FASB Emerging Issues Task Force

Issue No. 12-D

Title: Accounting for Joint and Several Liability for which the Total Amount of the Obligation at the Reporting Date Is Fixed

Document: Issue Summary No. 1, Supplement No. 1*

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Background

1. The objective of this Issue is to address diversity in practice in how entities recognize and measure obligations with joint and several liability. Some entities are recording the entire amount of the obligation and some entities are recording less than the total amount of the obligation, such as an amount allocated, an amount corresponding to proceeds received, or the amount expected to be paid.

2. Refer to Issue Summary No. 1 for additional background information regarding the Issue. To summarize, the recognition and measurement approaches are:

   a. View A: Apply the contingencies guidance (Topic 450)
   b. View B: Apply the guarantees guidance (Topic 460)
   c. View C: Record entire amount of the obligation.

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* **The alternative views presented in this Issue Summary Supplement are for purposes of discussion by the EITF. No individual views are to be presumed to be acceptable or unacceptable applications of Generally Accepted Accounting Principles until the Task Force makes such a determination, exposes it for public comment, and it is ratified by the Board.**

3. The Issue was discussed at the March 15, 2012 EITF meeting, and the Task Force requested that the FASB staff perform outreach on several matters before reaching a consensus for exposure.

4. Since the Task Force did not reach a consensus for exposure, the accounting issues included in this Issue Supplement are consistent with those included in Issue Summary No. 1. However, some of the FASB staff's analysis has been revised to reflect the information obtained during the outreach.

Outreach Summary

5. The FASB staff performed additional outreach with public and non-public financial statement users, preparers, and auditors on the scope of the Issue and the recognition and measurement approaches. The staff also performed outreach with an attorney to enhance its understanding of arrangements that involve joint and several liability.

6. The feedback from both public and non-public financial statement users was:

   a. With respect to the scope of the Issue, users did not express any preference.
   b. With respect to the recognition and measurement approaches, users made the following observations:
      i. Comprehensive disclosure of obligations with joint and several liability is the most important consideration for this Issue because no recognition and measurement approach alone could provide users with adequate information to make an informed decision given the inherent uncertainties associated with accounting for such obligations.
      ii. No user supported recognizing the entire amount of the obligation in all circumstances (View C). They believe that measurement of joint and several obligations should be consistent with the amount the entity expects it will pay.
      iii. A majority of users supported the expected payments approach (View A), but others supported the guarantee accounting approach (View B). Users

who supported View A believe that in many cases, the measurement of the obligation under Views A and B would result in a similar liability amount, and indicated that the additional amount under View B (the fair value of the stand ready obligation) may not provide useful information and may be difficult to understand.

7. The feedback from both public and non-public preparers was:
   a. With respect to the scope of the Issue, preparers did not express any preferences, except they thought private companies should be included in the scope of the Issue.
   b. With respect to the recognition and measurement approaches, preparers made the following observations:
      i. No preparer supported View C. They did not believe the liability recognized under this approach would provide useful information to users because it would not reflect the probable future use of assets necessary to satisfy the obligation. In addition, they stated that the usefulness of an entity's balance sheet (and possibly income statement) may be substantially reduced in circumstances in which many entities were subject to the obligation and each had a balance sheet that was relatively small compared to the total amount of the obligation (for example, the entire amount of the obligation could be many multiples of an individual entity's total assets).
      ii. All preparers supported View A because they believe that the balance sheet should reflect the obligations that the entity expects to pay. Many preparers' experiences with joint and several obligations were limited to entities under common control. Consequently, they did not have a strong preference between Views A and B because the measurement of the obligation would be the same under both of those approaches for entities under common control.
      iii. Many preparers expressed concern about the complexities and costs associated with measuring the fair value of the stand ready obligation

under View B. They stated that the level of estimate required to measure the fair value of the stand ready obligation for joint and several liability may cause comparability issues among entities, and they questioned whether the costs of the approach would outweigh the benefits to financial statement users. Prepares did not express any concerns about applying View A.

