

## Off-Balance Sheet Arrangements

### DISCUSSION

#### *Source*

#### **Regulation S-K: Item 303(a)(4)**

In a separately-captioned sub-section, a discussion should be included of the registrant's off- balance sheet arrangements that have or are reasonably likely to have a current or future effect on the registrant's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors. The disclosure should include the following items to the extent necessary to an understanding of such arrangements and effect and should also include such other information that the registrant believes is necessary for such an understanding:

- The nature and business purpose to the registrant of such off-balance sheet arrangements.
- The importance to the registrant of such off-balance sheet arrangements in respect of its liquidity, capital resources, market risk support, credit risk support or other benefits.
- The amounts of revenues, expenses and cash flows of the registrant arising from such arrangements; the nature and amounts of any interests retained, securities issued and other indebtedness incurred by the registrant in connection with such arrangements; and the nature and amounts of any other obligations or liabilities (including contingent obligations or liabilities) of the registrant arising from such arrangements that are or are reasonably likely to become material, and the triggering events or circumstances that could cause them to arise.
- Any known event, demand, commitment, trend or uncertainty that will result in or is reasonably likely to result in the termination, or material reduction in availability to the registrant, of its off-balance sheet arrangements that provide material benefits to it, and the

course of action that the registrant has taken or proposes to take in response to any such circumstances.

The term off-balance sheet arrangement means any transaction, agreement or other contractual arrangement to which an entity unconsolidated with the registrant is a party, under which the registrant has:

- Any obligation under a guarantee contract that has any of the characteristics identified in FASB ASC 460-10, and that is not excluded from the initial recognition and measurement provisions of FASB ASC 460-10.
- A retained or contingent interest in assets transferred to an unconsolidated entity or similar arrangement that serves as credit, liquidity or market risk support to such entity for such assets.
- Any obligation, including a contingent obligation, under a contract that would be accounted for as a derivative instrument, except that it is both indexed to the registrant's own stock and classified in stockholders' equity in the registrant's statement of financial position, and therefore excluded from the scope of FASB ASC 815-10.
- Any obligation, including a contingent obligation, arising out of a variable interest (as referenced in FASB ASC 810-10), in an unconsolidated entity that is held by, and material to, the registrant, where such entity provides financing, liquidity, market risk or credit risk support to, or engages in leasing, hedging or research and development services with, the registrant.

### **Regulation S-K; Instructions to Item 303(a)(4)**

No obligation to make disclosure arises in respect of an off-balance sheet arrangement until a definitive agreement that is unconditionally binding or subject only to customary closing conditions exists or, if there is no such agreement, when settlement of the transaction occurs.

Registrants should aggregate off-balance sheet arrangements in groups or categories that provide material information in an efficient and understandable manner and should avoid repetition and disclosure of immaterial information. Effects that are common or similar with respect to a number of off-balance sheet arrangements must be analyzed in the aggregate to the extent the aggregation increases understanding. Distinctions in arrangements and their effects must be discussed to the extent the information is material, but the discussion should avoid repetition and disclosure of immaterial information. Contingent liabilities arising out of litigation, arbitration or regulatory actions are not considered to be off-balance sheet arrangements.

Generally, the disclosure required should cover the most recent fiscal year. However, the discussion should address changes from the previous year where such discussion is necessary to an understanding of the disclosure. The discussion need not repeat information provided in the notes to the financial statements, provided that such discussion clearly cross-references to specific information in the relevant notes and integrates the substance of the notes into such discussion in a manner designed to inform readers of the significance of the information that is not included within the body of

such discussion. [ [Regulation S-K: Item 303\(a\)\(4\)](#) ]

