to settle obligations of consolidated entities, and for those liabilities of consolidated entities for which creditors (or beneficial interest holders) do not have recourse to the general credit of the reporting entity.

Alternative A1 - Require separate classification on the face of the reporting entity's balance sheet for assets of consolidated <u>structured</u> entities that can only be used to settle obligations of the consolidated <u>structured</u> entities, and for those liabilities of consolidated <u>structured</u> entities for which creditors (or beneficial interest holders) do not have recourse to the general credit of the reporting entity. **[Similar to the requirements in the Statement 167 amendments to Topic 810]**

Alternative B – Require separate classification on the face of the reporting entity's balance sheet for **financial** assets of consolidated entities that can only be used to settle obligations of the consolidated entity.

Alternative C - Permit, but do not require, separate classification of all elements of consolidated entities on the face of the reporting entity's financial statements.

Alternative D – Provide no guidance relating to separate presentation.

Staff Recommendation and Analysis

6. The FASB staff has received positive feedback from constituents that the separate presentation requirements in Statement 167 will result in a clearer understanding of the assets and liabilities of VIEs that are required to be consolidated under Statement 167. However, implementation questions have

been raised related to the separate presentation requirements and the objective for these requirements.

7. With regards to the separate presentation of a VIE's liabilities, some constituents have questioned whether the requirement results in most of the obligations of VIEs to be presented separately. Their concern is that unless recourse is specifically provided (either contractually or legally) by the reporting entity, the creditors of the VIE do not have recourse to the general credit of the reporting entity. Creditors or other parties that transact with a subsidiary will generally be unable to pierce the corporate veil of the VIE and therefore would not have recourse to the assets of other entities within the reporting entity. Accordingly under the Statement 167 requirements these obligations would be required to be disclosed separately.

8. In addition, some constituents have questioned whether the separate presentation requirements in Statement 167 should be applied to non financial assets owned by a VIE. These constituents are concerned that if an operating company is considered a VIE, it may be required to present certain assets separately on the face of their financial statements which would not be separately disclosed if the operating entity was not considered a VIE. For example, a building held by a consolidated operating entity that is considered a VIE would likely require separate presentation if a lien is attached to that property, as the proceeds from the sale of the building would first need to be used to repay the outstanding balance on the lien.

9. Staff that support Alternative A1 believe that separate presentation of the assets and liabilities within consolidated structured entities provides additional useful information to users of the financial statements. These staff believe that by requiring separate presentation of such elements rather than allowing this presentation provides users with meaningful information and promotes consistency in financial reporting. These staff also believe that this requirement was developed in response to the requests of users and preparers related to the presentation of assets and liabilities of structures that are consolidated as part of the Statement 167 project. Accordingly, the recommendation is consistent with the presentation requirements that are already in Statement 167.

10. These staff do note that if the boards were to determine that there should no longer be a delineation between structured entities and those entities controlled by vote for disclosure and presentation purposes, this requirement could result in excessive presentation on the face of the financial statements and would increase the complexity for users. Accordingly, they recommend that this presentation requirement is retained only for structured entities.

11. Other staff support view B which would restrict the requirement to separately disclose consolidated assets to financial assets. These staff believe that there is benefit in requiring the separate presentation of financial assets within a consolidated entity that are restricted to pay off the liabilities of a particular entity. This would provide additional information on the group's liquidity and would provide additional information in those circumstances in which the consolidated entity holds assets in typically riskier structures, such as CDOs, that can only be used to settle the obligations of that entity. The staff supporting view B do not believe that there should be a requirement to separately present liabilities of a consolidated entity.

12. Some staff believe prescribing any requirement is unnecessary and will result in minimal additional benefit for users of the financial statements. Under IFRS and U.S. GAAP, separate presentation is already permitted when a reporting entity concludes that such presentation would be beneficial to users of financial statements. These staff believe separate presentation is only useful to users of the financial statements when it reduces the ambiguity in a reporting entity's financial statements. If the separate presentation requirements were optional, a reporting entity will have the ability to present separately when the reporting entity believes the separate presentation will increase the understandibility of assets and liabilities of the consolidated entity.

Comparison with Other Authoritative Literature

13. The staff notes that there are currently other existing U.S. GAAP requirements related to separate classification of elements. Topic 944, *Financial Services—Insurance* requires that separate account assets and liabilities shall be reported as summary totals in the financial statements of insurance enterprises. In addition,

paragraph 860-30-45-1 of the Codification, states when accounting for noncash collateral provided by a transferee:

> If the secured party (transferee) has the right by contract or custom to sell or repledge the collateral, then the obligor (transferor) shall reclassify that asset and report that asset in its statement of financial position separately (for example, as security pledged to creditors) from other assets not so encumbered.

14. The staff acknowledges that separate accounts of life insurance entities are outside the scope of the VIE Subsection of Subtopic 810-10. However, the preceding examples illustrate the fact that requiring or allowing separate classification of elements, whether on the face of the financial statements or in disclosures, is not a new concept, and is not inconsistent with existing U.S. GAAP requirements in certain situations.

Question 1

The staff proposes the following alternatives:

Alternative A - Require separate classification on the face of the reporting entity's balance sheet for assets of all consolidated entities that can only be used to settle obligations of consolidated entities, and for those liabilities of consolidated entities for which creditors (or beneficial interest holders) do not have recourse to the general credit of the reporting entity.

Alternative A1 - Require separate classification on the face of the reporting entity's balance sheet for assets of consolidated <u>structured</u> entities that can only be used to settle obligations of the consolidated <u>structured</u> entities, and for those liabilities of consolidated <u>structured</u> entities for which creditors (or beneficial interest holders) do not have recourse to the general credit of the reporting entity. Some staff support this alternative.

Alternative B – Require separate classification on the face of the reporting entity's balance sheet for financial assets of consolidated entities that can only be used to settle obligations of the consolidated entity. Some staff support this alternative.

Alternative C - Permit, but do not require, separate classification of all elements of consolidated entities on the face of the reporting entity's financial statements.

Alternative D – Provide no guidance relating to separate presentation. Some staff support this alternative.

Which of these alternatives do the boards support?