8. The feedback from both public and non-public auditors was:
   a. With respect to the scope of the Issue, auditors did not have a consistent view on the type of entity that should be included in the scope. Some auditors thought the scope should include all entities because they did not think there was a conceptual basis for limiting the scope. Other auditors suggested the recognition and measurement approach selected might influence their opinion on the scope. Several auditors observed that if the scope excluded unrelated parties, then these entities might apply the recognition and measurement approach from a consensus on this Issue by analogy because there is no U.S. GAAP that directly addresses accounting for obligations with joint and several liability among unrelated parties. The auditors thought private companies should be included in the scope of the Issue. The auditors did not express any concerns about the type of obligation included in the scope of the Issue if the Task Force reached a consensus on Views A or B, but stated that the Task Force should reconsider the types of obligations included in the scope of the Issue if a consensus is reached in View C.
   b. With respect to the recognition and measurement approaches, the auditors made the following observations:
      i. No auditor supported View C for reasons similar to users and preparers.
      ii. Several auditors thought View B might be more supportable conceptually than View A. They observed that a guarantee and joint and several liability are economically similar; therefore, they thought it was preferable for the accounting approaches to be similar. However, they recognized that there might be complexities and costs associated with estimating the stand ready obligation under View B for joint and several obligations

involving related parties. They also were concerned about the offsetting entry under View B, particularly for the obligation to stand ready to perform.

iii. Given the practical concerns of preparers and the views of users on View B, some auditors indicated support for View A.

9. The information obtained through the outreach performed by the FASB staff is included in the analysis of the scope and recognition and measurement approaches discussed below.

Scope

10. This Issue applies to entities that are jointly and severally liable with other entities *under common control or related parties*, in which the total amount of the obligation at the reporting date is fixed, except for obligations that are accounted for under the following Codification Topics:

a. Topic 410, Asset Retirement and Environmental Obligations
b. Topic 450, Contingencies
c. Topic 460, Guarantees
d. Topic 715, Compensation–Retirement Benefits
e. Topic 740, Income Taxes.

11. Examples of obligations included in the scope of this Issue are debt arrangements, other contractual obligations for which the total amount at the reporting date is fixed, and settled litigation and judicial rulings.

12. The FASB staff previously formed a working group to evaluate the scope of the Issue. Refer to Appendix 12-DA of Issue Summary No. 1 for a report on the working group's discussion and analysis of the proposed scope.

13. With respect to the type of obligation included in the scope of the Issue, the working group generally thought the Issue should include all obligations with joint and several liability unless existing U.S. GAAP already addressed the accounting and there were no substantive practice

issues. The FASB staff continues to agree with that view based on feedback received during outreach. With respect to the type of entity included in the scope of the Issue, the working group generally thought the Issue should include all types of entities. Their rationale was that all types of entities can have obligations with joint and several liability, and they could not identify a conceptual basis for limiting the scope of this Issue to certain types of entities. Based on discussion at the March 15, 2012 EITF meeting and the additional outreach performed, the staff currently recommends limiting the scope of the Issue to obligations with joint and several liability among entities under common control or related parties because it would address the practice issues that have come to the staff's attention. In addition, the staff was not able to identify actual fact patterns in which unrelated parties had a joint and several obligation.

14. The FASB staff recommends that if the Task Force reaches a consensus-for-exposure on this Issue, the proposed Update include a question in the notice to recipients on the scope of this Issue, including whether this Issue should be applicable to unrelated parties.

Accounting Issue and Alternatives

How a reporting entity that is jointly and severally liable should account for an obligation whose total amount is fixed at the reporting date.

View A: Each reporting entity in the scope of this Issue that is jointly and severally liable should treat the obligation as a contingent liability and apply the loss contingency guidance in Subtopic 450-20, recording a liability when it is probable that the entity will be required to pay an amount and that amount can be reasonably estimated. The offsetting entry for any liability recognized will depend on the facts and circumstances (that is, cash, expense, receivable that is assessed for impairment, equity transaction, and/or another account).

15. Proponents of View A believe that each reporting entity is obligated only for the portion of the obligation that it is expected to pay. They look to the definition of a liability under FASB Concepts Statement No. 6, *Elements of Financial Statements*, which states that a liability has the following three essential characteristics:

> (a) it embodies a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, (b) the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and (c) the transaction or other event obligating the entity has already happened.

16. Proponents of View A believe that in order to meet the definition of a liability, there must be a present duty that entails a reasonable expectation of future transfer or use of assets at a specified or determinable date and that only the portion of the obligation that a reporting entity expects to pay meets that definition. They view this recognition and measurement approach as being consistent with the environmental obligations guidance in Subtopic 410-30. Paragraph 410-30-30-7 states:

> An entity should assess the likelihood that each potentially responsible party will pay its allocable share of the joint and several remediation liability. That assessment should be based primarily on the financial condition of the participating potentially responsible party. This assessment requires the entity to gain an understanding of the financial condition of the other participating potentially responsible parties and to update and monitor this information as the remediation progresses. The entity shall include in its liability its share of amounts related to the site that will not be paid by other potentially responsible parties or the government.