## **FRR No. 67**

The definition of off-balance sheet arrangement primarily targets the means through which companies typically structure off-balance sheet transactions or otherwise incur risks of loss that are not fully transparent to investors. For example, in many cases, in order to facilitate a transfer of assets or otherwise finance the activities of an unconsolidated entity, a company must provide financial support designed to reduce risks to the entity or other third parties. That financial support may assume many different forms, such as financial guarantees, subordinated retained interests, so-called keepwell agreements, derivative instruments or other contingent arrangements that expose the registrant to continuing risks or material contingent liabilities. [ [FRR No. 67](#) ]

### **Guarantees**

The definition of off-balance sheet arrangements addresses certain guarantees that may be a source of potential risk to a registrant's future liquidity, capital resources and results of operations, regardless of whether or not they are recorded as liabilities. The definition borrows concepts from U.S. GAAP in order to identify the types of guarantee contracts for which disclosure is required. The references to U.S. GAAP apply regardless of the particular GAAP under which a registrant presents its primary financial statements.

The first element of the definition refers to any obligation under a guarantee contract that has any of the following four characteristics identified by FASB ASC 460-10, and that is not excluded from the initial recognition and measurement provisions of that Interpretation:

- Contracts that contingently require the guarantor to make payments to the guaranteed party based on changes in an "underlying" that is related to an asset, a liability or an equity security of the guaranteed party (e.g., a financial standby letter of credit, a market value guarantee, a guarantee of the market price of the common stock of the guaranteed party or a guarantee of the collection of the scheduled contractual cash flows from individual financial assets held by an SPE). An "underlying" is defined as a specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, or other variable.
- Contracts that contingently require the guarantor to make payments to the guaranteed party based on another entity's failure to perform under an obligating agreement (e.g., a performance guarantee).
- Indemnification agreements (contracts) that contingently require the indemnifying party (guarantor) to make payments to the indemnified party (guaranteed party) based on changes in an underlying that is related to an asset, a liability or an equity security of the indemnified party (e.g., an adverse judgment in a lawsuit or the imposition of additional taxes due to either a change in the tax law or an adverse interpretation of the tax law).
- Indirect guarantees of the indebtedness of others, which arise under an agreement that

obligates one entity to transfer funds to a second entity upon the occurrence of specified events, under conditions whereby (1) the funds become legally available to creditors of the second entity and (2) those creditors may enforce the second entity's claims against the first entity under the agreement (e.g., keepwell agreements).

### **Retained or Contingent Interests**

As an alternative to guarantee contracts, companies may structure and facilitate off-balance sheet arrangements by retaining an interest in assets transferred to an unconsolidated entity. For example, a subordinated retained interest in a pool of receivables transferred to an unconsolidated entity can provide credit support to the entity by cushioning the senior interests in the event that a portion of the receivables becomes uncollectible. In this event, the value of the retained interest can decline and can therefore have a material effect on a registrant's financial condition. Accordingly, the second element of the definition of off-balance sheet arrangements includes retained or contingent interests in assets transferred to an unconsolidated entity, or similar arrangements that serve as credit, liquidity or market risk support to such entity for such assets.

### **Certain Derivative Instruments**

Similar to guarantees or retained interests, certain derivative instruments are used in structuring off-balance sheet arrangements. For example, a registrant may issue or hold derivative instruments that are indexed to its stock and classified as stockholders' equity under GAAP. The impact of those derivative instruments often is not transparent to investors because those derivative instruments are classified as equity and subsequent changes in fair value may not be periodically recognized in the financial statements. Therefore, the third element of the definition includes those derivative instruments to apprise investors of their impact.

### **Variable Interests**

The fourth element of the definition includes any obligation, including a contingent obligation, arising out of a material variable interest held by the registrant in an unconsolidated entity, where such entity provides financing, liquidity, market risk or credit risk support to, or engages in leasing, hedging or research and development services with, the registrant. The definition is intended to be consistent with the concept of a variable interest that is included in FASB ASC 810-10. The term "variable interest" is defined therein as contractual, ownership, or other pecuniary interests in an entity that change with changes in the entity's net asset value. In other words, variable interests are investments or other interests that will absorb a portion of an entity's expected losses if they occur or receive portions of the entity's expected residual returns if they occur. To apply this element of the definition, a registrant must assess the variable interests it holds in the specified unconsolidated entities regardless of whether the entity is deemed to be a "variable interest entity." To focus the disclosure on the most crucial off-balance sheet arrangements, however, the definition only applies to variable interests that are material to the registrant in entities that provide financing, liquidity, market risk or credit risk support to the registrant, or engage in leasing, hedging or research and development services with the registrant.

