



Project **Consolidation**

Topic **Disclosures—Implicit obligations to provide support**

Introduction

1. The purpose of this paper is to discuss whether or not a reporting entity should be required to disclose:
 - (a) the support is has provided to a structured entity when there was no legal or contractual obligation to do so, and
 - (b) its exposure to losses through implicit obligations to provide support.
2. This agenda paper discusses:
 - (a) the disclosure requirements addressing implicit obligations to provide support in Subtopic 810-10 as amended by Statement 167 and ED 10 *Consolidated Financial Statements*;
 - (b) the responses to ED10; and
 - (c) the staff analysis and recommendation.

Background

3. ED 10 does not specifically address implicit obligations or reputational risk within the proposed requirements to assess when a reporting entity controls another entity. Subtopic 810-10 also does not include any requirements that focus on reputational risk; however, Subtopic 810-10 does require an entity to consider its implicit financial responsibility to ensure that a variable interest entity (VIE) operates as designed when evaluating its consolidation decision.

This paper has been prepared by the technical staff of the IASCF for discussion at a public meeting of the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IASB.

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Both Subtopic 810-10 and ED10 include disclosure requirements related to implicit obligations.

Subtopic 810-10 disclosure requirements

4. Subtopic 810-10 contains the following disclosure requirements which address implicit obligations of the reporting entity.

810-10-50-3(d) Terms of arrangements, giving consideration to both explicit arrangements and implicit variable interests that could require the reporting entity to provide financial support (for example, liquidity arrangements and obligations to purchase assets) to the VIE, including events or circumstances that could expose the reporting entity to a loss.

810-10-50-5A(c) Whether the reporting entity has provided financial or other support (explicitly or implicitly) during the periods presented to the VIE that it was not previously contractually required to provide or whether the reporting entity intends to provide that support, including both of the following:

- (1) The type and amount of support, including situations in which the reporting entity assisted the VIE in obtaining another type of support
- (2) The primary reasons for providing the support.

Proposed requirements in ED10

5. Reputational risk is discussed in the Basis for Conclusions of ED 10:

BC 36. Reputational risk refers to a reporting entity's implicit commitment to provide support to unconsolidated structured entities without having a contractual or constructive obligation to do so. Some financial institutions have recently acquired financial interests in structured entities to provide funding that those entities could not obtain from third parties because of the lack of liquidity in the market. Those financial institutions had previously acted as sponsors when structuring those entities. They stated that there was no legal obligation for them to acquire the financial interests.

BC 37. Some asked the Board to consider whether reputational risk might be a basis for consolidation. The Board observed that before those transactions the financial institutions that were exposed to reputational risk did not control those structured entities. The Board concluded that the consolidation of structured entities on the basis of reputational risk is inconsistent with the controlling entity model.

BC 38. The Board investigated also whether it should use reputational risk as a separate basis for consolidation in addition to control. However, the Board was concerned about the structuring opportunities that two bases for consolidation would create. The Board concluded that reputational risk is not a sufficient basis for consolidation because it reflects only management's intentions. Instead, the Board decided to propose that an entity disclose the fact that it has provided

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support to unconsolidated structured entities without having a contractual or constructive obligation to do so.

6. Paragraph B47 of ED10 proposes:

If during the reporting period, a reporting entity has, without having a contractual or constructive obligation to do so, provided support to structured entities that were not consolidated at the time of providing the support, it shall disclose:

- (a) the extent of support provided, including its nature and amount, including situations in which the reporting entity assisted the structured entity in obtaining another type of support, or in which there are current intentions to do so;
- (b) an explanation of why the support was provided;
- (c) an explanation of how the provision of the support resulted in the reporting entity controlling the structured entity, if applicable.

7. Additionally, paragraph B46 proposes:

...a reporting entity shall disclose other information that is relevant to an assessment of the risks to which the reporting entity is exposed. That other information might include any of the following:

...

(e) In relation to support that has been provided by a reporting entity to structured entities during the reporting period whether:

- (i) the reporting entity purchased any debt or equity interests in structured entities, and whether any agreement required the reporting entity to make these purchases.
- (ii) other assistance was provided to structured entities in obtaining any other type of support.
- (iii) there are any current intentions to provide support or other assistance to structured entities in obtaining any other type of support.

Response to ED10

8. The Invitation to Comment asked constituents if the proposed disclosures in paragraph B47 are sufficient. A majority of the respondents that commented on this question agreed with the proposed disclosures in paragraph B47 of ED10. Respondents generally thought that a reporting entity should disclose in the notes to the financial statements when implicit support has been provided to an unconsolidated structured entity.