17. Proponents of View A believe that the portion of the obligation expected to be paid by other parties under the arrangement represents a contingent liability under Subtopic 450-20 and should be recorded only when it is probable that the entity will have to perform and the amount can be reasonably estimated. They look to the definition of a contingent liability under Subtopic 450-20 for the portion of the liability expected to be satisfied by others. Section 450-20-20 defines a loss contingency as:

> An existing condition, situation, or set of circumstances involving uncertainty as to possible loss to an entity that will ultimately be resolved when one or more future events occur or fail to occur. The term loss is used for convenience to include many charges against income that are commonly referred to as expenses and others that are commonly referred to as losses.

18. Proponents of View A believe that uncertainty exists about whether a reporting entity will have to perform for a portion of the obligation under joint and several liability. In many cases, the parties to the arrangement have sufficient collateral for their allocated portion of the obligation. While not within U.S. GAAP, proponents of this view also point to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets.* They note that IFRS has a similar definition of a liability in its conceptual framework, and, therefore, they think IAS 37 may be informative in considering the accounting under U.S. GAAP. Paragraph 29 of IAS 37 states:

> Where an entity is jointly and severally liable for an obligation, the part of the obligation that is expected to be met by other parties is treated as a contingent liability. The entity recognizes a provision for the part of the obligation for which an outflow of resources embodying economic benefits is probable, except in the extremely rare circumstances where no reliable estimate can be made.

19. Proponents of View A also believe that, in many cases, the unallocated portion of the obligation may meet the reasonably possible threshold in Subtopic 450-20 and additional disclosures may provide the most decision-useful information. They believe that the disclosures required under Section 850-10-50, Related Party Disclosures—Overall—Disclosure, should be provided for the arrangement, if the arrangement is with a related party.

20. Proponents of View A believe it is responsive to the needs of financial statement users as described above. In addition, they support View A because they believe that there are complexities and costs associated with the measurement of the stand ready obligation under View B that do not exist under View A.

21. Opponents of View A note that Subtopic 410-30, which addresses accounting for environmental remediation contingencies, is an interpretation of the contingency guidance in Subtopic 450-20, and, therefore, this guidance is not applicable to joint and several liability because there are no contingencies involved like there are for an environmental remediation liability. Opponents of View A also believe that when an arrangement is entered into voluntarily in a binding legal contract, it is not a contingent obligation and analogy to Subtopic 450-20 is not appropriate.

22. Some opponents of View A believe that the accounting for obligations with joint and several liability should be similar to the accounting for guarantees because the arrangements are often economically similar.

View B: Each reporting entity that is jointly and severally liable should treat the obligation as a guarantee and apply the guidance in Topic 460. The offsetting entry for any liability recognized will depend on the facts and circumstances (that is, cash, expense, receivable that is assessed for impairment, debt discount, equity transaction, and/or another account). Note that guarantees between parents and their subsidiaries or between entities under common control are excluded from the initial recognition and measurement requirements of Topic 460, but they are subject to the subsequent measurement and disclosure requirements.

23. Under View B, an entity would recognize what it expects to pay (consistent with View A), plus a stand ready obligation for the amount the other parties are expected to pay (unless the entity is under common control).

24. Proponents of View B believe that from an economic perspective, a joint and several liability is similar to a guarantee and should be treated as such for accounting purposes. Both guarantees and joint and several liabilities are subject to the right of contribution. Subtopic 460-10, Guarantees—Overall, provides recognition, measurement, and disclosure guidance for guarantees.

25. Opponents of View B do not believe that a guarantee is equivalent to being jointly and severally liable for accounting purposes because Topic 460 does not contemplate the notion of a joint and several liability. Further, they believe that treatment as such would imply that the other parties are only secondarily liable when the obligation meets the definition of a liability for the reporting entity.

26. Some opponents of View B also believe that the measurement of the stand ready obligation as required by Subtopic 460-10 may be more challenging because there may be significantly more parties involved in a joint and several arrangement than a guarantee.

View C: Each reporting entity that is jointly and severally liable should record the total amount of the obligation in their respective standalone financial statements. The offsetting obligation for any liability recognized will depend on the facts and circumstances (that is, cash, expense, receivable that is assessed for impairment, equity transaction, and/or another account).