### **Disclosure Threshold**

To apply the disclosure threshold, management first must identify and critically analyze the registrant's off-balance sheet arrangements, including its guarantee contracts, retained or contingent interests, derivative instruments and variable interests. Second, management must assess the likelihood of the occurrence of any known trend, demand, commitment, event or uncertainty that could affect an off-balance sheet arrangement (e.g., performance under a guarantee; an obligation under a variable interest or equity-linked or indexed derivative instrument; or recognition of an impairment). If management concludes that the known trend, demand, commitment, event or uncertainty is not reasonably likely to occur, then no disclosure is required in MD&A. If management cannot make that determination, it must evaluate objectively the consequences of the known trend, demand, commitment, event or uncertainty on the assumption that it will come to fruition. Disclosure is then required unless management determines that a material effect on the registrant's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources is not reasonably likely to occur. Consistent with other disclosure threshold determinations that management must make in drafting MD&A, the assessment must be objectively reasonable, viewed as of the time the determination is made

### **Information to Be Disclosed**

To provide flexibility to registrants and to filter out disclosure of insignificant details, disclosure is required only to the extent necessary to an understanding of a registrant's off-balance sheet arrangements and their material effects on financial condition, changes in financial condition, revenues and expenses, results of operations, liquidity, capital expenditures and capital resources. In addition to the specified information, the discussion must include such other information that the registrant believes is necessary for an understanding of its off-balance sheet arrangements and material effects.

Under the rules, a registrant must disclose the nature and business purpose of the off-balance sheet arrangements. This disclosure should explain to investors why a registrant engages in off-balance sheet arrangements and should provide the information that investors need to understand the business activities advanced through a registrant's off-balance sheet arrangements. For example, a registrant may indicate that the arrangements enable the company to lease certain facilities rather than acquire them, where the latter would require the registrant to recognize a liability for the financing. Other possible disclosure under this requirement may indicate that the off-balance sheet arrangement enables the registrant to obtain cash readily through sales of groups of loans to a trust; to finance inventory, transportation or research and development costs without recognizing a liability; or to lower borrowing costs of unconsolidated affiliates by extending guarantees to their creditors.

Also under the rules, a registrant must discuss the importance of its off-balance sheet arrangements to its liquidity, capital resources, market risk support, credit risk support or other benefits. This disclosure should provide investors with an understanding of the importance of off-balance sheet arrangements to the registrant as a financial matter. For example, if a registrant materially relies on off-balance sheet

arrangements for its liquidity and capital resources, a registrant may be required to disclose how often it securitizes financial assets, to what degree its securitizations are a material source of liquidity, whether it has materially increased or decreased securitizations from past periods and to explain such increase or decrease. Together with the other disclosure requirements, registrants should provide information sufficient for investors to assess the extent of the risks that have been transferred and retained as a result of the arrangements. In addition, the disclosure should provide investors with insight into the overall magnitude of a registrant's off-balance sheet activities, the specific material impact of the arrangements on a registrant and the circumstances that could cause material contingent obligations or liabilities to come to fruition.