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...We see that an entity's past actions may be an important factor in considering the substance of the relationship between the reporting entity and the subject [structured] entity. (CL 50)

9. Other respondents also supported this disclosure as an important part of the requirement to consider all facts and circumstances when evaluating control of an entity.
10. Respondents were not supportive of the requirement to disclose any current intentions to provide support to a structured entity that was not consolidated. Those respondents thought that it was unlikely, if not impossible, that a reporting entity would be able to disclose this information as it would be difficult to make an assessment about possible future support to be provided to an unconsolidated entity and for which there is no legal obligation to do so.
11. Respondents also questioned the use of the term 'support' without providing a definition. Respondents noted that support can be in many different forms, eg cash, services, contribution of equity, etc. Those respondents also questioned how a voluntary provision of support could be distinguished from a normal business transaction to invest or provide funding to an entity that results from a commercial/economic decision.
12. In addition, respondents commented that the duplication between the disclosures in paragraphs B46(e)(i)-(iii) and B47 was confusing. The disclosures required in paragraph B47 appeared to duplicate the disclosures listed in B46(e)(i)-(iii).

Staff Analysis and recommendations

Current intentions

View 1

13. Some staff agree with respondents comments to not require a reporting entity to disclose current intentions to provide support in the future to a structured entity. They believe that to ask a reporting entity to make disclosures about non-

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contractual intentions to provide future support would potentially be burdensome for preparers and is unlikely to provide any useful information to users—either a) a reporting entity will be unlikely to disclose non-contractual intentions about the future, or b) boilerplate language will develop.

14. In fact, paragraph BC145 of ED 10 states ‘The Board observed that the legal implications of a forward-looking disclosure about reputational risk might cause many reporting entities to provide only rather general statements about reputational risk. The Board did not think that such disclosure would provide benefit to users of financial statements’.

View 2

15. Other staff believe that the requirements currently in ASC Topic 810-10-50-5A(c) and ED 10 that requires a reporting entity to disclose if it intends to provide any financial or other support should be retained. These staff agree that forward-looking disclosures about a decision that may occur in the future would be unreasonable; however, they believe that if a reporting entity has decided that it intends to provide support, this should be disclosed. The staff opposed to this view believe that until an entity has communicated their intention, it is still subject to change. Accordingly, they believe that requiring the reporting entity to make this disclose may create a legal obligation.

Support

16. The staff agree that ‘support’ can have different meanings, but propose that the boards do not define the term. The staff is concerned that a definition of support would either be so broad that it would be an ineffective definition or would invite structuring so to avoid this disclosure. The staff believe that support is widely understood as a provision of resources to another entity, either directly or indirectly. In the case of implicit arrangements, the support is provided without having the contractual or constructive obligation to do so.
17. The Basis for Conclusions of Statement No. 167, in paragraph A88, states that an implicit arrangement is consistent with the definition of an implicit variable

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interest as defined in FASB Staff Position No. FIN 46(R)-5. Paragraph 810-10-25-51 of the Accounting Standards Codification states that an implicit variable interest is an implied pecuniary interest in an entity that changes with the changes in the fair value of the entity's net assets exclusive of variable interests. One example given is an implicit agreement to replace impaired assets held by a variable interest entity that protects holders of other interests in the entity from suffering losses. Although this is only one example of many, the staff thinks that this highlights the intention of what was meant when using the term 'support' in ED10. Generally, a financial commitment made when there is no contractual or constructive obligation to do so is made to ensure that the entity continues to operate as designed.

Duplication between B46(e)(i)-(iii) and B47

18. The staff agree with respondents that the duplication between the disclosures in paragraphs B46(e)(i)-(iii) and B47 of ED10 was confusing. The disclosures listed in paragraph B46 of the ED are not mandatory requirements. Therefore, to address this issue, the staff recommends removing the non-mandatory disclosures proposed in B46(e)(i)-(iii) and retaining the disclosure requirements proposed in B47 in the final standard.

Proposed disclosures

19. The staff recommends that the disclosure requirements proposed below apply to a reporting entity that is involved with any structured entity (including those that are consolidated). This is consistent with US GAAP and users have confirmed that such a disclosure requirement provides useful information. This would be a change for ED 10 which proposed this requirement for unconsolidated structured entities only.
20. The staff supporting view 1 recommends including the following disclosure requirement in the final standard:

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If during the reporting period, a reporting entity has, without having a contractual or constructive obligation to do so, provided support to structured entities, to ensure that the structured entity continues to operate as designed, it shall disclose:

- (a) The type and amount of support provided, including situations in which the reporting entity assisted the structured entity in obtaining another type of support;
- (b) An explanation of why the support was provided; and
- (c) An explanation of how the provision of support resulted in the reporting entity controlling the structured entity, if applicable.

21. The staff supporting view 2 would amend the requirements proposed in paragraph 20 of this memo to include a requirement that disclosure would be provided for situations in which the reporting entity has the intention to provide support.

Questions for the boards

1. Do the boards agree with the staff recommendation to require disclosure of support provided by a reporting entity to structured entities to ensure that the structured entities continue to operate as designed?
2. Do the boards believe that information about a reporting entity's current intentions to provide non-contractual support in the future should be disclosed?