27. Proponents of View C point to the characteristics of a liability as defined by Concepts Statement 6 and believe that at the individual reporting-entity level, the characteristics of a liability for the entire amount of the obligation have been met. Although each party may intend to pay a specified portion of the total obligation or intend to seek repayment from another party, the entire obligation may be enforced against the reporting entity without looking first to performance by the other parties. Further, the obligating event has already occurred.

28. Proponents of View C point to paragraph 405-20-40-1, which states:

> A debtor shall derecognize a liability if and only if it has been extinguished. A liability has been extinguished if either of the following conditions is met:
>
> a. The debtor pays the creditor and is relieved of its obligation for the liability. Paying the creditor includes the following:
>   1. Delivery of cash
>   2. Delivery of other financial assets
>   3. Delivery of goods or services
>   4. Reacquisition by the debtor of its outstanding debt securities whether the securities are cancelled or held as so-called treasury bonds.
>
> b. The debtor is legally released from being the primary obligor under the liability, either judicially or by the creditor. For purposes of applying this Subtopic, a sale and related assumption effectively accomplish a legal release if nonrecourse debt (such as certain mortgage loans) is assumed by a third party in conjunction with the sale of an asset that serves as sole collateral for that debt.

29. Proponents of View C believe that the reporting entity has not been legally released from being the primary obligor until the obligation is paid and, therefore, a liability exists. They believe that the total amount of the obligation should be reflected in the statement of financial position of each reporting entity that is jointly and severally liable and should not be derecognized until extinguished in accordance with paragraph 405-20-40-1. Opponents of View C believe that the guidance in Subtopic 405-20 applies to derecognition of a liability rather than to the initial recognition and should not be analogized to in such situations.

30. Opponents of View C do not believe that a liability should be recognized for the total obligation unless there is a probable future use of assets to satisfy the obligation.

31. Opponents of View C also believe that measuring an obligation as the total amount of the joint and several liability when the entity does not expect to pay the total amount does not provide decision-useful information to financial statement users. No users included in the FASB staff's outreach supported View C.

FASB Staff recommendation for recognition and measurement approach

32. The FASB staff recommends View A because:

a. It appears to be responsive to the needs of a majority of users included in the staff's outreach.
b. There may be complexities and costs associated with View B that do not exist for View A and those complexities and costs do not appear to outweigh the benefits as users did not prefer View B.
c. No user, preparer, or auditor included in the staff's outreach supported View C because they did not believe it would provide useful information.
d. The scope of the guarantees guidance for recognizing and initially measuring the fair value of the stand ready obligation excluded entities under common control due to the difficulties associated with measurement in circumstances in which no premium or consideration was exchanged for the guarantee. The staff believes that there would be an equivalent, if not greater, level of difficulty in measuring the stand ready obligation associated with joint and several liability because often there would be no apparent premium or consideration.

Offsetting entry

33. Some of the outreach participants suggested that the Issue provide guidance about the offsetting entry when recognizing and measuring a liability under any of the approaches. The FASB staff recommends that the Issue does not prescribe a specific account for the offsetting entry because the offsetting entry will depend on the facts and circumstances and the staff does not think that guidance can be developed that would be specific enough to be useful to preparers while being applicable to all circumstances.

Question 1: Does the Task Force agree with the following FASB staff recommendations:

- **a. The recognition and measurement approach as described in paragraph 32**
- **b. The scope of the Issue as described in paragraph 10?**

Recurring Disclosures

34. The FASB staff believes that the following disclosures should be required for each obligation with joint and several liability:

a. The nature of the joint and several liability, including how the liability arose and the term of the liability

b. The total outstanding amount of the liability, which shall not be reduced by the effect of any amounts that may possibly be recoverable from other entities

c. The current carrying amount of the liability, if any, for the entity's obligations under the joint and several liability and the outstanding balance of the receivable or debt discount recorded, if any

d. The nature of any recourse provisions that would enable recovery from other entities of the amounts paid

e. In the period the obligation is initially recognized and measured or in a period the measurement changes significantly, disclose the offsetting adjustment (that is, cash, expense, receivable that is assessed for impairment, debt discount, equity transaction, and/or another account).

Question 2: Does the Task Force agree with the FASB staff recommendation on the recurring disclosure requirements?

Transition

35. Presented below are two transition alternatives for consideration:

View A: Entities should apply this Issue on a retrospective basis to all joint and several liabilities by adjusting the opening balance of retained earnings for the earliest period presented. Early adoption is permitted.