The discussion also must identify any known event, demand, commitment, trend or uncertainty that will, or is reasonably likely to, result in the termination, or material reduction in availability to the registrant, of its off-balance sheet arrangements that provide the registrant with material benefits. Under this requirement, a registrant must disclose, for example, any material contractual provisions calling for the termination or material reduction of an off-balance sheet arrangement. The disclosure also should address factors that are reasonably likely to affect the registrant's ability to continue using off-balance sheet arrangements that provide it with material benefits. For example, if a registrant's credit rating were to fall below a certain level, some off-balance sheet arrangements may require the registrant to purchase the assets or assume the liabilities of an unconsolidated entity. In addition, a change in a registrant's credit rating could either preclude or materially reduce the benefits to the registrant of engaging in off-balance sheet arrangements. In such cases, the registrant will have to disclose known circumstances that are reasonably likely to cause its credit rating to fall to the specified level and discuss the material consequences of the drop in ratings. In addition, the registrant must discuss the course of action that it has taken or proposes to take in response to a termination or material reduction in the availability of an off-balance sheet arrangement that provides material benefits.

The rules instruct registrants to aggregate off-balance sheet arrangements in groups or categories that provide information in an efficient and understandable manner and avoid repetition and disclosure of immaterial information. Common or similar effects that may result from a number of different off-balance sheet arrangements must be analyzed in the aggregate to the extent that the aggregation increases understanding. For example, if particular triggering events or circumstances would either require a registrant to become directly obligated, or accelerate its obligations, under a number of off-balance sheet arrangements, and the overall obligations would be material, then the amendments will require an analysis of the circumstances and their aggregate effect to the extent it increases understanding. Registrants should discuss distinctions among aggregated off-balance sheet arrangements if such distinctions are material, but the discussion should avoid repetition and disclosure of immaterial information.

In light of the fact that the off-balance sheet arrangements covered under the rules are contractual, it is appropriate to apply the Commission's policy regarding MD&A disclosure of preliminary negotiations. Therefore, the amendments include an instruction that no obligation to make disclosure of an

off-balance sheet arrangement will arise until an unconditionally binding definitive agreement, subject only to customary closing conditions exists or, if there is no such agreement, when settlement of the transaction occurs.

## SEC Staff Letter

**Item 303(a)(4) of Regulation S-K** calls for a discussion of off-balance sheet arrangements that have (or are reasonably likely to have) a current or future material effect on the entity's financial condition, cash flows, results of operations, liquidity, capital expenditures, or capital resources. The Staff of the SEC's Division of Corporation Finance has sent a **form letter to registrants involved with non-consolidated conduits** (including structured investment vehicles, or SIVs) and collateralized debt obligations (CDOs) highlighting certain issues to be considered in preparing disclosures in response to **Item 303(a)(4)** in annual reports filed on **Form 10-K** or **Form 20-F** .

The Division of Corporation Finance suggests consideration of the following disclosures in respect of material SIVs and/or CDOs:

- Identification of the categories of assets held by an off-balance sheet entity (and the ratings of such assets).
- The weighted-average life of assets held by an off-balance sheet entity.
- Identification of the forms of funding of an off-balance sheet entity (and the weighted average life of such funding forms).
- A discussion of any material difficulties an off-balance sheet entity has experienced in issuing commercial paper or other forms of financing during the period.
- A discussion of any material write-downs or downgrades of assets held by an off-balance sheet entity.
- The amount of the maximum losses to be borne by any "first loss" note holders.
- Types of variable interests held by the registrant in an off-balance sheet entity.
- Detailed information (including material terms) regarding obligations under liquidity facilities with an off-balance sheet entity, including, as applicable (1) triggers associated with the registrant's obligation to fund the entity, (2) items that would limit the obligation to perform, (3) any obligations under the facilities (e.g., to purchase assets from an off-balance sheet entity or commercial paper issued by such entity), and (4) identification of other liquidity providers and the ranking of the registrant's obligation.
- Commercial paper or other securities issued by an off-balance sheet entity managed by the registrant that have been purchased by the registrant, including whether such purchases were required by agreement (or, if not, a discussion of the reasons for the purchase).
- A discussion of any support provided by the registrant to an off-balance sheet entity (or any assistance provided in obtaining support) and/or the registrant's intentions of doing so in the future.
- A discussion of the potential impact on the registrant of (1) debt ratios, (2) covenants, (3)

