

AN ALERT FROM BDO'S NATIONAL ASSURANCE PRACTICE

BDO KNOWS: PCC



► SUBJECT

FASB ENDORSES PCC EXEMPTION FOR CERTAIN VIEs

► SUMMARY

On February 19, 2014, the FASB endorsed a PCC proposal to allow private companies to opt out of applying the variable interest entity (VIE) consolidation guidance to certain common control leasing arrangements. Therefore, a private company lessee that meets the eligibility criteria and elects not to apply the VIE guidance would account for its lease under Topic 840 as either an operating or capital lease, as appropriate. Certain incremental disclosures would also be required. A final ASU has not been issued, but is anticipated in late March. The FASB has indicated that upon issuance of the ASU, early adoption will be available for 2013 year-end financial statements that are not yet available for issuance.

► BACKGROUND AND MAIN PROVISIONS

It is common for a private operating company to enter into a lease with a sister company (i.e., the lessor) for the use of the lessor's property, such as a manufacturing facility or a retail location. This situation frequently results in the operating company consolidating the lessor entity under the VIE consolidation guidance in Topic 810.

Based on its outreach and deliberations, the PCC concluded private companies should be permitted not to apply the VIE consolidation guidance in U.S. GAAP when all of the following conditions are met:

- a. The private company lessee and the lessor entity are under common control
- b. The private company lessee has a leasing arrangement with the lessor entity
- c. Substantially all of the activity between the two entities is related to the leasing activity of the lessor entity to the private company lessee

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- d. Any obligation of the lessor that is being guaranteed or collateralized by the private company lessee could, at inception of the obligation, be sufficiently collateralized by the asset(s) leased to the private company.

As part of endorsing the PCC's proposal, the FASB directed its staff to clarify how private companies would assess the notion of "sufficiently collateralized" under criterion (d.). Since the Board envisioned possible challenges in practice, it concluded certain drafting improvements on this point were necessary in the final ASU. As such, the final authoritative language is not yet available and private companies considering the effect of this new option are encouraged to review the ASU when it is posted to the FASB's website, which is expected in late March.

Private companies making the election would be required to disclose the amount and terms of significant liabilities recognized by the lessor that create financial exposure for the private company as well as significant arrangements that are not recognized, but nonetheless expose the private company to providing financial support to the lessor. These disclosures would replace the VIE disclosures that otherwise apply and supplement other applicable disclosures that remain in effect, such as those for related party transactions.

At the same meeting, the FASB decided to remove the example related to implicit variable interests from the Codification.¹ This will not remove the requirement to identify implicit variable interests and analyze them under Topic 810; it simply deletes the example because it was commonly associated with the related party leasing arrangements described above.

For additional information, see the FASB's [Tentative Board Decisions](#) for the February 19 meeting and the PCC's [Decision Overview](#). See our recent [Financial Reporting Newsletter](#) for the definition of a "private company" as well as additional considerations related to adopting one or more PCC alternatives.

¹Paragraphs 810-10-55-87 through 55-89