36. Proponents of View A observe that the FASB's conceptual framework describes comparability (including consistency) as one of the qualitative characteristics of accounting information. Those proponents refer to paragraph B7 of the Basis for Conclusions in FASB Statement No. 154, *Accounting Changes and Error Corrections*, which states that:

> The Board concluded that retrospective application improves financial reporting because it enhances the consistency of financial information between periods. That improved consistency enhances the usefulness of the financial statements, especially by facilitating analysis and understanding of comparative accounting data.

37. Proponents of View A note that obligations in which the reporting entity is jointly and severally liable are not routine transactions, and they anticipate that entities should have the information available to retroactively apply the consensus.

View B: Entities should apply this Issue using a modified retrospective approach in which the guidance in this Issue would only be applied to those joint and several liabilities that exist at the beginning of the fiscal year of adoption. The opening balance of retained earnings would be adjusted for the earliest period presented. Entities may elect to use hindsight in measuring the liabilities during the comparative periods (and that fact should be disclosed). Early adoption is permitted.

38. View B requires entities to evaluate only the arrangements in place at the date of adoption of this Issue. Proponents of View B believe that retrospectively applying the guidance in this Issue to obligations that have already settled in prior periods does not provide decision-useful information.

39. The FASB staff recommends View B because it does not think the incremental effort and costs of applying View A would provide more useful information to financial statement users. If an obligation in the scope of this Issue is settled prior to the date of adoption, then users primarily would be interested in the settled amount rather than historical estimates of the amount. Further, the staff does not think settled obligations with joint and several liability typically would provide a meaningful trend for users to consider in their analysis.

Transition Disclosures

40. The guidance on other presentation matters in Subtopic 250-10, Accounting Changes and Error Corrections—Overall, is applicable for any voluntary change in accounting principle, including a change in the method of applying an accounting principle. The FASB staff recommends that the Task Force require companies to apply the disclosure requirements in Section 250-10-50 for an accounting change required by this Issue (see Appendix 12-DA). Additionally, the staff recommends that the Task Force not require any additional disclosures other than the requirements in paragraphs 250-10-50-1 through 50-3.

Question 3: Does the Task Force agree with the FASB staff recommendations on the transition approach and transition disclosure requirements?

Appendix 12-DA

DISCLOSURE RECOMMENDATIONS FOR THE CONSENSUS-FOR-EXPOSURE

250-10-50 Accounting Changes and Error Corrections–Overall--Disclosure

>Accounting Changes
>> Change in Accounting Principle

50-1 An entity shall disclose all of the following in the fiscal period in which a change in accounting principle is made:

a. The nature of and reason for the change in accounting principle, including an explanation of why the newly adopted accounting principle is preferable.

b. The method of applying the change, including all of the following:

1. A description of the prior-period information that has been retrospectively adjusted, if any.

2. The effect of the change on income from continuing operations, net income (or other appropriate captions of changes in the applicable net assets or performance indicator), any other affected financial statement line item, and any affected per-share amounts for the current period and any prior periods retrospectively adjusted. Presentation of the effect on financial statement subtotals and totals other than income from continuing operations and net income (or other appropriate captions of changes in the applicable net assets or performance indicator) is not required.

3. The cumulative effect of the change on retained earnings or other components of equity or net assets in the statement of financial position as of the beginning of the earliest period presented.

4. If retrospective application to all prior periods is impracticable, disclosure of the reasons therefore, and a description of the alternative method used to report the change (see paragraphs 250-10-45-5 through 45-7).

c. If indirect effects of a change in accounting principle are recognized both of the following shall be disclosed:

1. A description of the indirect effects of a change in accounting principle, including the amounts that have been recognized in the current period, and the related per-share amounts, if applicable

2. Unless impracticable, the amount of the total recognized indirect effects of the accounting change and the related per-share amounts, if applicable, that are

> attributable to each prior period presented. Compliance with this disclosure requirement is practicable unless an entity cannot comply with it after making every reasonable effort to do so.

Financial statements of subsequent periods need not repeat the disclosures required by this paragraph. If a change in accounting principle has no material effect in the period of change but is reasonably certain to have a material effect in later periods, the disclosures required by (a) shall be provided whenever the financial statements of the period of change are presented.

50-2 An entity that issues interim financial statements shall provide the required disclosures in the financial statements of both the interim period of the change and the annual period of the change.

50-3 In the fiscal year in which a new accounting principle is adopted, financial information reported for interim periods after the date of adoption shall disclose the effect of the change on income from continuing operations, net income (or other appropriate captions of changes in the applicable net assets or performance indicator), and related per-share amounts, if applicable, for those post-change interim periods.