



## FASB Issues Private Company Exemption from Consolidation of Certain Variable Interest Entities

The FASB and Private Company Council (PCC) recently issued guidance that gives private company lessees the option to not apply the variable interest entity (VIE) consolidation guidance to some lessor entities.<sup>1</sup>

All entities other than public business entities, not-for-profit entities, and certain employee benefit plans, can elect the exemption but must do so for all qualifying leasing arrangements.<sup>2</sup>

### Key Facts

- Private company lessees can elect not to apply the VIE consolidation guidance to lessors under common control if certain conditions are met.
- Private companies electing the exemption need to disclose circumstances under which they may provide financial support to the lessor entity.
- The guidance is effective for annual periods beginning after December 15, 2014, and interim periods within annual periods beginning after December 15, 2015. Early adoption is allowed and retrospective application is required.

### Key Impacts

- More private company lessees may account for common control leasing arrangements off-balance sheet.
- Early adoption allows private company lessees to apply the exemption to financial statements that have not yet been made available for issuance, including December 31, 2013, financial statements that have not yet been made available for issuance.

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<sup>1</sup> FASB Accounting Standards Update No. 2014-07, Applying Variable Interest Entities Guidance to Common Control Leasing Arrangements, available at [www.fasb.org](http://www.fasb.org).

<sup>2</sup> Employee benefit plans within the scope of FASB ASC Topics 960 through 965 cannot apply the exemption. FASB ASC Topic 960, Plan Accounting—Defined Benefit Pension Plans; FASB ASC Topic 962, Plan Accounting—Defined Contribution Pension Plans; and FASB ASC Topic 965, Plan Accounting—Health and Welfare Benefit Plans, all available at [www.fasb.org](http://www.fasb.org). For information on the FASB's definition of a public business entity, see KPMG's Defining Issues No. 14-7, FASB Issues New Private Company Guidance, available at [www.kpmginstitutes.com/financial-reporting-network](http://www.kpmginstitutes.com/financial-reporting-network).

## Why Revisit the Accounting for Common Control Leasing Arrangements?

Under current U.S. GAAP, a lessee reporting entity generally must evaluate whether the lessor entity is a VIE that the lessee must consolidate. Entities that lease assets from a lessor under common control with the entity are more likely to consolidate those lessors under the VIE guidance because the entity may have an implicit variable interest in the lessor as a result of the lease based on an example in the FASB's consolidation guidance.<sup>3</sup>

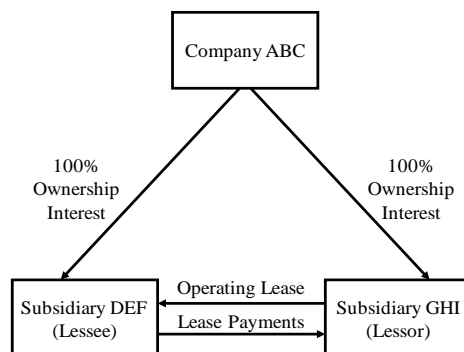
The PCC and FASB received input from private company stakeholders that the costs of applying the VIE consolidation guidance to common control leasing arrangements outweigh the benefits. Stakeholders indicated that private companies may establish common-control lessor entities for tax, estate-planning, and legal-liability purposes rather than to obtain off-balance sheet financing. Some constituents also indicated that consolidation by a lessee of a lessor entity under common control (1) is not relevant because users focus on the cash flows and tangible worth of the standalone lessee entity without regard to the lessor entity, and (2) distorts the financial statements of the lessee because the lessor's assets are generally not available to satisfy the lessee's obligations.

## How Do I Qualify for the Exemption?

A private company lessee can elect not to apply the VIE consolidation guidance if all of the following conditions are met:

- (A) The private company and lessor entity are under common control;
- (B) The private company has a lease arrangement with the lessor;
- (C) Substantially all of the activities between the two entities are related to (or in support of) leasing activities between those two entities; and
- (D) The principal amount of any lessor obligation related to the leased asset for which the private company provides an explicit guarantee or collateral does not exceed the value of the leased asset *at inception of such guarantee*.