- capital ratios, (4) credit ratings, or (5) dividends if the registrant was required to consolidate an off-balance sheet entity (or was to incur significant losses associated with the entity).
- To the extent that consolidation of variable interest entities has been identified by the registrant as a critical accounting policy, a discussion of (1) the circumstances under which consolidation of a variable interest entity would be required, (2) the likelihood of such consolidation, and (3) the frequency of (and the typical triggers requiring) reconsideration of whether the registrant is the primary beneficiary of a variable interest entity.

In addition, in response to the MD&A requirement to discuss known trends or uncertainties, the Staff reminds registrants to consider disclosing the amount of any material losses expected to be realized as a result of involvement with any material off-balance sheet entities.

## **SEC FILING EXAMPLES**

### ***Source***

#### **Apigee Corp.**

#### **(Excerpt from 2105 Form 10-K)**

### **Off-balance Sheet Arrangements**

During fiscal 2015, 2014 and 2013, we did not have any relationships with unconsolidated organizations or financial partnerships, such as structured finance or special purpose entities that would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

#### **ICU Medical Inc.**

#### **(Excerpt from 2015 Form 10-K)**

### **Off Balance Sheet Arrangements**

In the normal course of business, we have agreed to indemnify our officers and directors to the maximum extent permitted under Delaware law and to indemnify customers as to certain intellectual



property matters related to sales of our products. There is no maximum limit on the indemnification that may be required under these agreements. Although we can provide no assurances, we have never incurred, nor do we expect to incur, any liability for indemnification.

## **General Motors Company**

**(Excerpt from 2014 Form 10-K)**

### **Off-Balance Sheet Arrangements**

We do not currently utilize off-balance sheet securitization arrangements. All trade or financing receivables and related obligations subject to securitization programs are recorded on our consolidated balance sheets at December 31, 2014 and 2013.

## **Harris Corporation**

**(Excerpt from 2015 Form 10-K)**

### **Off-Balance Sheet Arrangements**

In accordance with the definition under SEC rules, any of the following qualify as off-balance sheet arrangements:

- Any obligation under certain guarantee contracts;
- A retained or contingent interest in assets transferred to an unconsolidated entity or similar arrangement that serves as credit, liquidity or market risk support to that entity for such assets;
- Any obligation, including a contingent obligation, under certain derivative instruments; and
- Any obligation, including a contingent obligation, under a material variable interest held by the registrant in an unconsolidated entity that provides financing, liquidity, market risk or credit risk support to the registrant, or engages in leasing, hedging or research and development services with the registrant.

Currently we are not participating in any material transactions that generate relationships with unconsolidated entities or financial partnerships, including variable interest entities, and we do not have any material retained or contingent interest in assets as defined above. As of July 3, 2015, we did not have material financial guarantees or other contractual commitments that are reasonably likely to adversely affect our results of operations, financial condition or cash flows. In addition, we are not currently a party to any related party transactions that materially affect our results of operations,

financial condition or cash flows.

We have, from time to time, divested certain of our businesses and assets. In connection with these divestitures, we often provide representations, warranties and/or indemnities to cover various risks and unknown liabilities, such as environmental liabilities and tax liabilities. We cannot estimate the potential liability from such representations, warranties and indemnities because they relate to unknown conditions. We do not believe, however, that the liabilities relating to these representations, warranties and indemnities will have a material adverse effect on our results of operations, financial condition or cash flows.

Due to our downsizing of certain operations pursuant to acquisitions, restructuring plans or otherwise, certain properties leased by us have been sublet to third parties. In the event any of these third parties vacates any of these premises, we would be legally obligated under master lease arrangements. We believe that the financial risk of default by such sublessees is individually and in the aggregate not material to our results of operations, financial condition or cash flows.