

**Board Meeting Handout
Consolidation: Principal versus Agent Analysis
January 8, 2014**

Purpose of This Meeting

1. At the January 8, 2014, Board meeting, the staff will ask the Board how to further integrate rights held by other parties, one of the principal versus agent factors included in the proposed FASB Accounting Standards Update, *Consolidation (Topic 810): Principal versus Agent Analysis*, within the existing guidance in Topic 810, Consolidation, for Voting Interest Entities (VIE) and Variable Interest Entities (VOE).

Background

2. The guidance in the proposed Update includes the following three factors to evaluate whether a decision maker is using its authority as a principal or an agent:
 - a. Rights held by other parties
 - b. Fees paid to a decision maker
 - c. Exposure to variability of returns from other interests.
3. At the December 11, 2013, Board meeting, the Board agreed that the principal versus agent factors should be integrated within the existing guidance in Topic 810 rather than included as a separate principal versus agent analysis.
4. The staff believes that rights held by other parties should be the first principal versus agent factor that is considered by the Board for integration as a part of redeliberations because the VOE model provides the greatest weighting or emphasis to voting rights when determining if shareholders have a controlling financial interest in a legal entity.
5. For purposes of this analysis, rights held by other parties pertain to voting rights, including:
 - a. Kick-out (removal) rights over the “decision maker”
 - b. Liquidation rights over the legal entity

- c. Participating rights over the activities that most significantly impact the entity's economic performance.

All of the items listed above are exercisable without cause and without barriers by a simple majority of holders (collectively referred to herein as "substantive voting rights").

6. The staff identified and will address two areas of Topic 810 that are significantly impacted by the evaluation of substantive voting rights:
 - a. Paragraph 810-10-15-14, which the staff has referred to herein as the "VIE/VOE scope determination"
 - b. Paragraph 810-10-25-38A, which the staff has referred to herein as the "Primary Beneficiary (PB) determination"
7. Furthermore, the staff will address respondents' concerns that redemption rights should be evaluated in the same manner as liquidation rights and, thus, should be considered a substantive voting right.
8. Therefore, at the January 8, 2014, Board meeting, the staff will ask the following questions:
 - a. *Question 1*- How should voting rights be evaluated in the VIE/VOE scope determination?
 - b. *Question 2*- Should voting rights be evaluated consistently when assessing voting rights for both the VIE/VOE scope determination and the PB determination?
 - c. *Question 3*- Should redemption rights be treated in the same manner as liquidation rights?

Alternatives for Board Consideration and Staff Recommendations

Question 1—How Should Voting Rights Be Evaluated in the VIE/VOE scope determination?

9. **Alternative A**—Substantive voting rights exercisable by all equity holders with equity at risk, excluding the decision maker and decision maker’s related parties,¹ should be required to meet the power characteristic² in the VIE/VOE scope determination.
10. **Alternative B**—Substantive voting rights exercisable by all equity holders with equity at risk, excluding the decision maker and decision maker’s related parties, should **not** be required to meet the power characteristic in the VIE/VOE scope determination. Voting rights should be evaluated based on the effectiveness of those rights within the equity group at risk, excluding the decision maker and decision maker’s related parties.
11. **Alternative C**—Substantive voting rights exercisable by all equity holders with equity at risk, excluding the decision maker and the decision maker’s related parties, should be required to meet the power characteristic in the VIE/VOE scope determination. However, this determination should be limited to limited partnerships and similar legal entities.
12. The staff recommends Alternative A.

Question 1 for the Board

Which alternative would the Board like to pursue when considering how to evaluate voting rights within the variable interest entity/voting interest entity scope determination?

Question 2—Should Voting Rights Be Evaluated Consistently When Assessing Voting Rights for Both the VIE/VOE Scope Determination and the PB determination?

13. **Alternative A**—Substantive voting rights exercisable by the specified variable interest holder group, excluding the decision maker and decision maker’s related parties, should

¹ The term *related parties* in this paragraph refers to all parties identified in paragraph 810-10-25-43.

² Paragraph 810-10-15-14(b)(1) includes a criterion that states that an entity would be considered a variable interest entity if the equity holders of a legal entity as a group lack the power through voting rights or similar rights to direct the activities of the entity that most significantly impact the entity’s economic performance (referred to herein as the power characteristic).

be a determinative factor in the power criterion³ that a decision maker in a VIE is not the PB. In addition, a unilateral right held by a variable interest holder also would be determinative.

14. **Alternative B**—Consistent with the guidance in the proposed Update, the effectiveness of substantive voting rights would need to be evaluated. Unilateral voting rights held by a single variable interest holder would be determinative that the decision maker in a VIE would not be the PB; however, voting rights held by a broader variable interest group, excluding the decision maker and its related parties, would need to be evaluated based on the facts and circumstances for its effectiveness.
15. **Alternative C**—The threshold for evaluating voting rights for the power criterion in the PB determination should only be on a unilateral basis.
16. The staff recommends Alternative A.

Question 2 for the Board

Which alternative would the Board like to pursue when considering voting rights within the PB determination?

Question 3—Should Redemption Rights Be Treated in the Same Manner as Liquidation Rights?

17. **Alternative A**—Redemption rights should be included as a substantive voting right based on facts and circumstances and the purpose and design of the legal entity.
18. **Alternative B**—Redemption rights should be not be included as a substantive voting right.
19. The staff recommends Alternative B.

Question 3 for the Board

Which alternative would the Board like to pursue when considering redemption rights?

³ The staff has referred to the guidance in paragraph 810-10-25-38Aa as the power criterion herein.