The following depicts a common control leasing arrangement.



<sup>3</sup> FASB ASC paragraphs 810-10-25-48 through 25-54 related to the guidance and 55-87 through 55-89 related to the example, available at [www.fasb.org](http://www.fasb.org).

## What Else Should I Be Thinking About?

**Evaluating Common Control.** To apply the exemption, a private company lessee and lessor must be under common control. While common control is used in other areas of U.S. GAAP (e.g., business combinations), it is not defined. The PCC and FASB decided not to define it in the ASU, but they did indicate they believe common control may exist (for purposes of applying this exemption) in more situations than those cited by the SEC staff in its remarks on EITF Issue No. 02-5 (for which no final consensus was reached).<sup>4</sup>

**Activities between Private Company and Lessor.** Applying the exemption also requires that substantially all activities between the private company and lessor must be related to, or supporting, their leasing activities. This criterion allows a private company lessee to apply the alternative even if the lessor entity conducts activities other than leasing to the private company as long as those activities are unrelated to the private company lessee. The following example activities were provided as implementation guidance.

Activity	Related to Leasing Activities?
A guarantee or collateral provided by the private company to the lender of a lessor for debt that is secured by the asset(s) leased by the private company	Yes
A joint and several liability arrangement for debt of the lessor, for which the private company is one of the obligors, that is secured by the asset(s) leased by the private company	Yes
Paying property taxes, negotiating the financing, and maintaining the asset(s) leased by the private company	Yes
Paying income taxes of the lessor when the only asset it owns is being leased either by only the private company or by both the private company and an unrelated party	Yes
Paying income taxes of the lessor on income generated by an asset that is not being leased by the private company	No
Purchase commitment (other than for the acquisition, or the support, of the leased asset)	No

<sup>4</sup> The SEC staff indicated in its observations on EITF Issue No. 02-5, Definition of “Common Control” in Relation to FASB Statement No. 141, that common control exists between (or among) separate entities only in the following situations:

- (a) An individual or enterprise holds more than 50 percent of the voting ownership interest of each entity.
- (b) Immediate family members hold more than 50 percent of the voting ownership interest of each entity (with no evidence that those family members will vote their shares in any way other than in concert).
- (c) A group of shareholders holds more than 50 percent of the voting ownership interest of each entity, and contemporaneous written evidence of an agreement to vote a majority of the entities’ shares in concert exists.

**Guarantees.** If a private company explicitly guarantees (or provides collateral for) any obligation of the lessor related to the asset it leases, the principal amount of the obligation at inception cannot exceed the value of the leased asset. This condition was added to the final ASU to mitigate off-balance sheet structuring opportunities. The private company lessee assesses this condition at inception and only needs to reassess it if the lessor entity subsequently refinances or enters into any new obligations that require collateralization and/or a guarantee by the private company.

**Disclosures.** If a private company applies the exemption, it considers both explicit and implicit guarantees when providing the following required disclosures:

- Amount and key terms of liabilities recognized by the lessor that expose the private company to providing financial support to the lessor; and
- A qualitative description of circumstances (e.g., certain commitments and contingencies) not recognized in the financial statements of the lessor that expose the private company to providing financial support to the lessor.

The determination of whether an implicit guarantee exists is based on facts and circumstances.

**Transition and Effective Date.** Private company lessees electing the exemption must apply it retrospectively for annual periods beginning after December 15, 2014, and interim periods within annual periods beginning after December 15, 2015. Permitted early adoption allows private company lessees to apply the exemption to financial statements that have not yet been made available for issuance, including December 31, 2013, financial statements that have not yet been made available for issuance.

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**Earlier editions are available at:** <http://www.kpmginstitutes.com/financial-reporting-network>

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